

California Bankruptcy Journal™

A Quarterly

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Foreign Debtors and Foreign Creditors Under
the United States Bankruptcy Code

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Thomas A. Labuda*

Use of the "Blanket" Security Interest
For Trade Creditors in Out-of-court Workouts

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Buying and Selling Real Estate in Bankruptcy¹

By John Collen

Reviewed by Kenneth N. Klee²

John Collen has written a treatise that is a useful addition to the library of every serious bankruptcy practitioner. Its main focus is the interaction of Bankruptcy and Real Estate law.³ The interaction almost exclusively concerns sales by the estate and acquisitions from the estate.⁴ Buying and Selling Real Estate in Bankruptcy is solid and easily accessible. Case research appears to be current through mid-1996. The treatise bears all of the hallmarks of John Collen's career as a proficient, practical bankruptcy and real estate lawyer. That said, in many areas the treatise is a primer rather than a comprehensive, exhaustive analysis of the subject matter.

Structurally, the treatise is divided into ten chapters and three appendices.⁵ Chapter 1 describes the bankruptcy process in general. Specific information is given on the structure of the Bankruptcy Code and basic concepts such as property of the estate and the players in bankruptcy cases. The chapter concludes with an overview of the court system and jurisdiction, covering topics such as jury trials and appeals. Chapter 1 is a decent synopsis that lays the groundwork for subsequent chapters. It is not the place to look for the answer to difficult jurisdictional questions, nor is it designed to be.

Chapter 2 canvasses the notice and hearing requirements for real estate sales in bankruptcy cases. This chapter properly emphasizes the importance of proper notice, and the consequences of failure to give appropriate notice of a real estate sale. The author develops the concept of "notice and hearing" and notes that even

¹ West Publishing Company, 1997.

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³ See generally, Lee R. Bogdanoff, The Purchase and Sale of Assets in Reorganization Cases-- Of Interest and Principal, of Principles and Interests, 47 Bus. L. 1367 (August 1992).

⁴ Some attention is devoted to acquisitions by the estate in ¶ 10.12. Sales outside of bankruptcy are discussed in ¶¶ 2.03[3], 6.05, and 10.07.

⁵ The Reviewer was not supplied with the Appendices.

though the Bankruptcy Code might not require a court order for a sale free and clear of liens, "it is extremely doubtful whether a sale free and clear of liens . . . can ever proceed without a court order." The treatise points out that title insurance companies want court orders to insure title of property transferred in a sale and asks who will insure that notice was appropriate in the absence of a court order? Regrettably, the treatise superficially explores the possibility of opinions of counsel as a possible solution.⁶ In the Reviewer's experience, in lieu of a court order, sometimes title insurance companies will accept opinions of counsel respecting scope and form of notice and verifying that no objection to the sale was filed. Of course, a court order is more desirable than an opinion of counsel, but the treatise fails to develop this topic adequately, noting simply that "the counsel who is willing to furnish [the opinion] becomes a de facto title insurer." Chapter 2 also discusses the impact of section 549 on an improperly noticed bankruptcy sale. The discussion is adequate, but sparse, particularly with respect to section 549(c), which is dealt with superficially. The strength of the chapter is its main focus, the importance of proper notice in bankruptcy sales, a good discussion of the ordinary course, outside of the ordinary course of business dichotomy, and advice on obtaining "comfort orders." The treatise devotes too little attention to case law interpreting due process in the context of notice of bankruptcy sales. Although the reader is advised not to dispense with notice, little guidance is provided how short notice may be and yet comport with due process.

Chapter 3 discusses Court Approval of Sales and is a potpourri. The author covers court jurisdiction as well as the legal standards, pleadings, and proof necessary to sell property outside of a reorganization plan. One of the strengths of this chapter is its general discussion of valuation techniques and appraisal methodology. Language commenting on "the inherent inefficiency of the real estate market,"⁷ could well find its way into briefs discussing valuation. Although this chapter does not substitute for a treatise on valuation, the discussion is useful, particularly for the lawyer who is encountering these issues for the first time. The Chapter could benefit from a more thorough discussion of blended discount rates to be used in highly leveraged single asset real estate cases, including multiple tranche blending common in modern court decisions.⁸

Chapter 4 focuses on Entry and Review of Orders Authorizing Sales. This chapter contains a nuts and bolts review of findings of fact, conclusions of law,

⁶ The topic of opinion letters in the context of court ordered sales is explored more fully in ¶ 9.03[4].

⁷ See ¶ 3.03[2][b].

⁸ See, e.g., *Pacific First Bank v. Boulders on the River, Inc.* (*In re Boulders on the River, Inc.*), 164 B.R. 99, 105-06 (B.A.P. 9th Cir. 1994) (describing blended rate method).

entry of judgments, reconsideration of judgments, and appeals. For the most part, the subject will be pedestrian for the experienced lawyer, but useful to the novice who can avoid pitfalls occasioned by the separate order doctrine⁹ and other niceties of the Federal Rules of Bankruptcy Procedure. Perhaps the most useful part of this chapter is the advice regarding specific findings of fact and conclusions of law that should be made with respect to sales orders.¹⁰ This provides a good starting check list for all cases. The chapter also contains a good discussion of the mootness doctrine and section 363(m).

