ACQUIRING REAL PROPERTY FROM A BANKRUPT SELLER

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Editors' Synopsis: Although the recent economic downturn has resulted in historically low interest rates and correspondingly high prices in the investment real estate marketplace, the downturn has also created opportunities to acquire discounted investment real estate by purchasing property from bankrupt sellers. This Article provides an overview of the procedural mechanics and strategic decisions buyers face when attempting to purchase real estate from bankrupt sellers. For example, an investor may opt to purchase property directly from a bankrupt seller, or if the property is worth little or no more than the encumbrance, the buyer may decide to acquire the mortgage in an indirect acquisition. Further, this Article describes the statutory requirements, customary procedure and potential risks that pertain to a section 363 sale, providing suggested acquisition strategies that eliminate such risks while complying with statutory requirements.

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I. INTRODUCTION

With about $1.4 trillion in commercial real estate loans maturing during the four-year period from 2012 through 2015[1] and nearly 10% delinquency rates among such loans,[2] bargain-hunting real estate "opportunity" funds have scoured the commercial real estate market with great anticipation but only limited success. Lenders have extended maturity dates for distressed borrowers, even those whose loans are in default, and the prices for income properties have jumped as a result of falling capitalization rates. When banks and special servicers foreclose, they often acquire the foreclosed property by credit bidding at the foreclosure sale, and they hold the property in their real estate owned (REO) portfolio rather than sell it and recognize a loss.[3] In the case of fully leased up investment properties, it is a seller's market, even when the seller is in distress. As a result, some investors have found it advantageous to take an indirect path to acquiring distressed real property by first acquiring the debt encumbering the property and then acquiring the property by foreclosure. Others have acquired properties directly from bankrupt sellers at a significant discount from the otherwise exorbitant prices generally prevailing outside the bankruptcy courthouse. This Article explores the procedure and some of the legal consequences of purchasing property from a bankrupt seller either directly, referred to as a "direct acqui-

[1] *Commercial Real Estate Mending, But Still Vulnerable to Ongoing Economic, Political Risks, Roundtable Survey Shows*, REAL ESTATE ROUNDTABLE (May 11, 2012), http://www.rer.org/ContentDetails.aspx?id=12241.

[2] *See* Eliot Brown, *'Zombie' Properties Come Back to Life*, WALL ST. J., Nov. 2, 2011, at C1.

[3] While loan losses hurt a bank's bottom line, they are even more painful to special servicers because in a typical commercial real estate securitization, the controlling class of bondholders has the sole power to hire and fire the special servicer. The controlling class is normally the most subordinate class whose bond balance has not been written down below 25% of its original balance. To preserve its position, special servicers frequently acquire the lowest class of bonds, which is the controlling class when the bonds are first issued. If these bonds are written down by more than 75% over time due to the sale of collateral at a loss, the next class in seniority becomes the controlling class, and those bondholders can summarily fire and replace the special servicer.

sition," or through acquisition of a mortgage on the property, referred to as an "indirect acquisition."

II. BANKRUPTCY COURT PROCEEDINGS

A. Overview of Direct and Indirect Acquisitions

In a direct acquisition from a bankrupt seller, the property may be acquired either during the pendency of the bankruptcy case pursuant to Bankruptcy Code section 363(b),[4] or pursuant to a confirmed plan of reorganization. By contrast, the indirect acquisition is a two-step process. First, the investor buys the mortgage from the lender in an arms-length negotiated sale, at an auction, or through the lender's insolvency proceeding. Second, once it has acquired the mortgage loan, the investor buys the property by credit bidding at a foreclosure proceeding or bankruptcy sale of the property.

