



**MID-MARKET RESTRUCTURING: WHAT HAPPENS IF NO ONE
COMES TO THE SALE?**

THE IMPLICATIONS OF *CLEAR CHANNEL*

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Clear Channel Outdoor, Inc. v. Knupfer, 391 B.R. 25 (B.A.P. 9th Cir. 2008)¹

Introduction

In *Clear Channel*, the Bankruptcy Appellate Panel for the Ninth Circuit (the “BAP”) issued a potentially sweeping decision on the ability of a debtor to sell its assets “free and clear” of “out of the money” liens under § 363(f) of the Bankruptcy Code. The BAP held that the debtor could not sell its property to a senior lienholder (under a “credit bid”) “free and clear” of the liens of a junior lienholder on the property. Although the decision came in the context of a “credit bid,” the Court’s reasoning could apply to prevent the sale of property “free and clear” of a junior lien under § 363(f) of the Bankruptcy Code in any case where the sale price is less than the amount of the junior lienholder’s claim.

If the *Clear Channel* opinion is followed by courts outside of the Ninth Circuit, it could have a dramatic impact on the growing trend of quick § 363 sales, especially in small to midsize chapter 11 cases. The opinion also changes the balance of power in a chapter 11 case, as “out of the money” junior lienholders will have substantial leverage to use “hold up” tactics to obtain payoffs or other concessions from the senior lienholder and/or the debtor.

Relevant Background and Summary of the Issues

In *Clear Channel*, PW, LLC (“PW”) owned large parcels of land (the “Property”) in Burbank, California. DB Burbank, LLC (“DB”), a hedge fund, held a \$40 million claim against PW which was secured by the Property. Clear Channel Outdoor, Inc. (“Clear Channel”) held a \$2.5 million claim against PW that was secured by a junior lien on the Property.

On November 20, 2006, PW filed a voluntary chapter 11 petition. Shortly thereafter, the chapter 11 trustee for PW’s estate (the “Trustee”) began the process of marketing the Property for a sale under § 363 of the Bankruptcy Code. In March 2007, the Trustee and DB negotiated the terms of a “stalking horse bid” for the Property, under which DB would “credit bid” its secured claim under § 363(k) of the Bankruptcy Code. The Bankruptcy Court approved bid procedures for the sale of the Property, including DB’s right to credit bid. DB’s bid was the highest bid for the Property. Accordingly, on April 26, 2007, over an objection by Clear Channel, the Bankruptcy Court entered an order (the “Sale Order”) authorizing “the sale free and clear of Clear Channel’s lien under § 363(f)(5)” of the Bankruptcy Code. 391 B.R. at 31-32. Because DB’s credit bid was solely the amount of its debt (other than payment of certain Trustee fees and related costs), Clear Channel received no consideration from the sale of the Property.

Clear Channel appealed the Sale Order to the BAP. DB and the Trustee moved to dismiss the appeal as moot. The BAP considered two issues on appeal. First, was Clear Channel’s appeal moot under principles of equitable mootness or under § 363(m) of the Bankruptcy Code? Second, “outside a plan of reorganization, does § 363(f) of the Bankruptcy

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Code permit a secured creditor to credit bid its debt and purchase estate property, taking title free and clear of valid, nonconsenting junior liens?” 391 B.R. at 29.

Analysis and Holding

Mootness

I. Equitable Mootness

The BAP first considered whether the appeal was equitably moot. In evaluating whether the appeal was equitably moot, the BAP analyzed “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.” 391 B.R. at 33-34. Equitable mootness typically focuses on the difficulty of “unscrambling the egg” after a sale is closed and money changes hands.

The BAP acknowledged the changes that had taken place since the sale closed.

The changes that have taken place in connection with and since the closing of the sale are numerous and complex, which calls into question whether this appeal is equitably moot. Title to PW's property has been transferred to DB, and the Trustee has relinquished control over the development of PW's property to DB. DB has assumed the executory contracts and unexpired leases. DB has also executed and recorded a number of documents necessary to effectuate the sale. All of these have required significant expenditures.

