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Tenth and Eleventh Circuits Address Dismissal as Moot Under 11 U.S.C § 363(m) of Appeals Relating to Asset Sales

ERIC W. FLYNN AND GREGORY G. HESSE

The authors of this article review two recent circuit court decisions, which dismissed as moot under 11 U.S.C. § 363(m) appeals of orders authorizing the sale of assets.

Recently, two courts of appeal dismissed as moot under 11 U.S.C. § 363(m) appeals of orders authorizing the sale of assets. The courts' analysis focused on whether granting the appellant's relief from the lower courts' order would affect the asset sale. Thus the trend in the appellate courts is that only appeals that will not affect the sale itself (such as a dispute over the distribution of sale proceeds) are not subject to being dismissed as moot.

The Eleventh Circuit Court of Appeals issued an opinion in *Steffen v. Menchise (In re Steffen)* ("Steffen")¹ affirming an order of the district court dismissing the debtor's appeal of a bankruptcy court order as moot under 11 U.S.C. § 363(m).² The Chapter 7 debtor appealed to the district court an order by the bankruptcy court authorizing the sale of her home by the Chapter 7 trustee.

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The bankruptcy court denied a stay pending appeal and the trustee closed on the sale of the property while the appeal to the district court was pending. Having closed on the sale, the trustee moved to dismiss the appeal to the district court on the basis that it was moot under 11 U.S.C. § 363(m). The district court found in favor of the trustee and dismissed the appeal. The debtor appealed the decision of the district court to dismiss the appeal to the Eleventh Circuit Court of Appeals, which affirmed the decision finding that the debtor's appeal to the district court had been mooted by the sale of her home.

The Tenth Circuit Court of Appeals issued an opinion in *Rushton v. ANR Co., Inc. et al (In re C.W. Mining Co.)* ("Rushton") affirming an order of the district court to dismiss various consolidated appeals stemming from the sale of estate assets by the Chapter 7 trustee. Prior to the sale of the assets, the trustee obtained an order from the bankruptcy court finding the assets to be property of the estate and ordering those assets not in the trustee's possession or control be turned over to the estate. The counterparties to the action for turnover appealed the bankruptcy court's decision to the district court. While the parties appealed the bankruptcy court's turnover order, the trustee sold the assets that were the subject of the turnover order and moved to dismiss the appeals to the district court as moot under Section 363(m). The district court found the appeals to have been mooted by the sale of the assets and dismissed them. The appellants to the district court filed an appeal of the district court's order dismissing the appeals. The Tenth Circuit Court of Appeals affirmed the district court's order as to five of the six appeals finding that the appeals were moot under Section 363(m) but reversing the district court for one of the appeals, finding that the remedies sought by the appellant would not invalidate the asset sale by the trustee.

Both the Tenth Circuit and the Eleventh Circuit decisions are instructive for all parties to a purchase of assets out of a bankruptcy estate. For bankruptcy trustees and purchasers, the decisions are indicative of the procedural safeguards provided by Section 363(m) and willingness of courts to enforce such protections. For holders of assets that are potentially subject to sale by the trustee, the decisions are instructive as to the need to avail themselves of any and all protections during the course of a bankruptcy proceeding and to not simply rely on the potential ability to challenge the sale of assets on appeal at a later date.

STEFFEN v. MENCHISE (IN RE STEFFEN)

Case Background

Ms. Steffen, the debtor, owned a parcel of real property (the “Property”) which was part of her Chapter 7 bankruptcy estate. The bankruptcy court issued a written order on February 6, 2012, authorizing the trustee to sell the Property in accordance with a sale contract that the trustee had negotiated with a buyer. The sale contract provided for a closing date of on or before February 10, 2012. The trustee and buyer consummated the sale two days early—on February 8, 2012. On February 14, 2012, Ms. Steffen moved the bankruptcy court for a stay pending appeal, which the bankruptcy court orally denied at a hearing on February 21, 2012.

Ms. Steffen appealed to the district court, and the trustee moved to dismiss the appeal as moot. On December 18, 2012, the district court dismissed the appeal on the grounds that § 363(m) prevents an appellate court from granting relief if the bankruptcy court has not issued a stay. Ms. Steffen filed a motion for reconsideration, which the district court denied by written order on February 7, 2013. Ms. Steffen in turn appealed the district court’s order dismissing her appeal to the Eleventh Circuit Court of Appeals.

The Eleventh Circuit Decision

On appeal to the Eleventh Circuit, Ms. Steffen argued that her appeal to the district court was not moot even though she did not obtain a stay of the sale. Specifically, she argued that the bankruptcy court’s denial of her motion for stay was “illusory” because the trustee had already sold the property when the motion was filed and thus violated Fed. R. Bankr.P. 6004(h), which provides for an automatic 14-day stay period following “[a]n order authorizing the use, sale, or lease of property other than cash collateral.” She also argued that the district court abused its discretion by expediting the deadline for her to respond to the trustee’s motion to dismiss and by applying the heightened Rule 59(e) standard in deciding her motion for reconsideration knowing that her counsel was unable to respond to the expedited deadline to respond to the trustee’s motion to dismiss.