B. The Automatic Stay and Acquiring the Property Through Foreclosure

The borrower's filing of a bankruptcy petition creates an automatic stay of enforcement actions against the borrower.[5] The scope of the automatic stay is broad and prohibits almost any type of formal or informal action against the debtor or the property of the estate.[6] Section 362(d) of the Bankruptcy Code specifies four alternative grounds for obtaining relief from the automatic stay:

> (1) "[F]or cause, including the lack of adequate protection of an interest in property . . .;"
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> (2) If "the debtor does not have . . . equity in [the] property; and [the] property is not necessary to an effective reorganization;"
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> (3) With respect to a single asset real estate case, if the debtor fails to either (a) timely file a "plan of reorganization [having] a reasonable possibility of being confirmed within a reasonable time" or (b) timely commence monthly payments meeting certain specified criteria; or
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> (4) In cases where creditors are secured by real estate, if the bankruptcy filing "was part of a scheme to delay,

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[4] *See* 11 USC § 363(b) (2006).

[5] *See* 11 U.S.C. § 362(a)(2) (2006).

[6] *See* 3 COLLIER ON BANKRUPTCY § 362.04 (16th ed. 2010).

> hinder, or defraud creditors" involving either (a) "multiple bankruptcy filings affecting [the] property" or (b) a real estate transfer made without creditor or court consent.[7]

The first ground, "for cause," requires a brief explanation in the context of seeking stay relief in pursuit of a foreclosure action. Generally, but not exclusively, cause is established by showing a lack of adequate protection.[8] Most frequently, a lack of adequate protection is established by demonstrating an insufficient equity cushion.[9] Although courts determine the sufficiency of an equity cushion on a case-by-case basis,[10] courts frequently have found an equity cushion of 20% to be adequate protection for a secured creditor.[11] On the other hand, courts often have found equity cushions below 12% to be insufficient.[12] A lender with a large equity cushion generally cannot expect to obtain relief from the stay because the borrower has stopped making payments.[13]

After the lender has obtained relief from the automatic stay, it may institute foreclosure proceedings against the borrower in accordance with the laws of the state where the property is located. In a typical foreclosure sale, the trustee sells the property at public auction to the highest bidder for cash; however, the foreclosing lender may credit bid—offsetting its bid by cancelling all or part of the mortgage balance.[14] Generally, the purchaser at the foreclosure sale takes title to the property "free and clear" of all liens and encumbrances junior to those of the foreclosing lender but subject to any

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[7] *See* 11 U.S.C. § 362(d).

[8] *See, e.g.*, Ellis v. Parr (*In re* Ellis), 60 B.R. 432, 435 (B.A.P. 9th Cir. 1985) (construing 11 U.S.C. § 362(d)(1) (1978) ("Lack of adequate protection is but one example of 'cause' for relief from stay.").

[9] Pistole v. Mellor (*In re* Mellor), 734 F.2d 1396, 1400 (9th Cir. 1984) ("[T]he existence of an equity cushion as a method of adequate protection . . . is the classic form of protection for a secured debt justifying the restraint of lien enforcement by a bankruptcy court."). *Mellor* defines the term "equity cushion" as "the value in the property, above the amount owed to the creditor with a secured claim, that will shield that interest from loss due to any decrease in the value of the property during time the automatic stay remains in effect." *Id.* at 1400, n.2 (citing to *In re* Roane, 8 B.R. 997, 1000 (Bankr. E.D. Pa. 1981)).

[10] *See In re* Holt, No. 09-62439-13 2010 WL 3294693, at *6 (Bankr. D. Mont. Aug. 20, 2010).

[11] *See, e.g.*, *In re Mellor*, 734 F.2d at 1401 (discussing cases with such holdings).

[12] *See In re* Holt, 2010 WL 3294693, at *6 (citing cases with such holdings).

[13] *See id.*; *see also In re* Avila, 311 B.R. 81, 83–84 (Bankr. N.D. Cal. 2004).

