"Top 10" Changes to Asset Sales Under § 363 of the Bankruptcy Code

Robert M. Charles, Jr., Moderator
Lewis Roca Rothgerber LLP; Tucson, Ariz.

Hilary L. Barnes
Allen Maguire & Barnes, PLC; Phoenix

Oren B. Haker
Stoel Rives LLP; Portland, Ore.

Hon. Margaret M. Mann
U.S. Bankruptcy Court (S.D. Cal.); San Diego

Credit Bidding Considerations for Distressed Debt Investors

Oren Haker
Stoel Rives LLP, Portland, Oregon

I. Introduction

Recent cases grappling with distressed debt traders employing section 363(k) to execute "loan-to-own" strategies in bankruptcy cases raise a number of normative questions relevant and timely to possible reform of section 363 of title 11 of the United States Code ("Bankruptcy Code"), including:

- Should different rules apply to original lenders seeking to credit bid versus creditors who purchased the debt at a discount in the secondary market? How much weight should the secured creditor's intent be given in the determination to cap a secured creditor's credit bid right?

- Should the secured creditor be required to disclose to the Bankruptcy Court the price at which it purchased the original loan? Is the secured creditor's refusal to disclose purchase terms relevant to the analysis and determination to cap a credit bid right? Is it relevant to whether the creditor is participating in good faith?

- Is the prepetition secured creditor's use of a DIP facility to drive a quick bankruptcy sale pursuant to section 363(b) sufficient "cause" to cap that creditor's ability to participate in the sale process with a credit bid, particularly if the Creditors' Committee has not completed its investigation of the validity, extent and priority of the liens securing the assets on the auction block?

- Should Bankruptcy Courts be more aggressive in slowing down bankruptcy sales involving melting bananas rather than melting ice cubes?

- If the secured creditor is an insider of the prepetition debtor, is that fact alone sufficient "cause" to compel the secured creditor to affirmatively establish to the Bankruptcy Court that its claim is secured by a valid lien that covers the assets subject to sale prior to approval of such a sale?

Not surprisingly, these questions elicit strong reactions from interested parties, including debtors, secured creditors, unsecured creditors and purchasers in a bankruptcy case and, by extension,

their professionals. Recent case law, particularly two reported decisions out of the Bankruptcy Courts of Delaware and Virginia, has addressed directly the role of distressed debt traders in section 363(b) sales and the use of the credit bid right in section 363(k) to purchase estate assets. These cases have attracted significant commentary that has focused on the court's use of the exception in section 363(k) to foster a competitive and robust bidding process in an effort to ensure that each estate benefits from a sale of its assets.

Furthermore, the Final Report and Recommendations by the ABI Commission to Study the Reform of Chapter 11 ("Commission") acknowledged that "all credit bidding chills an auction process to some extent" and stated that the Commission "did not believe that the chilling effect of credit bids ***alone*** should suffice as cause under section 363(k)." See Report, § V.B.4., p. 147 (***emphasis added***). While the Commission did not recommend a change to the standard to credit bid pursuant to section 363(k), it did recommend "that the chilling effect of a credit bid not be deemed sufficient cause to limit a credit bid, but that courts should attempt to mitigate any chilling effect through the auction and sale procedures approved in the case." *Id.* In addition, and perhaps most substantively, the Commission did recommend a 60-day moratorium on section 363 sales of all or substantially all of a debtor's assets (absent a showing of clear and convincing evidence that the debtor's value will be substantially impaired without an earlier sale). The purpose of this moratorium is to ensure that the stand-alone sale mechanism provides the best restructuring option for the debtor and its stakeholders.

The remainder of these materials sets forth first principles of bankruptcy sales and credit bidding, then summarizes the recent decisions that have dealt with active distressed debt buyers, and finally, raises some bright-line observations about the sales process that distressed debt buyers should keep in mind going forward.

II. First Principles

The right of a secured creditor to credit bid in connection with a sale of a debtor's assets is codified in section 363(k) of the Bankruptcy Code. That Code section provides:

> At a sale under subsection (b) of this section of property that is subject to a lien that secures an ***allowed claim***, unless the court ***for cause*** orders otherwise the holder of such claim may bid at such sale, and, if the holder of such claim purchases such property, such holder may offset such claim against the purchase price of such property.

11 U.S.C. § 363(k) (emphasis added). There are a number of bright-line rules relating to this statutory right that should be, for the most part, noncontroversial. First, it is a general expectation of a secured creditor in bankruptcy that in the event a debtor seeks to sell property that is subject to the creditor's lien, the lienholder can credit bid its allowed claim for the assets being sold. This expectation generally holds true where a debtor is seeking to implement a stand-alone sale of its assets under section 363(b) of the Bankruptcy Code or where the sale is to be consummated pursuant to a plan of reorganization or liquidation in accordance with section 1129(b)(2) of the Code.

Second, section 363(k) gives a secured creditor the right to credit bid the face amount of its allowed claim. Any argument that a secured creditor's right to credit bid its allowed claim should be capped by the economic value of its lien or security interest is not supported by the plain reading of the statute. Bankruptcy courts are uniformly on board with the concept that the purpose of section 363(k) is to avoid a valuation by the Bankruptcy Court, and recent examples of bankruptcy judges capping secured creditors' credit bid rights have all acknowledged that section 363(k) speaks of an "allowed claim" and the ability of a secured creditor to credit bid "such claim." On this principle, *In re SubMicron Sys. Corp*., 432 F.3d 448 (3d Cir. 2006), is directly on point.

Third, section 363(k) affords the right to credit bid only to a creditor holding an allowed claim secured by a lien, and the burden to establish the validity, priority and extent of a lien is squarely on the creditor seeking to credit bid its "allowed claim." 11 U.S.C. § 363(p). If a lien is the subject of a bona fide dispute, the creditor will need to establish that its lien is valid prior to participating with a credit bid in an auction. Furthermore, determining the scope of a lien is just as important as the validity of a lien for credit bidding purposes.

Fourth, section 363(k) does not give a secured creditor an absolute right to credit bid the face amount of its allowed claim. Rather, the right is subject to "unless the court for cause orders otherwise." "Cause" is not defined in the Bankruptcy Code.

Fifth, bankruptcy is a public process that values, above all, transparency. Effectuating a "private sale" through a public process creates tension, perhaps unnecessarily if the asset is more akin to a banana rather than an ice cube. Public auctions are strongly preferred.

Finally, the purpose of section 363(k) is to allow secured lenders the ability to create a price floor for the sale price of their collateral by debtors in bankruptcy. Its purpose is inherently defensive in nature: to avoid an artificially low sale price of a secured lender's collateral that is the property of the debtor's estate and subject to a bankruptcy sale, under either section 363(b) or section 1129(b)(2) of the Bankruptcy Code.

