

## BANKRUPTCY LAW

# Senior Lienholder's Leverage in Disposition of Its Collateral

## A Section 363 sale reminder

By Alan J. Brody

**C**an a debtor always compel its non-consenting secured lender to accept a money satisfaction of its interest in the debtor's property? Not according to the United States Bankruptcy Court for the District of Delaware.

Recently, the court in *In re Ferris Properties*, No. 14-10491 (Del. Bankr. Ct. July 30, 2015), wrestled with two issues involving the debtors' proposed Section 363 sale of 11 parcels of real property. First, could the secured lender be compelled to accept a money satisfaction of its interest in the properties, and, second, could the secured lender's failure to properly object to the sale motion be deemed consent to the sale.

Debtors Ferris Properties and Lexell sought to sell 11 parcels of real property through a proposed bulk sale, free and clear of all liens, claims, encumbrances and interests pursuant to Section 363 of the Bankruptcy Code. All 11 properties were encumbered by mortgages either held by or serviced

by Wells Fargo Bank, which objected to the sale because, inter alia, the proposed purchase price of \$240,000 fell far short of Wells Fargo's indebtedness of \$1,337,545. Believing there was a pool of investors willing to bid higher, Wells Fargo was in the process of foreclosing on the majority of the properties at the time of the bankruptcy filing and had filed a motion for relief from the automatic stay in order to proceed with the foreclosure and take the properties to sheriff's sale.

Section 363(b)(1) of the Bankruptcy Code provides that a debtor, "after notice and hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate." 11 U.S.C. §363(b)(1). Although Section 363 of the Bankruptcy Code does not specify a standard for determining when it is appropriate for a court to authorize the use, sale or lease of property of the estate, courts generally require a debtor to show that each of the following elements has been met before a Section 363(b) sale may be approved: (i) that a sound business reason exists for the proposed transaction; (ii) that the sale has been proposed in good faith; (iii) that the sale price is fair and reasonable; (iv) that accurate and reasonable notice of the transaction has been provided.

See *In re WDH Howell*, 298 B.R. 527, 534 (D.N.J. 2003); *In re Stroud Ford*, 163 B.R. 730 (Bankr. M.D. Pa. 1993). Courts have made it clear that a debtor's showing of a sound business justification need not be exhaustive, but rather a debtor or trustee is "simply required to justify the proposed disposition with sound business reasons." *In re Baldwin United Corp.*, 43 B.R. 888, 906 (Bankr. S.D. Ohio 1984). In *Ferris Properties*, the debtors simply claimed that the purchase price was reasonable and of sufficient value for the court to approve the sale and move the case closer to conclusion. Whether or not there are sufficient business reasons to justify a sale depends upon the facts and circumstances of each case. *In re Lionel Corp.*, 722 F.2d 1063, 1071 (2d Cir. 1983).

One-Pie Investments, the proposed purchaser of the properties, argued that the sale was proper under Section 363(f)(5) because Wells Fargo could be compelled to accept a money satisfaction of its interest in the properties and, alternatively, that the sale was proper under Section 363(f)(2) because Wells Fargo did not properly object to the sale motion and must be deemed to have consented to it. The court rejected the debtors' and One-Pie's arguments that the bank could be compelled to

---

*Brody is a shareholder with Greenberg Traurig in Florham Park. His practice focuses on bankruptcy, corporate restructuring, commercial insolvency and financing.*

take less than the full amount of its debt. *Ferris Props.*, slip op. at 1.

Section 363(f) of the Bankruptcy Code provides, in pertinent part, as follows:

(f) [t]he trustees 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.

11 U.S.C. §363(f).

In its opinion, the Bankruptcy Court first examined Section 365(f)(5), which allows a debtor to sell property free and clear of liens, claims and encumbrances of another entity if that entity “could be compelled, in a legal or equitable proceeding, to accept money satisfaction of such interest.” 11 U.S.C. §363(f)(5). Because the sales price offered by One-Pie was insufficient to pay Wells Fargo in full, the court found that the sale proponents must show more than the existence of a theoretically possible legal or equitable proceeding that could compel it to accept a money satisfaction of its interest in the properties to be sold. *Ferris Props.*, slip op. at 4. (citing *In re PW*, 391 B.R. 25, 45 (B.A.P. 9th Cir. 2008)).

