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### Bankruptcy Sales Uncertain After Justices' Section 363 Ruling

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Carrie Brosius, a partner in the Vorys Cleveland office, and Thomas Loeb, an associate in the Vorys Cleveland office, co-authored an article for *Bankruptcy Law360* titled "Bankruptcy Sales Uncertain After Justices' Section 363 Ruling."

The full text of the article is included below with permission from *Law360*.

### Bankruptcy Sales Uncertain After Justices' Section 363 Ruling

On April 19, the U.S. Supreme Court held in *MOAC Mall Holdings v. Transform Holdco* that Section 363(m) of the Bankruptcy Code is not a jurisdictional provision.

Thus, challenges to Section 363 sales that have closed can be heard on appeal notwithstanding a Section 363(m) finding in the sale order, so long as the appellate decision does not affect the validity of the sale to a good faith purchaser.[1]

#### Background

The original dispute arose between Mall of America owner MOAC Mall Holdings LLC and Transform Holdco LLC. In its Chapter 11 bankruptcy, Sears Roebuck & Co. "sold most of its pre-bankruptcy assets to respondent Transform Holdco LLC, including the right to designate to whom a lease between Sears and petitioner MOAC Mall Holdings LLC should be assigned." [2]

Thereafter, Transform "designated the Mall of America lease for assignment to its wholly owned subsidiary," Transform Leaseco LLC. [3]

MOAC objected to this assignment, "in part because Transform Holdco is a nonretail entity that does not plan to occupy the space, and is therefore not an appropriate assignee of the lease" [4] under Section 365(f)(2)(B) of the Bankruptcy Code. [5]

The U.S. Bankruptcy Court for the Southern District of New York did not find MOAC's argument convincing and permitted the assumption and assignment of the lease.[6]

MOAC, "looking to §363(m)'s safe harbor for certain orders that are 'stayed pending appeal,'"[7] sought a stay on the assignment. The bankruptcy court denied MOAC's request and "emphasized that Transform had explicitly represented that it would not invoke §363(m) against MOAC's appeal" of the assignment.[8]

On appeal, the U.S. District Court for the Southern District of New York initially agreed with MOAC and concluded that the assumption and assignment of the lease did not satisfy Section 365(f) of the Bankruptcy Code. However, Transform sought a rehearing, and for the first time argued that Section 363(m) barred "the District Court of Jurisdiction to grant MOAC's requested relief," "back[ing] away from its previous disclaimers" on the Section 363(m) issue.[9]

The district court, noting that it was "'appalled' by Transform's gambit of waiting to invoke §363(m) until after losing the merits of the appeal," nevertheless determined that U.S. Court of Appeals for the Second Circuit precedent requires that Section 363(m) be treated as jurisdictional, rendering it not subject to "waiver [or] judicial estoppel." [10]

Based on this, the district court held that Section 363(m) was applicable, barring the appeal and leaving the assignment order in place.[11]

At the appellate level, the Second Circuit affirmed the district court ruling, with the Supreme Court reversing the Second Circuit's decision.

### **Bankruptcy Code Provisions at Issue**

Sections 363(b)(1) and 363(m) of the Bankruptcy Code drive this issue.

Section 363(b)(1) "generally permits a bankruptcy trustee, after notice and hearing, to use, sell or lease property that belongs to the bankruptcy estate outside of the ordinary course of business." [12]

Section 363(m) "protects good faith purchasers at these bankruptcy sales, and states that the reversal or modification on appeal of a Section 363 bankruptcy sale or lease does not affect the validity of that sale or lease where the subject property was acquired in good faith, unless the sale or lease was stayed pending appeal." [13]

In full, Section 363(m) states that:

The reversal or modification on appeal of an authorization under subsection (b) or (c) of this section of a sale or lease of property does not affect the validity of a 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.[14]

### Judicial Interpretation of Section 363(m)

Prior to this Supreme Court case, Transform was successful in convincing courts — both the district court and the Second Circuit — that MOAC lacked jurisdiction, arguing that Section 363(m)'s prohibition on appellate courts "affect[ing] the validity of a sale or lease" that has closed to a good faith purchaser stopped those courts from hearing issues regarding such sales.[15] As noted by the Second Circuit, such a jurisdictional bar reflects Congress' "uniquely important interest in assuring the finality" of Section 363 sales.[16]

The Supreme Court, disagreeing with the Second Circuit and overturning its decision, held that "Section 363(m) is not a jurisdictional provision." [17] In doing so, the Supreme Court explained that "jurisdictional rules" — i.e., whether a court can hear a dispute in the first place — "pertain to 'the power of the court,'" are "impervious to excuses like waiver or forfeiture," [18] and do not pertain to "the rights or obligations of the parties," i.e., what rights a party has on appeal. [19]

As articulated by the Supreme Court, a statute only creates a jurisdictional bar on appellate courts hearing disputes when "Congress 'clearly states' as much." [20]

Regarding Section 363(m), because Congress did "not clearly stat[e] that the provision is a limit on judicial power, rather than a mere restriction on the effects of a valid exercise of that power when a party successfully appeals a covered authorization" [21], Section 363(m) does not prevent appellate courts from hearing issues stemming from Section 363 sales.

In sum, and as stated above, issues stemming from Section 363 sales that have closed can be heard on appeal, so long as the appellate decision does not affect the validity of the sale to a good faith purchaser.

### Future Impact of Supreme Court Decision

The issue now becomes: What can an appellate court decide on appeal under this framework? If a successful appeal does not affect the validity of the underlying sale, what exactly does an appellant gain?

The Supreme Court did not provide substantive clarity on this question, leaving future parties to Section 363 sales at the mercy of courts across the nation that may have differing perspectives on the issue.