These "first principles" are relatively uncontroverted today. However, how these principles are applied has been the subject of much debate in light of the recent decisions in the *Fisker* and *Free Lance-Star* cases. In both of those cases, buyers of distressed debt in the secondary markets tried to leverage the credit bid right in section 363(k) offensively, effectively seeking to chill the bidding process so that they could acquire the assets at the lowest possible price.

III. Discussion of Recent Cases

A. *In re Fisker Auto. Holdings, Inc.*, 510 B.R. 55 (Bankr. D. Del. 2014).

Fisker Automotive Holdings ("Fisker" or "debtor") produced hybrid electric cars but ran into financial distress due to operating difficulties. Shortly after the company's senior secured loan from the U.S. Department of Energy in the amount of $168 million was purchased by Hybrid Tech Holdings, LLC ("Hybrid") at a deep discount of $25 million, the company entered into negotiations over the terms of its sale to Hybrid. The debtor filed a chapter 11 petition with Hybrid's support and with the intent to sell substantially all of its assets to Hybrid. Hybrid's purchase offer was a credit bid of $75 million of the $168 million loan that it purchased just prior to the bankruptcy petition date. The debtor planned to propose a liquidating chapter 11 plan after the sale closed.

The Creditors' Committee opposed the debtor's proposed transaction with Hybrid, which essentially amounted to an attempt to consummate a "private sale" within a month or two after the commencement of the bankruptcy case. The Committee favored a public auction in which Hybrid and another interested purchaser, Wanxiang America Corporation ("Wanxiang"), would participate. In Wanxiang, the Committee saw a strategic buyer who could provide the bankruptcy estate with real value. Wanxiang had just purchased certain assets of A123 Systems for $300 million, assets that included the lithium ion battery, a key component for the Fisker cars.

The Committee's request to limit Hybrid's right to credit bid was predicated on the following allegations: first, that Hybrid did not have a properly perfected lien on certain of the assets that would be sold; and second, that limiting the credit bid would facilitate a competitive auction. Both the debtor and the Committee stipulated that if Hybrid's ability to credit bid was

not capped, an auction would be futile because Wanxiang was not prepared to bid an amount in excess of the $75 million credit bid. In fact, a joint stipulation entered into by the parties was very much relied upon by the Bankruptcy Court in its ultimate decision to cap Hybrid's credit bid.

In deciding to cap Hybrid's right to credit bid its secured claim at $25 million, the Bankruptcy Court reasoned that section 363(k) did not give creditors an unqualified right to credit bid. The court observed that if it did not limit the credit bid of Hybrid, there would be no bidding by Wanxiang. Furthermore, the court reasoned that neither the Debtor nor Hybrid provided the court with a satisfactory reason why the debtor's assets needed to be sold within a month of the bankruptcy filing pursuant to a private sale rather than pursuant to an auction. The Bankruptcy Court ruled that such a rushed and private process was inconsistent with the notion of fairness and transparency. Finally, the Bankruptcy Court was cognizant of the Committee's concerns that the nature of Hybrid's claim was uncertain. In fact, Hybrid acknowledged that its lien on certain of the assets to be sold was not perfected. Thus, while the amount of the claim was $168.5 million as of the petition date, it was unclear how much of that claim was secured by the assets being sold versus how much of the claim was unsecured or disputed.

Ultimately, the Bankruptcy Court in *Fisker* determined that cause existed to cap Hybrid's credit bid because failure to do so would only chill bidding to the detriment of the debtor's estate.

B. *In re Free Lance-Star Publ'g Co. of Fredericksburg*, 512 B.R. 798 (Bankr. E.D. Va. 2014).

The debtors in this case were a family-owned publishing, newspaper, radio and communications company that owned and operated four radio stations and printing and newspaper businesses. The major secured creditor in the debtors' bankruptcy cases was DSP

Acquisition, LLC ("DSP"), which had purchased the secured debt from Branch Banking & Trust ("BB&T"), the original lender to the debtors in June 2013. Importantly, BB&T did not obtain any liens on or security interests in *certain of* the debtors' assets when it made the loans back in 2006. In particular, BB&T did not obtain security interests in the "Tower Assets" nor in the "Tower Parcels." BB&T sold its loan to DSP or an affiliated entity of DSP in June 2013.

What happened after June 2013, when DSP stepped into the shoes of the original lender, became both the subject and the object of the three-day evidentiary hearing in March 2014. That hearing was set to determine DSP's right to credit bid its claim against the debtors' assets and to determine the validity, extent and priority of the liens asserted by DSP against those same assets. The evidentiary record, as relayed by the Bankruptcy Court in its decision capping DSP's credit bid rights, established the following events:

- Shortly after purchasing the loan from BB&T, DSP informed the business that it intended to buy its assets pursuant to a section 363 bankruptcy sale;

- In the summer of 2013, DSP floated a "Restructuring Timetable" that contained the expectation that the business would record executed deeds of trust on the Tower Parcels and then file for bankruptcy protection sometime thereafter;

- Without any agreement on the Restructuring Timetable, DSP filed UCC financing statements in the three counties in which the Tower Assets were located sometime in August 2013;

- On or about September 24, 2013, DSP provided the business with a forbearance agreement that included a blanket release of all claims held by the business against DSP, and the business' attempt to limit the release was rejected by DSP;

- DSP explained to the business at this time its intent to obtain security interests in the Tower Assets through a DIP financing vehicle;

- DSP renewed its pressure on the business for a speedy bankruptcy filing 90 days after recording the UCC fixture filings, and insisted there was no need to market the business assets and that a sale could be consummated within six weeks from the petition date; DSP also objected to the business' engagement of a financial advisor (Protiviti);

- Protiviti, which was retained by the debtors, developed cash flow projections that indicated the debtors could survive without a DIP facility, which was contested by DSP, which wanted the debtors to borrow from DSP in exchange for granting liens on the Tower Assets;

- After withdrawing support for a bankruptcy filing, DSP recorded additional financing statements in various jurisdictions without giving the debtors any notice; and

- During the cash collateral hearing, DSP did not disclose to the Bankruptcy Court that it had recorded financing statements against the Tower Assets in August 2013 and again just prior to the debtors' bankruptcy filing in January 2014.