[14] *See, e.g.*, CAL. CIV. CODE §§ 2924g–h (West 2012). The lender's credit bid may include not only the unpaid principal but also accrued interest and foreclosure expenses. *See, e.g.*, Cornelison v. Kornbluth, 542 P.2d 981, 992 n.10 (Cal. 1975).

senior liens or encumbrances.[15] If there are any sales proceeds, the trustee distributes them first to pay the costs of the sale; then to satisfy the debt of the foreclosing lender; next to pay any junior lienholders in their order of priority; then any surplus to the borrower.[16] The foreclosing lender often credit bids all or part of the unpaid balance of its loan at the foreclosure sale.[17] If there are no higher bidders, the foreclosing lender will acquire the property at the sale in return for the satisfaction of its loan to the extent of its credit bid.

C. Acquiring the Property Under a Confirmed Plan

Under the Bankruptcy Code, a plan of reorganization may allow for the sale of some or all of the property of the estate "either subject to or free of any lien."[18] As a result, if the lender wishes to acquire the property but is unable or elects not to obtain relief from the automatic stay, it may have to compete with prospective bidders in the borrower's bankruptcy sale. The lender does, however, have one advantage over other bidders: it may credit bid at the sale. Under section 1129(b)(2)(A)(ii) of the Bankruptcy Code, the right of a secured creditor to credit bid extends to a sale under a confirmed plan,[19] and the U.S. Supreme Court recently affirmed this right.[20]

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[15] *See, e.g.*, Streiff v. Darlington, 68 P.2d 728, 729 (Cal. 1937).

[16] *See, e.g.*, CAL. CIV. CODE § 2924k(a) (West 2012).

[17] Because a full credit bid is the equivalent of "a total satisfaction of the secured obligation," it follows that the lender making a full credit bid gives up any right to pursue the borrower for a deficiency judgment. *Cornelison*, 542 P.2d at 992. For this reason, lenders who are able to attend the auction often credit bid only the amount necessary to win the auction. However, in states such as California where virtually all foreclosures are conducted by way of a trustee's sale, deficiency judgments are typically unavailable (except in the case of fraud or bad faith waste) because of the statutory bar against deficiency judgments following a trustee's sale. *See* CAL. CIV. PROC. CODE § 580d (West 2011 & Supp. 2012). As a result, in such states, full credit bids are common, especially in the case of smaller loans where it is impractical for the lender to send a representative to the foreclosure sale.

[18] 11 U.S.C. § 1123 (a)(5)(D) (2006).

[19] *See id.* § 1129(b)(2)(A)(ii).

[20] *See* RadLAX Gateway Hotel, L.L.C. v. Amalgamated Bank, 132 S. Ct. 2065 (2012). Prior to *RadLAX*, there was a split of authority as to whether a secured creditor had an absolute right to credit bid at a sale under a confirmed plan: The Third and Fifth Circuits held that a secured creditor does not have a right to credit bid if the plan otherwise provides the creditor with the "indubitable equivalent" of its claim, but the Seventh Circuit stated that a secured creditor retains its right to credit bid, notwithstanding the fact that it has been offered indubitable equivalent. *See In re* Philadelphia Newspapers, L.L.C., 599 F.3d 298 (3d Cir. 2010) (holding that there is no absolute right to credit bid); *In re* Pacific Lumber Co., 584 F.3d 229 (5th Cir. 2009) (holding the same). *But see In re* River Road Hotel Partners, L.L.C. v. Amalgamated Bank (*In re* River Road Hotel Partners, L.L.C.), 651 F.3d 642 (7th

D. Acquiring the Property at a Section 363 Sale

Section 363(b)(1) of the Bankruptcy Code[21] gives the bankruptcy debtor or the debtor's trustee[22] authority to sell estate property outside of the ordinary course of business after notice and a hearing. Unless the debtor was in the business of buying and selling real estate, a sale of real property will be outside the ordinary course of business, and the sale will require bankruptcy court approval. In its approval order, "the court must not only articulate a sufficient business reason for the sale, it must further find it is in the best interest of the estate."[23]