By way of example, the U.S. Court of Appeals for the Third Circuit, which has differed from the Second Circuit and did not consider Section 363(m) to be a jurisdictional barrier, required in its 2020 decision in *In re: Energy Future Holdings Corp.* that an appellate court consider "whether the grant of relief would, in effect, 'claw back the sale'" and a Section 363 sale challenger to "demonstrate that the relief affects only 'collateral issues not implicating a central or integral element of a sale'" for said challenger to be successful on appeal. [22]

In sum, the standard provides little perspective certainty for all parties to a 363 sale, with the Third Circuit itself noting that the "requested relief may require more careful study depending on the nature of the claim and the type of relief sought." [23]

In other words, and in light of the complex negotiations and terms often found in Section 363 sales, following a successful appeal, courts now will have to grapple with whether a petitioner's requested relief in response to a challenged sale term would affect the validity of the Section 363 sale with little concrete guidance and, if so, determine what alternative relief would be appropriate.

This lack of concrete guidance has led to past controversial opinions on Section 363(m) in jurisdictions not subject to the Second Circuit's now-overturned jurisdictional bar.

For example, in *In Re: ICL Holding Co.*, the U.S. government appealed a Section 363 sale term wherein the 363 purchaser would place \$3.5 million in a trust for the benefit of general unsecured creditors, arguing that the arrangement would violate the Bankruptcy Code's creditor-payment hierarchy. The Third Circuit ultimately held in 2015 that the \$3.5 million was not the property of the bankruptcy estate and therefore not subject to the code's creditor-payment hierarchy.

However, the Third Circuit separately noted that the \$3.5 million fund could have been altered — if the court so chose — without violating Section 363(m), as doing so would not have changed a fundamental term of the transaction. The Third Circuit came to this decision despite the fact that: (1) both the unsecured creditors committee and the debtor felt differently, and (2) the \$3.5 million was negotiated in exchange for a commitment by the committee to not object to the Section 363 sale at the outset.[24]

Although the Supreme Court's reasoning is sound, the uncertainty stemming from this decision may affect debtors-in-possession, trustees, third parties with standing to object to sale terms, and purchasers. The decision may create leverage for parties of interest to demand more favorable sale terms in exchange for resolving their sale objections. It may hamstring debtors-in-possession or trustees in countering those objections, as debtors and trustees may be apprehensive of allowing the courts to decide an issue that may subject them to a lengthy and expensive appeal.

The decision also may concern a purchaser's willingness to engage in the 363 sale process if there is a chance that the sale terms may change after the fact. Whether this uncertainty limits the pool of potential 363 purchasers, and therefore limits the value of bankruptcy estate property sold under Section 363, remains a possibility for future bankruptcy debtors.

Further, prospective 363 purchasers that are willing to engage may insist on reduced purchase prices due to the risk of sale terms being changed on appeal or negotiate a sale process wherein a sale order is entered but does not officially close until resolution of all appeals, requiring additional administrative costs during an interim period.

As the Third Circuit has noted, Section 363(m)'s "certainty attracts investors and helps effect [ ] debtor rehabilitation. ... Without it, the risk of litigation would chill prospective bidders or push them to 'demand a steep discount.'"[25]

In the future, the extent to which Section 363(m) attracts investors, prevents steep discounts of property sold in Section 363 sales and provides the much-needed certainty that all parties involved in a 363 sale seek will fall entirely on how often courts in the applicable jurisdiction rely on Section 363 as authority to preserve challenged sale terms.

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[1] See *MOAC Mall Holdings LLC v. Transform Holdco LLC et al.* Case No. 21-1270 (2023).

[2] See *id.* at syllabus.

[3] See *id.*

[4] See Thomas Loeb and Drew Parobek, What High Court Sears Case May Mean for Section 363 Sales, <https://www.law360.com/articles/1512112/what-high-court-sears-case-may-mean-for-section-363-sales>; see also 11 U.S.C. § 365(f)(2)(B).

[5] Section 365(f)(2)(B) only permits a trustee to assign an unexpired lease only where "adequate assurance of future performance by the assignee of such contract or lease is provided[.]"

[6] See *MOAC Mall Holdings LLC*, No. 21-1270 at syllabus.

[7] See *id.*

[8] See *id.*

[9] See *id.*

[10] See *id.*

[11] See *id.*

[12] See Thomas Loeb and Drew Parobek, What High Court Sears Case May Mean for Section 363 Sales <https://www.law360.com/articles/1512112/what-high-court-sears-case-may-mean-for-section-363-sales>; see also 11 U.S.C. § 363(b)(1).

[13] See *id.*; see also 11 U.S.C. § 363(m).

[14] 11 U.S.C. § 363(m).

[15] See *MOAC Mall Holdings LLC*, No. 21-1270 at syllabus.

[16] See *In re Sears Holdings Corp.*, 2021 U.S. App. LEXIS 37358, at \*5 (2nd Cir. 2021).

[17] See *MOAC Mall Holdings LLC*, No. 21-1270 at syllabus.

[18] See *id.*, slip op. at 7 (internal citations omitted).

[19] See *id.*, slip op. at 8 (internal citations omitted).

[20] See id.

[21] See id., slip op. at 13.

[22] In re Energy Future Holdings Corp., 949 F.3d 806, 821 (3rd Cir. 2020) (internal citations omitted).

[23] See id.

[24] See In re ICL Holding Co., 802 F.3d 547 (3rd Cir. 2015); see also See Thomas Loeb and Drew Parobek, What High Court Sears Case May Mean for Section 363 Sales, <https://www.law360.com/articles/1512112/what-high-court-sears-case-may-mean-for-section-363-sales>.

[25] See In re ICL Holding Co., 802 F.3d at 554 (internal citations omitted).