The Bankruptcy Court succinctly summarized the above-referenced facts as follows: (i) DSP had less than fully secured lien status on the assets being sold; (ii) DSP engaged in an overly zealous loan-to-own strategy; and (iii) DSP's misconduct had an negative impact on the auction process that the debtors wanted to run. In particular, the Bankruptcy Court observed that DSP "does not have a right to assert a credit bid on assets that do not secure DSP's allowed claim," and that limiting DSP's credit bid "will restore enthusiasm for the sale and foster a robust bidding process." 512 B.R. at 805. Based on DSP's inequitable conduct, including the false declaration filed by DSP in support of its motion for summary judgment on the validity, extent and priority of its liens, and on the fact that it did not have a valid lien on certain of the assets being sold by the debtors, the Bankruptcy Court capped DSP's credit bid on assets on which DSP had a valid lien to $1.2 million for assets relating to debtors' radio business and $12.7 million for assets relating to debtors' newspaper and printing business. It is particularly noteworthy that the Bankruptcy Court further ordered that prior to credit bidding, DSP must provide proof to the debtors and the Creditors' Committee that DSP is the true assignee of the note payable to BB&T in the original principal amount of $45,842,400. Apparently, the evidentiary record was deficient on who exactly held the claim.

C. *In re Charles Street African Methodist Episcopal Church of Boston,* 510 B.R. 453 (Bankr. Mass. 2014).

In challenging the prepetition secured creditor's right to credit bid its allowed claim, the debtor in this case disavowed any reliance on the *Fisker* decision, or on its concern that the secured creditor's ability to credit bid would chill bidding. Rather, the debtor sought to prohibit credit bidding based on the fact that the creditor's claim was subject to alleged counterclaims, and thus was in bona fide dispute. While the Bankruptcy Court acknowledged that the existence of a bona fide dispute as to the secured claim is cause to cap a credit bid in many instances, it was not cause here, because the debtor did not challenge the validity of the underlying claim. Accordingly, there was no risk that the secured creditor would be paid on an invalid claim. Rather, the risk was only that an untested counterclaim by the debtor would go unsatisfied.

While it appears that the limited basis for challenging the secured creditor's right to credit bid backfired, the debtor was able to limit the secured creditor's ability to credit bid insofar as any winning bidder would be required to pay, in cash, the break-up fee of the stalking horse bidder. Accordingly, the credit bid of the secured creditor was limited to exclude the first $50,000 of consideration (i.e., the amount of the break-up fee).

D. *In re RML Dev., Inc.,* 528 B.R. 150 (Bankr. W.D. Tenn. 2014).

While the Bankruptcy Court acknowledged the decisions in *Free Lance-Star* and *Fisker* that credit bidding is not an absolute right, the Bankruptcy Court stated in a footnote that it was "not prepared to go as far as some of these courts and hold that the mere 'chilling' of third party bids is sufficient cause to justify modifying or denying a secured creditor's rights." 528 B.R. at 155 n.11. The Bankruptcy Court stated that denial or modification of credit bid rights should be an "extraordinary exception that is used only upon equitable considerations (e.g., competing claims, collusion, or other fraudulent or bad faith acts)." *Id.*

However, the Bankruptcy Court, for cause, modified the secured creditor's credit bid rights under section 363(k) to require that it provide a letter of credit, surety bond, or other instrument in the amount of its proposed credit bid and/or distribution from the section 363 sale proceeds, pending ultimate resolution of its "allowed claim."

IV. Takeaways for Distressed Debt Buyers in Bankruptcy Sales

Both the *Fisker* and *Free Lance-Star* decisions have generated significant commentary from bankruptcy practitioners. The commentary has been particularly focused around the negative effects that these decisions may have on the activity in the secondary markets for distressed debt. The concept that bankruptcy judges have discretion to cap the right to credit bid if a cap will advance general bankruptcy principles inserts uncertainty into lenders' expectation that, absent inequitable conduct or a disputed claim or challenged lien, a secured creditor should be allowed to credit bid the face amount of the claim in a section 363(b) sale. As the argument goes, uncertainty dries up liquidity, which, in turn, will adversely affect distressed companies in search of new money.

The problem with some of the commentary is that it ignores the fact that, in both *Fisker* and *Free Lance-Star*, the bankruptcy judges found evidence of undue control by the secured lender of the sales process, and, in *Free Lance-Star*, evidence of inequitable conduct. In both cases, there were questions as to whether the secured creditors held liens on the assets being sold. By extension, neither creditor in either case walked into a sales auction with an "allowed claim" in an amount certain. And yet both creditors were advocating—quite aggressively and not surprisingly—private sales of assets to themselves on expedited timeframes.

At the same time, both decisions raise important questions—in particular, the relevance of whether the secured creditor is the original lender or a creditor that purchased the claim at a

deep discount. Neither Hybrid in *Fisker* nor DSP in *Free Lance-Star* had credit exposure for the full face amount of the respective debts and corresponding claims. In fact, in *Fisker*, Hybrid had purchase the debt at a deep discount and in *Free Lance-Star*, DSP appears to have refused to disclose its purchase price for the original loan. The fact that both creditors were distressed debt players employing "loan-to-own" strategies illustrates their motivation to act more like an investor and less like a creditor. In other words, the intent of each party was not to recover the full amount of the credit, but rather to capture the greatest possible return on investment. The Bankruptcy Court in *Free-Lance Star* observed that "DSP made no secret of the fact that it acquired the Loan in order to purchase the Company." 512 B.R. at 806. The Court went on to say that the purpose of the credit bid—to protect secured lenders against undervaluation of collateral sold in a bankruptcy sale—does not necessarily "function properly when a party has bought the secured debt in a loan-to-own strategy in order to acquire the target company." *Id.*

These recent decisions provide a not-so-gentle reminder of three maxims. First, bankruptcy courts are suspicious of private sales, especially private sales to a prepetition lender on a fast track (i.e., within weeks of the commencement of the bankruptcy case). Second, secured creditors can only credit bid secured claims that are allowed, which may not be the amount of the debt outstanding in instances where the claim holder's lien does not encumber certain of the assets being sold, where the validity of the lien is subject to dispute, or even further, where the amount of the debt is disputed. Third, section 363(k) provides that courts may limit the credit bid right for cause, and cause may include, under the current statute, the chilling effects that a large credit bid may have on the bidding process.

Ultimately, distressed debt traders may have to live with some uncertainty—in particular, the uncertainty that an attractive buy-in on the front end of a bankruptcy may very well

hamstring the investor's ability to purchase the assets in bankruptcy pursuant to a credit bid of the face amount of the claim. These cases are a reminder that the bankruptcy process can be a rocky road. Bankruptcy judges are tasked with weighing not only the secured lender's legal rights in collateral that is property of a debtor's estate, but also the interests of other creditors, employees, state agencies and the public interest. A secured lender who fails to diligence the scope and extent of its liens up front and in advance of funding a sale process will do itself no favors when it comes time to execute on its loan-to-own strategy in the Bankruptcy Court.