The Eleventh Circuit dismissed her arguments, finding that Ms. Steffen’s

appeal was moot pursuant to Section 363(m) because she did not obtain a stay pending appeal. In reaching its decision, the Eleventh Circuit found that the fact that she filed a motion for stay that the bankruptcy court rejected did not create an exception to Section 363(m). Additionally, the court found that there was no exception where the trustee has sold the property before the 14-day automatic stay period provided by Fed. R. Bankr.P. 6004(h) expires. Indeed, the court noted that Ms. Steffen suffered no prejudice as a result of the trustee's sale of the property before the 14-day stay period expired because she was able to file a request for stay pending appeal prior to the sale which is what Rule 6004(h) was designed to provide.³

RUSHTON v. ANR CO., INC. ET AL (IN RE C.W. MINING CO.)

Case Background

C.W. Mining mined coal on land belonging to two related entities, COP Coal Development Co. ("COP") and ANR Co. Inc. ("ANR"). C.W. Mining had the exclusive right to mine coal on COP and ANR's property per leases C.W. Mining had with both. Hiawatha Coal Co., Inc. ("Hiawatha") also mined coal, but on a much smaller scale than C.W. Mining.

Charles Reynolds and his family lived in a house connected to the mine's major operations center (the "scale house") while he managed the Bear Canyon mine. COP owned the scale house, but because the scale house was under C.W. Mining's exclusive control per its mining contract with COP, Reynolds lived at the home with C.W. Mining's permission.

Creditors filed an involuntary Chapter 11 bankruptcy petition against C.W. Mining in January 2008. In September 2008, the bankruptcy court entered an order for relief against C.W. Mining. Two months later, in November 2008, the bankruptcy court converted the case into a Chapter 7 bankruptcy case. In that same month, Rushton was appointed the C.W. Mining bankruptcy estate's trustee.

Rushton filed several adversary proceedings in bankruptcy court to recover C.W. Mining's assets, including its coal mining operation at the Bear Canyon mine, its scale house at the mine, and its contracts with ANR and COP. The bankruptcy court ordered all assets to be returned to the estate.

ANR, Hiawatha, Reynolds, and COP each appealed to the district court.

While the appeals were pending in the district court, Rushton sold the Bear Canyon mining operations, scale house, and mining contracts to another mining company, Rhino, for \$15 million. Rushton and Rhino relied on the bankruptcy court's prior rulings that established the estate's ownership of the mining operations, scale house, and mining contracts. After reviewing the sale, the bankruptcy court issued an order finding that Rhino was a good faith purchaser and entitled to the protection of § 363(m). None of the appellants moved to stay the sale order, and the sale closed in August 2010. On August 25, 2010, Rhino took possession and transferred the mining operation to its wholly owned subsidiary, Castle Valley, which promptly began mining.

After the sale closed, Rushton and Rhino moved to dismiss as moot the various appeals still pending in district court, citing § 363(m) mootness. The district court agreed and dismissed the appeals. ANR, Hiawatha, Reynolds, and COP appealed the district court's decisions to dismiss the appeals to Tenth Circuit Court of Appeals.

THE TENTH CIRCUIT DECISION

The key consideration for the Tenth Circuit in evaluating each of the six appeals before it was whether the remedy the appellants sought on appeal to the district court would invalidate the sale of the appellant's assets as ordered by the bankruptcy court. In five of the six appeals, the Tenth Circuit found that the relief requested by the appellant would invalidate the sale ordered by the bankruptcy court and thus, was moot under Section 363(m). In the one appeal in which the Tenth Circuit reversed the district court's dismissal, the Tenth Circuit found that the relief requested by the appellant would have not have invalidated the sale and thus, should be allowed to proceed.

Burden of Proof

At the outset of its decision, the Tenth Circuit set forth the relative burdens of proof borne by each party in the context of Section 363(m). The Tenth Circuit found that while the trustee bears the burden of proving that a bankruptcy appeal is moot under § 363(m) and the appellants bear no

burden to produce evidence or argument, the appellants will not overcome a motion to dismiss for § 363(m) mootness simply because the trustee fails to disprove every possible legal remedy imaginable. Instead, the appellants must at least identify an available remedy that will not affect the sale's validity.