One-Pie contended that Wells Fargo could be “compelled” to accept a money satisfaction (the proceeds of

the sale) because such “legal or equitable proceeding” existed under either Section 724(b) or 1129(b)(2)(a) of the Bankruptcy Code. See *In re Grand Slam U.S.A.*, 178 B.R. 460, 463 (E.D. Mich. 1995). The court found that Section 724(b), which subordinates certain tax liens to administrative expenses, could support a sale under Section 363(f)(5). However, the court distinguished the cases relied upon by One-Pie, since Wells Fargo was not a tax lienor but rather a first lien mortgagee. Therefore, Section 724(b) was not a proceeding under which Wells Fargo’s interest could be subordinated or under which it could be compelled to accept a money satisfaction which was less than its claim.

The court further determined that, even assuming, arguendo, that a cram down proceeding under Section 1129(b)(2) is a legal proceeding by which a sale proponent could satisfy Section 363(f)(5), the debtors failed to demonstrate that cram down requirements could be met where Wells Fargo was not retaining its lien, was not receiving deferred payments totaling at least the amount of its allowed claim, or was not receiving the indubitable equivalent of its claim. *Ferris Props.*, slip op. at 5-6; 11 U.S.C. §1129(b)(2)(A). Therefore, the debtors could not use either Section 724(b) or 1129(b) to support a sale free and clear of Wells Fargo’s liens under Section 363(f)(5).

One-Pie further argued that Wells Fargo could be compelled to accept a money satisfaction of its interest in the properties through a state court monition sale. In a monition sale, property with delinquent taxes is sold, free and clear of other liens and encumbrances, to pay back taxes. See Del. Code Ann. tit. 9, §8727. One-Pie asserted that, because eight of the properties were delinquent on water and sewage taxes, the county government could pursue a monition sale, which would then subordinate Wells Fargo’s mortgage liens on the properties, compelling it to accept a money

satisfaction from any proceeds left after payment of the delinquent taxes.

However, the court recognized that, even if the Superior Court confirms a monition sale, anyone who has an interest or lien on the property may still redeem the property within one year of confirmation by paying the monition sale purchase price plus 15 percent. *Ferris Props.*, slip op. at 8. Del. Code Ann. tit. 9, §8760. As such, Wells Fargo could avoid a monition sale by paying the delinquent taxes or redeeming the property if it were sold. Accordingly, the court dismissed One-Pie’s state law arguments of monition and partition stating each theory could not support a sale of the properties free and clear of Wells Fargo’s liens under Section 363(f)(5).

The Bankruptcy Court also addressed Section 363(f)(2) and One-Pie’s contention that Wells Fargo “consented” because it failed to object to the sale where Wells Fargo listed claims on 13 properties, but the mortgages on two of the properties had actually been satisfied. The Bankruptcy Court considered Fed.R.Bank.P. 9005, which applies Fed.R.Civ.P. 61. *Ferris Props.*, slip op. at 9. Specifically, Rule 61 provides that “the court must disregard all errors and defects that do not affect any party’s substantial rights.” Fed.R.Civ.P. 61. The Bankruptcy Court held that, because neither of the properties on which Wells Fargo erroneously claimed to hold a mortgage was subject to the sale motion, the error did not significantly affect the debtors’ (or One-Pie’s) rights. Therefore, the error was not so significant as to void Wells Fargo’s objection and be deemed a consent to the sale.

The Bankruptcy Court’s opinion in *Ferris Properties* serves as a humble reminder to Chapter 11 debtors of the leverage a senior lienholder has in the disposition of its collateral and of the necessary hurdles that must be overcome to sell property of the estate “free and clear” in a Section 363 sale absent the consent of the senior lienholder. ■