365 . . . 363, Livin' In Perfect Harmony:

Reconciling Bankruptcy Code §§ 363(f) and 365(h)

Hilary L. Barnes, Esq.
Khaled Tarazi

Allen Maguire & Barnes PLC
Phoenix, Arizona

Reconciling Bankruptcy Code §§ 363(f) and 365(h)

Hilary L. Barnes, Esq.
Khaled Tarazi[1]
Allen Maguire & Barnes PLC
Phoenix, Arizona

The Bankruptcy Code's primary purpose is to provide debtors with a meaningful opportunity to reorganize and make a fresh start while maximizing assets for the benefit of creditors. The Code also attempts to balance the debtor's need for a fresh start while providing certain protections to particular parties. As a result, certain Code provisions are difficult to harmonize because they seem to favor opposing interests. One such example is the apparent conflict between Code § 363(f), which allows the sale of bankruptcy estate property free and clear of any interest in the property so long as certain requirements are met, and § 365(h), which protects leasehold interests in estate property.

Code § 365 empowers the trustee (or a debtor in a Chapter 11 reorganization) "to use valuable property of the estate and to renounce title to and abandon burdensome property."[2] Most debtors enter bankruptcy as parties to executory contracts and leases that require future performance. Some of these contracts and leases may be favorable to the bankruptcy estate, while others may impose an undue burden on the estate that, without remedy, will frustrate reorganization. Code § 365 allows debtors to assume (and in some cases assign) or reject these executory contracts or unexpired leases and defines the remedies available to the other parties to these contracts.

In a landlord's bankruptcy, the debtor-lessor is free to reject an unfavorable lease to benefit the bankruptcy estate. However, Congress consistently has recognized the need to

[1] J.D. May 2015 from the Sandra Day O'Connor College of Law at Arizona State University; 2015 American College of Bankruptcy Student of the Year Award for the Ninth Circuit.
[2] *In re Orion Pictures Corp.*, 4 F.3d 1095, 1098 (2d Cir. 1993) (citations and quotations omitted).

protect the lessee's property rights in such cases. The protection of leasehold interests can be found in Code § 365(h),[3] pursuant to which the lessee can choose either to treat the lease as terminated, or retain its appurtenant rights under the lease. The statute was designed to "preserve a lessee's possessory interest in its leasehold while allowing a debtor-lessor to escape the burden of providing continuing services to a tenant."[4]

Code § 363, entitled "[u]se, sale, or lease of property," provides the authorization and framework for a debtor to sell estate assets while in bankruptcy. Code § 363(f)[5] authorizes the debtor in certain circumstances to sell estate property "free and clear of *any interest* in such property of an entity other that the estate."[6] Courts have generally construed "any interest" to include leasehold interests.[7] When property is sold free and clear of an interest, upon request,

---

[3] Code § 365(h) states in pertinent part:

> (h) (1) (A) If the trustee rejects an unexpired lease of real property under which the debtor is the lessor and--
>
> (i) if the rejection by the trustee amounts to such a breach as would entitle the lessee to treat such lease as terminated by virtue of its terms, applicable nonbankruptcy law, or any agreement made by the lessee, then the lessee under such lease may treat such lease as terminated by the rejection; or
>
> (ii) if the term of such lease has commenced, the lessee may retain its rights under such lease (including rights such as those relating to the amount and timing of payment of rent and other amounts payable by the lessee and any right of use, possession, quiet enjoyment, subletting, assignment, or hypothecation) that are in or appurtenant to the real property for the balance of the term of such lease and for any renewal or extension of such rights to the extent that such rights are enforceable under applicable nonbankruptcy law.

[4] *In re Lee Road Partners, Ltd.*, 155 B.R. 55, 60 (Bankr. E.D.N.Y. 1993).

[5] Code § 363(f) 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 of such interest.

[6] (Emphasis added).

[7] *See, e.g., Precision Indus. v. Qualitech Steel SBQ, LLC*, 327 F.3d 537, 545-46 (7th Cir. 2003).

that interest must be provided with "adequate protection,"[8] which may be a cash payment, a replacement lien, or the indubitable equivalent of the interest in such property, arguably including continued possession. Thus, §§ 363(f) and 365(h) seem to conflict: "Section 365(h) appears to grant the tenant the right to retain the benefits of the lease, while Section 363(f) appears to allow the [debtor] to divest the tenant of its leasehold."[9] The issues that divide courts are (a) whether the phrase "any interest" authorizes a debtor-lessor to sell an asset free and clear of a lessee's leasehold interest and (b) how to reconcile the apparently conflicting statutes.

THE MAJORITY VIEW

The courts that prefer the view that the protections afforded lessees under § 365(h) trump the debtor-lessor's § 363(f) powers to sell property free and clear of any interest[10] rely principally on three arguments:

1. Specific legislation governs general legislation. Courts espousing the majority view follow the rule of statutory construction that the "specific governs the general."[11] Code § 365(h) "specifically references the situation where the debtor is the lessor and *with great*

---

[8] 11 U.S.C. § 363(e) states:

> Notwithstanding any other provision of this section, at any time, on 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 such use, sale, or lease as is necessary to provide adequate protection of such interest. This subsection also applies to property that is subject to any unexpired lease of personal property (to the exclusion of such property being subject to an order to grant relief from the stay under section 362.

[9] *Precision Indus., Inc. v. Qualitech Steel SBQ, LLC*, 2001 U.S. Dist. LEXIS 8328, 2001 WL 699881, at *11 (S.D. Ind. Apr. 24, 2001) (holding that § 365(h) overrides § 363(f) . . . "There is no statutory basis for allowing the debtor-lessor to terminate the lessee's possession by selling the property out from under the lessee, and thus limiting a lessee's post-rejection rights solely to cases where the debtor-lessor remains in possession of the property.") *Id.* at *14, *rev'd*, 327 F.3d 537 (adopting minority view).

[10] *In re LHD Realty Corp.*, 20 B.R. 717, 719 (Bankr. S.D. Ind. 1982) (holding that § 365 is the exclusive remedy available to a debtor-lessor); *In re Churchill Props. III, Ltd. P'shp.*, 197 B.R. 283, 288 (Bankr. N.D. Ill. 1996); *In re Haskell L.P.*, 321 B.R. 1, 9 (Bankr. D. Mass 2005); *In re Samaritan Alliance, LLC*, 2007 Bankr. LEXIS 3896, 2007 WL 4162918, *4 (Bankr. E.D. Ky. Nov. 21, 2007).