Id. at 33-34.

The BAP nevertheless held that the appeal was not equitably moot. DB was the only party impacted by the appeal, not any third parties, and DB “was aware of the risks of going forward with the sale.” *Id.* at 34. The BAP could also grant relief on the appeal without undoing the sale, by merely finding that Clear Channel's lien attached to the Property, now owned by DB.

II. Statutory Mootness

Section 363(m) of the Bankruptcy Code protects sales under § 363 made in good faith from being reversed on appeal, absent the grant of a stay pending appeal. The BAP held that § 363(m) did not make the appeal moot because that subsection applies only to sales under § 363(b) and (c), and not to “lien stripping” under § 363(f). The BAP also noted that a sophisticated lender like DB was aware of the risks of closing on the sale and cannot use § 363(m) to avoid appellate review.

The BAP's mootness analysis ignores that DB likely would not have bid, or would have negotiated different terms for the deal, had it known that it would be acquiring the Property subject to Clear Channel's lien. Prior to the BAP's decision, it was well established that a buyer could acquire property free and clear of junior liens under § 363(f)(5) of the Bankruptcy Code. *See, e.g., In re Trans World Airlines, Inc.*, 322 F.3d 283, 290-91 (3d Cir. 2003); *In re James*, 203 B.R. 449, 453 (Bankr. W.D. Mo. 1997); *In re Grand Slam U.S.A., Inc.*, 178 B.R. 460, 462 (E.D. Mich. 1995). DB should have been entitled to rely on those decisions in

closing on the sale, especially when the Bankruptcy Court followed their reasoning in entering the Sale Order.

While Clear Channel had the right to challenge that line of authority at a hearing on approval of the sale, allowing a post-closing attachment of a junior lien through an appellate attack unfairly defeats the benefit of DB's bargain. It also introduces a whole new layer of uncertainty to § 363 sales, as buyers may price assets differently or refuse to bid at all due to the possibility that § 363(f) challenges are not cut off by an unstayed order approving the sale.

Sale Free And Clear Of Liens Under Section 363(f)

The BAP next analyzed whether the Trustee could sell the Property to DB "free and clear" of Clear Channel's lien under § 363(f) of the Bankruptcy Code. The two potentially applicable provisions were §§ 363(f)(3) and (5), which provide as follows:

(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 ...

(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; ...

(5) such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.

I. Section 363(f)(3)

The BAP held that § 363(f)(3) could not be used as a basis to sell assets free and clear of a junior lien. The dispute centered around whether the phrase "aggregate value of all liens" means (a) the face value of all claims with a lien on the assets being sold, or (b) the value of the lienholder's secured claim under § 506(a) of the Bankruptcy Code. DB argued that the BAP should choose (b), which essentially would allow a Bankruptcy Court to approve a free and clear sale over all "out of the money" liens under § 363(f)(3).

The BAP ruled that DB's interpretation, followed by some courts,² was too broad. The BAP noted that the interpretation:

would essentially mean that an estate representative could sell estate property free and clear of any lien, regardless of whether the lienholder held an allowed secured

² See, e.g., *In re Beker Indus. Corp.*, 63 B.R. 474, 476-77 (Bankr. S.D.N.Y. 1986); *In re Terrace Gardens Park P'ship*, 96 B.R. 707, 713-15 (Bankr. W.D. Tex. 1989); *In re Oneida Lake Dev., Inc.*, 114 B.R. 352, 357 (Bankr. N.D.N.Y. 1990); *In re WPRV-TV, Inc.*, 143 B.R. 315, 320 (D.P.R. 1991); *In re Milford Group, Inc.*, 150 B.R. 904, 906 (Bankr. M.D. Pa. 1992); *In re Collins*, 180 B.R. 447, 450-01 (Bankr. E.D. Va. 1995).

claim. We think the context of *paragraph (3)* is inconsistent with this reading. If Congress had intended such a broad construction, it would have worded the paragraph very differently.

