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What High Court Sears Case May Mean for Section 363 Sales

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Drew Parobek, a partner in the Vorys Cleveland office, and Thomas Loeb, an associate in the Vorys Columbus office, co-authored an article for *Law360* titled "What High Court Sears Case May Mean for Section 363 Sales." The full text of the article is included below with permission from *Law360*.

WHAT HIGH COURT SEARS CASE MAY MEAN FOR SECTION 363 SALES

The U.S. Supreme Court has agreed to hear a dispute between Mall of America owner MOAC Mall Holdings LLC and Transform Holdco LLC as to whether a lease Transform acquired at a bankruptcy sale can be challenged after that sale has closed.

The dispute pertains to the former three-story Sears Holding Corp. anchor store located at the sprawling Mall of America in Minnesota. Through a bankruptcy sale order, Transform Holdco purchased from Sears the right to assign Sears' lease covering the anchor store space to a third party.

After the bankruptcy sale closed, the bankruptcy court authorized Transform Holdco to assign the Sears lease to its wholly owned subsidiary, Transform Leaseco LLC.

Mall of America objected to this arrangement, 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 under the Bankruptcy Code, in Mall of America's view.[1]

Transform Holdco LLC has thus far successfully argued that an appellate court does not have jurisdictional authority to review this aspect of the bankruptcy sale. However, Mall of America has successfully convinced the Supreme Court to chime in.

Sections 363(b)(1) and 363(m) of the Bankruptcy Code are at play here.

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.

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.

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.[2]

Specifically at issue is to what extent an appellate court can modify a Section 363 sale or lease where the sale or lease has already closed and was not stayed pending appeal.

The view espoused by the U.S. Court of Appeals for the Second Circuit in the Sears case being heard by the Supreme Court is that Section 363(m) creates a jurisdictional limitation on appellate courts in this circumstance, and only allows for review of a lease or sale to challenge the good faith aspect of the transfer.[3]

The Second Circuit further held that an appellate court cannot review a specific transaction that occurred under Section 363, absent a stay, where doing so would affect the validity of the sale at large. According to the Second Circuit, these jurisdictional limitations reflect Congress' "uniquely important interest in assuring the finality" of Section 363 sales.

However, the Second Circuit's view that Section 363(m) creates a jurisdictional bar to appellate review is a minority position. While the U.S. Court of Appeals for the Fifth Circuit aligns itself with Second Circuit on this issue, outside circuits have rejected the Second Circuit's jurisdictional approach.[4][5]

The Supreme Court petitioners argue that the Supreme Court should scrutinize the legitimacy of the Second Circuit's strict jurisdictional view. According to the petitioners, courts should be free to fashion remedies to a Section 363 sale or lease so long as the remedy "'does not affect the validity of the [sale]' to a good faith purchaser."[6]

Now, the Supreme Court has agreed to consider the legitimacy of the Second Circuit's jurisdictional prohibition against appellate review of Section 363 sales.

Any person or business that is considering purchasing bankruptcy estate property should take note.

Section 363 sales or leases may become more vulnerable to unraveling by appellate courts if the Supreme Court provides a carveout allowing for such appellate authority.

Why? Because the Second Circuit's jurisdictional bar on appellate review of Section 363 sales — regardless of its wisdom — provides an ironclad assurance to bankruptcy sale and lease purchasers that sale terms will not be functionally altered by an appellate court after the sale has closed.

Any standard less than a jurisdictional bar allows an appellate court — and not the Section 363 sale's stakeholders — to determine whether a proposed change to a sale's terms affects the validity of the sale or a material sale term.

For example, and as discussed in the petitioners' petition for writ of certiorari, the U.S. Court of Appeals for the Third Circuit has adopted a framework of multiple standards to determine whether a proposed sale remedy can be implemented without that remedy affecting the validity of the sale.[7]

The framework requires that a court consider "whether the grant of relief would, in effect, 'claw back the sale,'"[8] and further requires the sale challenger to "demonstrate that the relief affects only 'collateral issues not implicating a central or integral element of the sale.'"[9]

Needless to say, which sale elements are integral, central or conversely collateral will oftentimes fall in the eye of the beholder.

For example, the Third Circuit previously held in *In re: ICL Holding Co.* in 2015 that the U.S. government's proposed reallocation of purchase funds from a Section 363 sale among creditors would not have changed a fundamental term of the transaction, despite the fact that both the unsecured creditors' committee and the debtor argued to the contrary.[10]

If the Supreme Court paves the way for this type of judicial intervention across the U.S., similar holdings allowing for appellate court meddling may arise.

Next Steps for Future Section 363 Purchasers

Those considering purchasing property at Section 363 sales should keep this pending Supreme Court case in mind. Depending on how the Supreme Court rules, creditors may or may not be able to challenge sale terms that purchasers find important to their transactions on appeal.

Potential purchasers can also use this circuit split, and the Supreme Court's decision to review it, to their advantage while negotiating a Section 363 sale.

For example, a purchaser may consider arguing against a collateral sale provision that it does not prefer by reminding the debtor that the provision may cause a creditor to challenge the sale, and that the provision may ultimately be altered or overturned by an appellate court.

A purchaser may also consider negotiating a lower purchase price in exchange for agreeing not to support any creditor that challenges a sale provision on appeal.

Future Section 363 purchasers have these negotiation tools at their disposal during this time of uncertainty.

[1] Petition for Writ of Certiorari, *MOAC Mall Holdings LLC v. Transform Holdco LLC & Sears Holdings Corp.*, 2022 U.S. S. Ct. Briefs LEXIS 913 (2022).

[2] 11 U.S.C. §363(m).

[3] *In re Sears Holdings Corp.*, 2021 U.S. App. LEXIS 37358 (2nd Cir. 2021).

[4] See *In re Gilchrist*, 891 F.2d 559 (5th Cir 1990) (interpreting Section 363(m) "to moot an appeal in the absence of a stay").

[5] See, e.g., *In re Stanford*, 17 F.4th 116, 122 (11th Cir. 2021) (Section 363(m) "is not jurisdictional"); *In re Energy Future Holdings Corp.*, 949 F.3d 806, 820 (3d Cir. 2020) (Section "363(m) [is] a constraint not on our jurisdiction, but on our capacity to fashion relief"); and *In re Brown*, 851 F.3d 619 (6th Cir. 2017).

[6] Petition for Writ of Certiorari, *MOAC Mall Holdings LLC v. Transform Holdco LLC & Sears Holdings Corp.*, 2022 U.S. S. Ct. Briefs LEXIS 913 (2022).

[7] *In re Energy Future Holdings Corp.*, 949 F.3d 806, 821 (3d Cir. 2020).

[8] See *id.*

[9] See *id.*

[10] *In re ICL Holding Co.*, 802 F.3d 547 (3d Cir. 2015).