[11] *Morales v. Trans World Airlines, Inc*., 504 U.S. 374, 384, 112 S. Ct. 2031, 119 L.Ed. 2d 157 (1992) (*citation omitted*).

particularity sets forth the rights and duties of the lessor and lessee while § 363 does not."[12] Accordingly, the specificity of § 365(h) should take precedence over the generality of § 363(f).[13]

2. The legislative history of § 365(h). The legislative history "evinces a clear intent on the part of Congress to protect a tenant's estate when the landlord files bankruptcy."[14] To allow a sale free and clear of the lessee's interest would be "in direct contravention of the lessee protections" Congress specifically afforded in Code § 365.[15]

3. Allowing a free and clear sale under § 363(f) would render § 365(h) meaningless. If courts allowed § 363(f) sales to terminate lessees' property interests, the application of § 365(h) "as it relates to non-debtor lessees would be nugatory."[16]

THE MINORITY VIEW

A few courts have sidestepped the conflict between §§ 363(f) and 365(h) by construing them to avoid a conflict altogether, reasoning that § 365(h) applies only to lease rejections and not to property sales; the statute is implicated only when a debtor-lessor remains in possession and rejects the lease, not when it sells the property subject to the leasehold interest.[17] Thus, no conflict exists should the debtor-lessor sell the property under § 363(f) without first rejecting the lease.[18] The United States Court of Appeals for the Seventh Circuit, the sole appellate court to

---

[12] *In re Taylor*, 198 B.R. 142, 165 (Bankr. D.S.C. 1996) (emphasis in the original); *see also In re Churchill Props. III, Ltd. Pshp.*, 197 B.R. 283, 288 (Bankr. N.D. Ill. 1996).

[13] *Dishi & Sons v. Bay Condos, LLC*, 510 B.R. 696, 702 (S.D.N.Y. 2014) (canvassing the majority and minority views, declining to adopt the view that the two provisions conflict).

[14] *Id.*

[15] *Id.*

[16] *In re Churchill Props. III, Ltd. P'shp.*, 197 at 288; *see also In re Haskell L.P.*, 321 B.R. 1, 9 (Bankr. D. Mass. 2005) ("If the Court were to grant the Debtor's Sale Motion, the provisions of § 365(h) would be eviscerated").

[17] *In re Downtown Ath. Club of N.Y. City (Cheslock-Bakker & Assocs. Inc.)*, 2000 U.S. Dist. LEXIS 7917, *12-13 (S.D.N.Y. June 9, 2000); *In re R.J. Dooley Realty, Inc*., 2010 Bankr. LEXIS 1761, 2010 WL 2076959, *6-8 (Bankr. S.D.N.Y. May 21, 2010). *See also* Robert M. Zinman, *Precision in Statutory Drafting: The Qualitech Quagmire and the Sad History of § 365(h) of the Bankruptcy Code*, 38 J. MARSHALL L. REV. 97, 106-18 (2004)

[18] *Qualitech*, 327 F.3d at 547-48.

consider the relationship between these two statutes, in *Precision Indus. v. Qualitech Steel SBQ, LLC*, 327 F.3d 537 (7th Cir. 2003), supported this minority view with three main arguments:

1. Neither statute indicates that § 365(h) trumps § 363(f). Despite cross-references in §§ 363 and 365 limiting those provisions, nothing in either statute indicates that one supersedes or limits the other.[19] This "omission suggests that Congress did not intend for the latter section to limit the former."[20]

2. The plain language of § 365(h). Code § 365(h) has a limited scope: "[b]y its own terms, that subsection applies 'if the [debtor-lessor] *rejects* an unexpired lease of real property.'"[21] The rejection triggers the lessee's rights to retain its possessory interest; without a rejection, a debtor-lessor may sell free and clear of that possessory interest. Accordingly, the two statutes apply to discrete circumstances, and § 365(h) does not affect § 363(f) sales where the debtor-lessor does not first reject the lease.

3. Lessees are provided adequate protection under § 363(e). Code § 363(e) allows any entity that has an interest in property that is sold under § 363(f) to request adequate protection of that interest. While this provision does not guarantee a lessee's continued possession of the property, it ensures that lessees are adequately compensated in the event a § 363(f) sale divests them of their possessory interests.[22]

The minority position honors the plain meaning of § 363(f) by avoiding the exclusion of a lessee's right to possession from "any interest," but again, it effectively repeals the protections

[19] *Id.* at 547.
[20] *Id.*
[21] *Id.* (emphasis in original).
[22] *Id.* at 547-48.

of § 365(h) by allowing a lessor to escape its obligations simply by selling its property free and clear without formally rejecting the lease.[23]

> Section 365(h) applies when a debtor-lessor remains in possession of its property and rejects a lease, not when the debtor-lessor sells property subject to an interest (such as a lease) free and clear of that interest pursuant to Section 363. Thus, when the debtor lessor sells property subject to a lease free and clear of that lease pursuant to Section 363(f), the Court will not apply Section 365(h).[24]

In *Qualitech* and other minority view cases, the circumstances involved a debtor selling free and clear without a formal assumption or rejection of a lease. This enabled the minority-view courts to sidestep any true resolution to the conflict between the statutes addressed by the majority-view courts.[25]

THE HYBRID VIEW

Some courts have declined to adopt a *per se* rule favoring one statute above the other, while still holding that §§ 363(f) and 365(h) are irreconcilable. One court described this approach as a "case-by-case, fact-intensive, totality of the circumstances, approach, rather than a bright line rule."[26] Factors considered include a) whether the lease is below market, b) whether the lease is recorded, and c) if the lessee will otherwise in fact suffer any economic harm.[27]

THE HARMONIOUS VIEW

In *Dishi & Sons v. Bay Condos LLC*,[28] the United States District Court for the Southern District of New York in 2014 confronted a situation in which a lease had been rejected (unlike Qualitech) and the debtor-lessor sold the property free and clear of the leasehold interest. The

---

[23] *Dishi*, 510 B.R.at 704-05.

[24] Downtown Athletic Club, 2000 U.S. Dist. LEXIS 7917, 2000 WL 744126, *4.

[25] *Dishi*, 510 B.R.at 705.

[26] *In re Spanish Peaks Holdings II LLC*, 2014 Bankr. LEXIS 913, *51 (Bankr. D. Mont. Mar. 10, 2014).

[27] *Id.* at 51-56. Of interest, in *Qualitech*, the Seventh Circuit specifically mentioned that the lease at issue was a 10-year lease with an annual rent of $1, and the lease was never recorded. These factors may have informed the Court's decision to find in favor of extinguishing the tenant's lease as part of the sale.

[28] 510 B.R. 696, 699 (S.D.N.Y. 2014).