391 B.R. at 40.

The BAP therefore held that § 363(f)(3) does not authorize a sale of assets free and clear of a lien “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.” 391 B.R. at 41. Because the sales price for the Property was not greater than the claims held by Clear Channel, a junior lienholder, § 363(f)(3) did not allow the Trustee to sell the Property free and clear of the Clear Channel lien.


II. Section 363(f)(5)

The BAP next considered whether the Trustee could sell the Property free and clear of Clear Channel’s lien under § 363(f)(5). The BAP held that the Trustee could not do so.

The BAP held that Clear Channel could not be “compelled . . . to accept a money satisfaction” of its interest within the meaning of § 363(f)(5). The BAP began by rebuking the Bankruptcy Court’s contention that § 363(f)(5) applied whenever a claim could be satisfied with money. Instead, the BAP reasoned that § 363(f)(5) applies only when a procedure exists to force a creditor’s interest to be completely satisfied without full payment of the amount owed (e.g., a liquidated damages clause or other contractual provision).

The BAP also held that § 363(f)(5) required the Trustee or DB to point to a specific “legal proceeding” in which Clear Channel could be compelled to accept a money satisfaction of its interest. 391 B.R. at 48-49. The BAP stated that neither the parties nor the Bankruptcy Court had identified any such proceeding. While some courts have considered a cramdown (nonconsensual plan confirmation) under § 1129(b)(2) of the Bankruptcy Code as a qualifying “proceeding,” the BAP refused to follow that line of authority. The BAP reasoned that “[i]f the proceeding authorizing the satisfaction was found elsewhere in the Bankruptcy Code (i.e., in § 1129(b)(2)), then an estate would not need § 363(f)(5) at all; it could simply use the other Code provision.” 391 B.R. at 50-51. In addition, the BAP noted that § 1129 only allows a cramdown of a lien “in the context of plan confirmation.” *Id.*

Because the Trustee could not sell the Property free and clear of Clear Channel’s lien, it reversed the portion of the Sale Order under § 363(f). The BAP, however, remanded the case to the Bankruptcy Court to determine if the parties could identify a qualifying “proceeding” (perhaps a mortgage foreclosure) under non-bankruptcy law that would allow the sale free and clear of Clear Channel’s lien under § 363(f)(5).



Implications of the Decision

The *Clear Channel* case could have a significant impact on § 363 sales if it is adopted by other courts. In many cases, especially small to mid-size cases, an expeditious § 363 sale for less than the value of all liens on the property is the only viable “exit strategy” for the case. If parties cannot rely on § 363(f)(5) to sell assets free and clear of junior liens outside of a plan, senior secured lenders may be disinclined to lend money and more cases will end up in a chapter 7 liquidation. Buyers of assets also may reduce their purchase price or demand escrows if they cannot be assured of buying free and clear of all liens. The entire § 363 process could lack uncertainty under a *Clear Channel* regime, which will reduce competition for assets and drive down value for creditor constituencies.

Moreover, *Clear Channel* changes the balance of power in a chapter 11 case. Before the decision, undersecured or unsecured junior lienholders had little power in a chapter 11 case. Under *Clear Channel*, “out of the money” junior lienholders will have substantial leverage to use “hold up” tactics to obtain payoffs or other concessions from the senior secured creditor and/or the debtor. At a minimum, the case will be cited by every litigious junior lienholder until the opinion is either discredited or overruled. A thoroughly researched decision by the Bankruptcy Court on remand identifying a mortgage foreclosure (or UCC sale, in the case of a sale of personal property) as a qualifying “proceeding” under § 363(f)(5) is the best hope for an appropriate conclusion to this hasty and (in our view) incorrect decision.