Reynolds Appeal Not Moot Under Section 363(m)

The Tenth Circuit reversed the district court's decision to dismiss the appeal by Reynolds. After C.W. Mining was forced into bankruptcy, Rushton filed an adversary proceeding in bankruptcy court to establish ownership of the scale house and to evict the Reynolds family. Reynolds opposed Rushton's action, arguing that he was the rightful owner of the scale house, not C.W. Mining's bankruptcy estate. Reynolds also filed a counterclaim under the Utah Occupying Claimant Statute ("UOCS")⁴ seeking \$175,000 for purported improvements to the scale house. This counterclaim served as an alternate remedy in the event that the bankruptcy court determined the estate owned the house. Ultimately, the bankruptcy court did in fact find that the estate owned the scale house, and the court also rejected Reynolds's counterclaim. Reynolds then appealed both decisions to the district court. Rushton sold the scale house and moved to dismiss Reynolds's appeal on the basis of Section 363(m) mootness. The district court granted the motion to dismiss the appeal as moot. Reynolds appealed the district court's order to the Tenth Circuit.

Before the Tenth Circuit, Reynolds sought only the value of his home or, alternatively, the value of the improvements to his home from the estate's sale proceeds. The Tenth Circuit found that under the UOCS, such relief was available to Reynolds, at least as to the value of any improvements he made to the scale house and that such relief would not invalidate the sale of the scale house. Accordingly, the Tenth Circuit reversed the district court's dismissal, finding that the appeal was not moot under Section 363(m).

Appeals by ANR, Hiawatha, and COP Moot Under Section 363(m)

Before the bankruptcy court, ANR sought only a determination that its agreement with C.W. Mining had in fact been terminated. In the alterna-

tive, ANR requested that Rushton “pay all unpaid royalties due to ANR” and others “as provided in” a set of documents ANR submitted to the bankruptcy court. The bankruptcy court denied both requests and ANR appealed to the district court.

In June 2008, during the “gap period” between when C.W. Mining’s creditors filed an involuntary bankruptcy petition and when the bankruptcy court granted that petition, C.W. Mining attempted to transfer essentially all of its assets to Hiawatha. Once Rushton became trustee of C.W. Mining’s bankruptcy estate, he filed an adversary action against Hiawatha to recover the transferred property under §§ 549(a) (avoiding the transfer) and 550(a) (recovering the transferred property). Hiawatha opposed the action. Additionally, Hiawatha filed a counterclaim for an improver’s lien under § 550(e), arguing that as a good faith transferee, it was entitled to a lien on the property based on its alleged expenditures to improve the property. The bankruptcy court found in favor of the trustee and ordered Hiawatha to return all of the transferred property to the estate. Additionally, the bankruptcy court ruled against Hiawatha’s counterclaim finding that Hiawatha had provided insufficient evidence to support the creation of an improver’s lien. Hiawatha appealed the bankruptcy court’s order on the turnover action and the counterclaim to the district court.

Before the bankruptcy court, COP, the former owner of the Bear Canyon mine, sought damages of over \$10 million for what COP alleged was C.W. Mining’s failure to operate the Bear Canyon mine in accordance with the terms of a contract between the two. The bankruptcy court disagreed with COP’s argument and as a result, concluded that the estate owed COP only \$1,320,930.89 for C.W. Mining’s defaults. COP then appealed to the district court.

While the appeals by ANR, Hiawatha, and COP were pending before the district court, Rushton sold the assets that were the subject of the appellants’ appeals. Rushton subsequently moved to dismiss the appeals asserting that the sale of said assets rendered the appeals moot under 363(m). The district court found in favor of Rushton and the appellants appealed to the Tenth Circuit.⁵

The Tenth Circuit affirmed the district court’s decision to dismiss these appeals, finding that the appeals were moot because the relief the appellants sought would affect the validity of the sale which is prohibited under Section

363(m) and, in certain instances, the appellants failed to properly preserve arguments regarding remedies that may not have implicated Section 363(m) by not raising the arguments before the district court.

CONCLUSION

Both the Tenth Circuit and the Eleventh Circuit decisions are instructive for all parties to a purchase of assets out of a bankruptcy estate. For bankruptcy trustees and purchasers, the decisions are indicative of the procedural safeguards provided by Section 363(m) and willingness of courts to enforce such protections. For holders of assets that are potentially subject to sale by the trustee, the decisions are instructive as to the need to act quickly and avail themselves of any and all protections during the course of a bankruptcy proceeding and to not simply rely on the potential ability to challenge the order approving sale of assets on appeal at a later date.

NOTES

¹ 13-11052, 2014 WL 170860 (11th Cir. Jan. 16, 2014).

² Section 363(m) states:

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.

³ *In re Steffen*, 13-11052, 2014 WL 170860 (11th Cir. Jan. 16, 2014) (“Rule 6004(h) was designed to provide: “sufficient time for a party to request a stay pending appeal of an order authorizing the use, sale, or lease of property under § 363(b).” Fed.R.Bankr.P. 6004, Advisory Committee Note (1999)).

⁴ Utah Stat. Ann. § 57-6-1 *et seq.*

⁵ In addition to the appeals discussed above, COP and Hiawatha filed separate appeals challenging the bankruptcy court’s order approving the asset sale. As neither party obtained a stay pending appeal, the Tenth Circuit affirmed the district court’s dismissal of their appeals as moot pursuant to Section 363(m).