District Court harmonized §§ 363(f) and 365(h) and reasoned that § 365(h) preserves a lessee's possessory interest if the debtor-lessor rejects the lease but does "not give the lessee absolute rights that take precedence over the [debtor-lessor's] right to sell free and clear of interests.[29] While § 365(h) allows the tenant to retain its appurtenant rights notwithstanding rejection of the lease, § 363(f) authorizes a debtor-lessor "to extinguish the lessee's appurtenant rights—like any other interest in property—but only if one of five conditions is satisfied."[30] Thus, § 365(h) protects the lessee's appurtenant rights under rejection, and § 363(e) ensures that these rights are adequately protected in any proposed free and clear sale.[31] As stated by the District Court:

> This interpretation allows for the best reading of the Code as a whole. If § 365(h) provides lessees with an absolute right to possession that trumps the trustee's power to sell under § 363(f), it is difficult to see why the lessee's right does not also trump the trustee's other powers, such as the power to avoid interests as a bona fide purchaser, 11 U.S.C. § 544(a)(1), or to avoid interests that were fraudulently transferred by the debtor. . . Rejection of a lease—a power supposedly provided to enhance the debtor's estate—would then morph into a "superman" right of a lessee to override every other provision in the Bankruptcy Code, perhaps to the *detriment* of the estate. The majority interpretation proves too much. The purpose of § 365(h) is to clarify that rejection is not an avoidance power—not to give the lessee rights that may never be avoided by some other means.[32]

Consequently, a rejection giving rise to a lessee's § 365(h) possessory right does not mean that the lessee's right cannot be extinguished by means of a § 363(f) sale (again, assuming one of the five conditions is met); nothing in § 365(h) precludes the trustee from terminating the lessee's appurtenant rights if so empowered elsewhere in the Code, as is the case with § 363(f).[33]

Because the tenant's lease was timely rejected, the *Dishi* Court found that the tenant was entitled to retain its appurtenant rights pursuant to § 365(h), unless the successful bidder could

---

[29] *Id.*

[30] *Id.*

[31] *Id.*; James H. Millar, *Treatment of Leases Under Sections 363(f) and 365(h) of the Bankruptcy Code*, 2013 Ann. Surv. Bankr. L. 11 (2013) ("[U]nder any scenario, the lessee's rights under the lease must be respected.").

[32] *Id.* at 707-708 (citations and quotations omitted).

[33] *Id.* at 708.

show that § 363(f)(1) through (5) were applicable.[34] However, the successful bidder could not make the requisite showing.[35] Further, the Court agreed with the bankruptcy court that even if § 363(f) were met, § 363(e) required that the tenant continue in possession because many courts agree that in many cases, due to a tenant's unique property interest, "adequate protection can be achieved only through continued possession of the leased premises."[36] Consequently, the District Court affirmed the bankruptcy court's order allowing the tenant continued possession because it was neither unprecedented nor unreasonable.[37]

CONCLUSION

Code § 365(h) reflects the balance between the bankruptcy estate's needs and a tenant's rights to obtain the benefit of its bargain. However, § 363(f) provides the debtor with the ability to sell free and clear of the tenant's possessory interest so long as certain requirements are met (363(f)(1) through (5)), and the debtor can adequately protect the tenant's interest. A debtor moving forward with a § 363 sale should anticipate what might constitute adequate protection (perhaps a carve-out from the sale proceeds), or the buyer may end up with an unwanted and unexpected tenant.

---

[34] *Id.*
[35] *Id.* at 708-11.
[36] *Id.* at 712, citing *Haskell*, 321 B.R. at 10.
[37] *Id.*

American Bankruptcy Institute
Southwest Bankruptcy Institute

"Top 10" Changes to Asset Sales Under § 363 of the Bankruptcy Code

Robert M. Charles, Jr.
Lewis Roca Rothgerber LLP
3993 Howard Hughes Parkway, Suite 600
Las Vegas, NV 89169
Tel: 702.949.8320
Fax: 702.949.8321
RCharles@LRRLaw.com

Unanswered Questions

Rob Charles, Lewis Roca Rothgerber LLP

The Bankruptcy Code has been part of the legal environment since 1978, and Ninth Circuit courts have applied the Code during several periods of economic distress. After the "Great Recession" of 2008-2009 and its aftermath, Ninth Circuit courts continue to struggle with sale issues under Bankruptcy Code § 363. This paper highlights a couple of those issues, and closes with the recommendations of the ABI Commission to Study the Reform of Chapter 11.

1. What Are The Standards For Sale Of Substantially All Estate Assets Out Of The Ordinary Course Of Business.

Courts outside the Ninth Circuit have relatively well established precedents to guide a bankruptcy court considering a motion for sale of substantially all estate assets out of the ordinary course of business outside a plan of reorganization. In the Ninth Circuit, neither the Circuit nor the Bankruptcy Appellate Panel has published an opinion delineating the rules. However, there following principles appear non-controversial, if not yet grounded in Ninth Circuit precedent.

Under Bankruptcy Code § 363(b)(1), the 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." The Bankruptcy Code permits a sale "free and clear of any interest in such property of an entity other than the estate" if "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," or "such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest."[1] "All sales not in the ordinary course of business may be by private sale or by public auction."[2]

[1] 11 U.S.C. § 363(f)(3), (5).
[2] Fed. R. Bankr. P. 6004(f)(1).

"The standard used for judicial approval of the use of estate property outside of the ordinary course of business is . . . the business judgment of the debtor."[3]

The court exercises its discretion in considering such a sale.[4]

The debtor must establish, and the court must determine, that there is a "sound business justification" for the sale.[5] The test has four requirements: i) a sound business reason; ii) accurate and reasonable notice; iii) fair and reasonable price; and iv) good faith.[6]

To the contrary, generally, "[a] bankruptcy court can authorize the sale of substantially all of the assets of the estate under §363(b) upon a proper showing that the sale is in the best interests of the estate, that there is a sound business purpose for the sale, and that it was proposed in good faith."[7]

2. A Chapter 11 Plan Is Not Always Required

Courts have debated whether a high burden should be required before authorizing sale of substantially all estate assets outside a plan. A sale of substantially all of a debtor's assets under Section 363(b) of the Bankruptcy Code must be "closely scrutinized" because of the risk that a sale outside of a plan of reorganization may deprive creditors of

---

[3] *See In re Genco Shipping & Trading Ltd.*, 509 B.R. 455 (Bankr. S.D.N.Y. 2014); *see In re Lahijani*, 325 B.R. 282, 289 (9th Cir. BAP 2005) ("Ordinarily, the position of the trustee is afforded deference, particularly where business judgment is entailed in the analysis or where there is no objection.").

[4] *Clear Channel Outdoor, Inc. v. Knupfer (In re PW, LLC)*, 391 B.R. 25, 32-33 (9th Cir. BAP 2008).

[5] *See In re Del. & Hudson Ry. Co.*, 124 B.R. 169, 176 (D. Del. 1991) ("Once a court is satisfied that there is a sound business reason or an emergency justifying the pre-confirmation sale, the court must also determine that the trustee has provided the interested parties with adequate and reasonable notice, that the sale price is fair and reasonable and that the purchaser is proceeding in good faith"); *see also In re Lionel Corp.*, 722 F.2d 1063, 1068-69 (2d Cir. 1983) (finding no sound business reason for proposed 363 sale).