Chapter 5 is devoted entirely to sales free and clear. The author does a nice job of setting forth the elements of section 363(f) and pointing out that the statute does not authorize a sale free of all liens and encumbrances. There is a particularly good discussion of enigmatic section 363(f)(5). The strength of the chapter, and indeed a strong point of the entire Treatise, is the extensive exposition on interests that cannot always be removed in a sale free and clear.¹¹ If the reader is involved with a sale that implicates covenants running with the land, easements or licenses, reciprocal easements, future interests or limited estates, lis pendens, co-owners, community and marital interests, rights of first refusal, leases, redemption rights, unknown owners, surveys, equitable liens and constructive trusts, purchaser's liens, real estate tax liens, farm sales, successor liability, environmental liability, or zoning, reading this chapter is a must.

Chapter 6 covers modes of sale, embracing private sales, auction sales, sales under a plan of reorganization, and postconfirmation sales. The author develops advantages and disadvantages of the various modes of sale, including brief discussion of the "creditors' rights exception" in the purchaser's title insurance.¹² The bulk of the chapter is devoted to a basic confirmation primer and an explanation of auction sales. The latter material acquaints the reader with concepts of overbid protection, break-up fees, and the like.¹³ Although the basics are laid out, the treatise falls short of an exhaustive discussion of these important subjects. Limited empirical data are provided, and the reader is left with rough rules of thumb for guidance. The treatise gives scant mention to criminal prohibitions on bankruptcy sales, and no mention whether the debtor in possession or its officers

⁹ The requirement that every judgment be set forth in a separate document is contained in Fed. R. Bankr. P. 9021.

¹⁰ See ¶ 4.01[2].

¹¹ See ¶ 5.03.

¹² See ¶ 6.02[2].

¹³ See ¶ 6.03[1][a].

are eligible to purchase at a bankruptcy sale.¹⁴ Nor does the treatise discuss whether the trustee may conduct a going out of business sale that would violate state laws.¹⁵ Presumably, real estate will rarely be sold as part of a going out of business sale.

Chapter 7 deals with lease assignments, and it should play into Collen's strength as a real estate lawyer. Indeed, the material covers financing leases, true leases, and briefly discusses synthetic leases.¹⁶ But it omits discussion of the real estate issues that an acquirer would want to satisfy before acquiring a lease. Although this chapter contains a good primer on leases in bankruptcy, the discussion of subleases is sparse. For example, there is little or no discussion of nondisturbance or state statutes protecting tenants in the event of a master lease termination. The treatise simply notes that if the acquirer is purchasing a sublease, it should insist on assumption of the master lease as adequate assurance of future performance.¹⁷ The treatment of anti-assignment clauses is adequate, but not exhaustive with respect to reported case law.¹⁸ Although the chapter gives some insight whether an acquirer should negotiate with the landlord or the estate, the discussion is not deeply incisive.¹⁹ In short, the Reviewer was disappointed that Collen did not do more to develop these important topics, but the treatment given should be enlightening for the new practitioner who has never done a lease acquisition or sale in bankruptcy.

Chapter 8 reviews the retention and compensation of real estate professionals. This is essential reading for the panoply of professionals that extract fees from real property sales. What this chapter lacks in academic or policy analysis is more than compensated by practical advice for real estate professionals. The author crisply reviews various categories of professionals and provides a synopsis of the law whether employment is required. The bottom line advice for most professionals is not surprising: get employed by court order before rendering services. In the event

¹⁴ The treatise briefly notes that under 18 U.S.C. § 154, a trustee may not purchase property at a bankruptcy sale. See ¶ 6.03[4][a] n.45. But the treatise gives no guidance whether that section applies to a debtor in possession.

¹⁵ There is a question whether section 363 of the Bankruptcy Code, 11 U.S.C. § 363, preempts state law or whether 28 U.S.C. § 959(b) requires adherence to such laws, particularly where the sale is conducted in the course of business operations as opposed to after the business is closed. See ¶ 9.03[3][c][ii]n.40, discussing 28 U.S.C. § 959(b) in the context of obtaining internal corporate authority to sell property.

¹⁶ The synthetic lease is discussed at ¶ 7.01 n.3.

¹⁷ See ¶ 7.05[1].

¹⁸ See ¶ 7.06.

¹⁹ See ¶ 7.08.

that advice is not followed, get an order of employment nunc pro tunc if you can.²⁰ The author's treatment of indemnities for professionals is rather sparse.²¹

Chapter 9 contains a bankruptcy analysis of common terms in sales contracts. The chapter contains a good discussion of various contingencies and warranties that arise in the sale context. Although the treatise recognizes the asymmetry that arises in binding the acquirer and not binding the trustee after execution of the sales contract and prior to court approval, development of the law on this topic is anemic.²² Limited space is devoted to the topics of escrow instructions, deeds, and title insurance.

Chapter 10 concludes the body of the treatise by focusing on a miscellany of special transactions ranging from sales and leasebacks²³ to gap period sales.²⁴ If your transaction involves special kinds of property such as timeshare interests,²⁵ stock,²⁶ or residences,²⁷ this is the part of the Treatise to consult first, unless the sale involves a farm.²⁸

Selling real estate in bankruptcy is not a simple proposition. John Collen has authored a Treatise that will smooth the road for those who engage in these transactions. The treatise will probably answer most basic questions and give a good lead on many complex problems.

²⁰ See ¶ 8.02[3][b] for a concise but thorough discussion of this topic.

²¹ See ¶ 8.05[6].

²² See ¶ 9.01.

²³ See ¶ 10.02.

²⁴ See ¶ 10.06.

²⁵ See ¶ 10.08.

²⁶ See ¶ 10.04[1].

²⁷ See ¶ 10.09.

²⁸ Farm sales in chapter 12 cases are discussed very briefly in ¶ 5.04.