[6] *See In re Titusville Country Club*, 128 B.R. 396, 399 (Bankr. W.D. Pa. 1991).

[7] *See In re Kellogg-Taxe*, No. 2:12-BK-51208-RN, 2014 WL 1016045, at *4 (Bankr. C.D. Cal. Mar. 17, 2014); *see also Stephens Indus., Inc. v. McClung*, 789 F.2d 386, 390 (6th Cir. 1986) ("[A] bankruptcy court can authorize a sale of all a Chapter 11 debtor's assets under § 363(b)(1) when a sound business purpose dictates such action."); *In re Lionel Corp.*, 722 F.2d 1063 (7th Cir. 1983).

substantial rights inherent in the plan confirmation process. Accordingly, the debtor bears a "heightened burden of proving the elements necessary for authorization."[8] Furthermore, in order for a sale under Section 363 of the Bankruptcy Code to be expedited, the debtor must establish a compelling justification for expedited sale.[9]

Other courts find that absent loss of rights protected by the chapter 11 plan and disclosure process, even a sale of substantially all the assets of the debtor in possession outside a plan may be approved.[10]

3. The Court Must Determine That Property Is Property Of The Estate Before A Section 363(f) Sale

As a threshold issue, it is axiomatic that a debtor is not authorized to sell property that it does not own.[11]

Courts have struggled with the level of determination that property is "property of the estate" before exercising the sale power under § 363(f). There is authority for the proposition that § 363(f) should not be held up over alleged disputes over the estate's interest in the property.[12]

---

[8] *In re Channel One Commc'ns, Inc.*, 117 B.R. 493, 496 (Bankr. E.D. Mo. 1990) (citing *In re Indus. Valley Refrigeration & Air Conditioning Supplies, Inc.*, 77 B.R. 15, 17 (Bankr. E.D. Pa. 1987); *In re Woods*, 215 B.R. 623, 626 (10th Cir. BAP 1998) (quoting *Collier on Bankruptcy* ¶ 363.02[4], at 363-19 (Lawrence P. King ed., 15th ed. rev. 1997)).

[9] *See*, *e.g.*, *In re Beker Indus. Corp.*, 89 B.R. 336, 339 (S.D.N.Y. 1988) (denying sale where, although reorganization plan was not imminent, there was an "absence of any compelling circumstances permitting a sale").

[10] *In re Work Recovery, Inc.*, 202 B.R. 301 (Bankr. D. Ariz. 1996).

[11] *See Cincola v. Sharffenberger*, 248 F.3d 110, 121 (3d Cir. 2001) (bankruptcy authorized the sale of property of the estate, as defined in section 541 of the Bankruptcy Code).

[12] *In re Fillion*, 181 F.3d 859, 862 (7th Cir. 1999) (dispute over ownership would not prevent sale under 11 U.S.C. § 363(f)(4)); *cf. In re Millerburg*, 61 B.R. 125 (Bankr. E.D.N.C. 1986) ("The potential preference action against GMAC would certainly qualify as a *bona fide* dispute for purposes of § 363(f)(4)."); *see also In re Julien Co.*, 117 B.R. 910, 916, 918-20 (Bankr. W.D. Tenn. 1990) (trustee could sell cotton collateral under § 363 because debtor had redemption rights despite lender's assertion that it had ownership of cotton).

A published Ninth Circuit opinion, later withdrawn, stands for the proposition that the court must determine whether property is estate property before exercising the sale power.[13] Other courts agree.[14]

Arguably, the *Rodeo Canon Development* opinion has no precedential value because it was withdrawn from the Federal Reporter pursuant to a settlement.[15]

4. The Sale Process Is Reviewed For The Trustee's Business Judgment

It is the debtor in possession's business judgment, not the secured creditor's business judgment, which guides the Court.[16] "If valid business justification exists, then a strong presumption follows that the agreement at issue was negotiated in good faith and is in the best interests of the estate; the burden of rebutting that presumption falls to parties opposing the transaction."[17]

---

[13] *In re Rodeo Canon Dev. Corp.*, 362 F.3d 603, 608 (9th Cir. 2004); *accord Darby v. Zimmerman (In re Popp)*, 323 B.R. 260 (9th Cir. BAP 2005).

[14] *See In re Clark*, 266 B.R. 163, 172 (9th Cir. BAP 2001) (sale free and clear of claims denied because not property of the estate); *In re Atl. Gulf Cmtys. Corp.*, 326 B.R. 294 (Bankr. D. Del. 2005) (similar); *In re Claywell*, 341 B.R. 396 (Bankr. D. Conn. 2006) (sale disallowed pending resolution of debtor's ownership in property

[15] *See In re Rodeo Canon Dev. Corp.*, 126 Fed. App'x 353 (9th Cir. 2005); *see also In re Naranjo*, 768 F.3d 332, 344 n.15 (4th Cir. 2014) (withdrawn opinion loses precedential weight); *In re Global Reach Inv. Corp.*, No. BAP NC-11-1187-SADH, 2012 WL 933594, at *4 n.9 (9th Cir. BAP Mar. 20, 2012) (noting that the published opinion in *Rodeo Canon* was withdrawn and questioning viability of *In re Popp*, 323 B.R. 260 (9th Cir. BAP 2005), because *Popp* "was primarily based on" *Rodeo Canon*); 3 *Collier on Bankruptcy* ¶ 363-55, at ¶ 363.06[6] (16th ed. 2015) ("[T]he Ninth Circuit withdrew its opinion two weeks *after* the [bankruptcy] appellate panel's decision, so whether the appellate panel's decision will have any more than persuasive effect is unclear.").

[16] *See In re Cont'l Air Lines, Inc.*, 780 F.2d 1223, 1226 (5th Cir. 1986) (the Trustee must "satisfy [his] fiduciary duty to the debtor, creditors and equity holders, [by articulating some] business justification for using, selling, or leasing the property outside the ordinary course of business"); *In re Lionel Corp.*, 722 F.2d at 1070 ("The history surrounding the enactment in 1978 of current Chapter 11 and the logic underlying it buttress our conclusion that there must be some articulated business justification . . . for using, selling or leasing property out of the ordinary course of business."); *In re MF Global Inc.*, 467 B.R. 726, 730 (Bankr. S.D.N.Y. 2012) (sales under § 363 must "be based on the sound business judgment of the debtor or trustee").

[17] *MF Global*, 467 B.R. at 730 (citing *In re Integrated Res., Inc.*, 147 B.R. 650, 656 (S.D.N.Y. 1992).

The debtor in possession may exercise discretion in the manner of sale.[18] That discretion is reviewed with deference.[19] As a Texas district court explained: "'As long as [the sale] appears to enhance a debtor's estate, court approval of a [Trustee's] decision to [sell] should only be withheld if the [Trustee's] judgment is clearly erroneous, too speculative, or contrary to the provisions of the Bankruptcy Code . . . .'"[20]

5. And Now A Word From Our Sponsor

Among the extraordinary pieces of the ABI Commission to Study the Reform of Chapter 11[21] is the discussion and recommendations concerning Use, Sale, or Lease of Property of the Estate.[22] The Commission's recommendations are thought-provoking:

Recommended Principles:

- Except in the context of a sale of all or substantially all of a debtor's assets (i.e., a section 363x sale), the court should approve the use, sale, or lease of a debtor's assets outside the ordinary course of business only if the court finds by a preponderance of the evidence that the trustee exercised reasonable business judgment in connection with the proposed transaction. This approach often is referred to as an "enhanced" or "intermediate" level of review that considers not only the process adopted by the board of

[18] *See In re Terrace Chalet Apts., Ltd.*, 159 B.R. 821, 825 (N.D. Ill. 1993) ("[C]ourts have consistently acknowledged, '[t]he manner of sale is within the discretion of the Trustee . . . .'" (quoting *In re Alisa P'ship*, 15 B.R. 802, 802 (Bankr. D. Del. 1981))); *In re Canyon P'ship*, 55 B.R. 520 (Bankr. S.D. Cal. 1985) ("[T]he manner of sale is within the discretion of the Trustee and . . . any such sale is not a judicial sale as was the case under Section 70 of the Bankruptcy Act.").
[19] *In re Gulf States Steel, Inc.*, 285 B.R. 497, 516 (Bankr. N.D. Ala. 2002) (citing *In re Bakalis*, 220 B.R. 525, 531–32 (Bankr. E.D.N.Y. 1998)).
[20] *GBL Holding Co., Inc. v. Blackburn/Travis/Cole, Ltd.*, 331 B.R. 251, 255 (N.D. Tex. 2005) (quoting *Richmond Leasing Co. v. Capital Bank, N.A.*, 762 F.2d 1303, 1309 (5th Cir. 1985), and upholding the Debtor's exercise of business judgment in a decision to assume a lease).
[21] http://commission.abi.org/ (visited 8/11/2015).
[22] https://abiworld.app.box.com/s/rca12wvv3qih6phex1yk (visited 8/11/2015).

directors (or similar governing body) to approve the transaction but also the reasonableness of the decision itself.

- Only the trustee should be able to propose the use, sale, or lease of a debtor's assets outside the ordinary course of business. Accordingly, no change to existing law is suggested on this point.

- A secured creditor's collateral should not be subject to a mandatory surcharge in favor of the estate but the court should retain the authority to make appropriate allocations of value to the estate as may be warranted under the circumstances pursuant to sections 506(c) and 552(b) of the Bankruptcy Code, as clarified by the related principles. See Section VI.C.3, Section 506(c) and Charges Against Collateral; Section VI.C.4, Section 552(b) and Equities of the Case.

- For the standard of review governing section 363x sales, see Section VI.B, Approval of Section 363x Sales.

The Commission separately addressed and made recommendations concerning sales free and clear.[23]

Recommended Principles:

- In general, the trustee should be able to sell a debtor's assets free and clear of all interests in a debtor's assets, including liens and encumbrances, to the extent permitted by the U.S. Constitution and the guidelines set forth in these principles. In addition, the trustee should be able to sell a debtor's assets free and clear of all claims related to a debtor's assets in the context of a sale of all or substantially all of a debtor's assets under section 363x (or a transaction involving less than

[23] https://abiworld.app.box.com/s/rca12wvv3qih6phex1yk (visited 8/11/2015).

substantially all of the debtor's assets if the court determines that the trustee has otherwise complied with the requirements of section 363x).

- A trustee should be able to sell assets free and clear of interests if applicable nonbankruptcy law would permit the owner of such assets to sell them free and clear of such interests. The foreclosure rights of a creditor or other third party should not be determinative in this context. Bankruptcy Code section 363(f)(1) and (5) should be amended accordingly.

- A trustee should be able to sell assets free and clear of interests without the consent of any lienholder and regardless of whether the assets generate value in excess of the aggregate value of the liens in the assets, provided that the liens attach to the proceeds of the sale or the lienholder receives another appropriate form of adequate protection of the lien. Section 363(f)(3) should be amended accordingly.

- In the context of a section 363x sale, a trustee should be able to sell assets free and clear of any successor liability claims (including tort claims) other than those specifically excluded from free and clear sales by these principles.

- The court should not approve a sale of a debtor's assets free and clear of the following kinds of interests: (i) easements, covenants, use restrictions, usufructs, or equitable servitudes that are deemed to "run with the land" under applicable nonbankruptcy law; (ii) environmental obligations that are deemed to "run with the land" under applicable nonbankruptcy law; (iii) successorship liability for purposes of federal labor law; and (iv) partial, competing, or disputed ownership interests, except to the extent specified in section 363(h) or (i).

- The sale of a debtor's assets free and clear of executory contracts and unexpired leases should be governed by section 365 or, for collective bargaining agreements, section 1113. Accordingly, the trustee should be permitted to sell the debtor's

assets free and clear of executory contracts and unexpired leases only to the extent such contracts and leases are rejected in accordance with section 365 or section 1113, as applicable, and the trustee is permitted by section 365 to recover the property free and clear of the nondebtor counterparty's rights to use or possess such property.

- The court's approval of a sale free and clear of interests or claims under section 363(f) should continue to be considered part of the court's approval of the overall transaction under section 363(b) or (c). Accordingly, no change to existing law is suggested on this point.

- To the extent permitted by these principles for other claims, the trustee should be able to sell a debtor's assets free and clear of any monetary claims by the federal government or a state government against the debtor or the estate, provided that such monetary claims constitute "claims" under section 101(5) under current law. The trustee should not be able to sell a debtor's assets free and clear of any enforcement rights of such government to the extent that such rights are within such government's police or regulatory powers and could be enforced against the debtor or the estate under section 362(b)(4), or to the extent that the state or federal government incurs costs post-sale in the exercise of its police or regulatory powers.

Finally, the Commission made a recommendation as to credit bidding.[24]

Recommended Principles:

- In a sale under section 363 of the Bankruptcy Code involving a secured creditor's collateral, the secured creditor should be permitted to credit bid up to the amount of its allowed claim relating to such collateral unless the court orders otherwise for cause. For purposes of this principle, the potential chilling effect of a credit bid

[24] https://abiworld.app.box.com/s/rca12wvv3qih6phex1yk (visited 8/11/2015).

alone should not constitute cause, but the court should attempt to mitigate any such chilling effect in approving the process. Section 363(k) should be clarified accordingly.