1. Mechanics of a Section 363 Sale

To show that the proposed sale is in the best interest of the estate, the proponent of the sale must demonstrate, among other things, that it has taken reasonable steps to maximize the sale price.[24] In the words of one court, this means the property must be "exposed to the market[place]."[25] Such exposure is almost always accomplished by retaining an experienced real estate broker to market the property. Typically, the broker will try to find a buyer willing to enter into an asset purchase agreement, subject to bankruptcy court approval and conditioned upon the absence of overbids. In addition to fixing the purchase price, the asset purchase agreement should specify which liens or interests the sale will extinguish, as well as the amount of the deposit, the form of deed to be used, the amount of any "break-up" fee, the procedure for overbids, the allocation of closing costs, the method of proration of income and expenses, and any contingencies or closing conditions. A prudent buyer will insist on customary real estate closing conditions, such as the delivery of satisfactory title insurance, tenant estoppel certificates, and the absence of a materially adverse change in the property. Of course, closing will be explicitly conditioned upon the bankruptcy court's entry of an order of sale in accordance with the terms of the agreement.

Cir. 2011), *aff'd*, 132 S. Ct. 2065 (2012) (finding that the right to credit bid exists even if creditor given the indubitable equivalent of its claim).

[21] *See* 11 U.S.C. § 363(b)(2) (2006).

[22] Although section 363 explicitly empowers only the trustee, a debtor in possession in a Chapter 11 bankruptcy proceeding generally has the same powers as a trustee. *See* 11 U.S.C. § 1107(a) (2006). The use of the term "trustee" in this Article includes reference to the debtor in possession when the court has not appointed a trustee in a Chapter 11 case.

[23] *In re* Wilde Horse Enterprises, Inc., 136 B.R. 830, 841 (Bankr. C.D. Cal. 1991).

[24] *See In re* Bakalis 220 B.R. 525, 532 (Bankr. E.D. N.Y. 1998).

[25] *In re* Mama's Original Foods, Inc., 234 B.R. 500, 504 (Bankr. C.D. Cal 1999).

This agreement is important to the estate because it establishes a floor for both the purchase price and subsequent bidding. Traditionally, the prospective buyer signing a conditional asset purchase agreement in a section 363 sale is referred to as the "stalking horse" or the "stalking horse bidder."[26] The stalking horse bidder typically will demand some compensation for its time, effort, and expense in analyzing the property and negotiating an asset purchase agreement in the event that it ultimately does not purchase the property. Bankruptcy courts generally have permitted reasonable fees to be paid to the stalking horse in this circumstance.[27]

The most common form of fee paid to the stalking horse is the break-up fee, which is paid to the stalking horse in the event it is not the winning bidder.[28] Agreements usually express break-up fees as a percentage of the purchase price, and generally, courts consider fees of less than 3% of the purchase price to be reasonable and approve such fees.[29] However, not all courts have approved break-up fees, and the published cases denying break-up fees cite differing standards to employ to determine whether to approve a break-up fee.[30] Notwithstanding decisions that deny break-up fees, most

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[26] 11 U.S.C. § 363 (2006).

[27] Courts employ different standards in determining whether to approve fees paid to stalking horse bidders. Perhaps the most common standard employed is the business judgment standard, under which break-up or other fees will be denied only if the fees are likely to chill bidding for the sale assets or are unreasonable relative to the purchase price of the assets. *See, e.g.*, *In re* Metaldyne Corp., 409 B.R. 661 (Bankr. S.D.N.Y. 2009); *In re* ASARCO L.L.C., 441 B.R. 813 (S.D. Tex. 2010). *See also In re* Am. West Airlines, Inc., 166 B.R. 908, 912 (Bankr. D. Ariz. 1994) (employing a "best interests of the estate" standard); *In re* Reliant Energy Channelview L.P., 594 F.3d 200, 206 (3d Cir. 2010) (citing to Calpine Corp. v. O'Brien Envtl. Energy, Inc. (*In re* O'Brien Envtl. Energy, Inc.), 181 F.3d 527 (3d Cir.1999) (employing the same standard used for administrative expenses under section 503(b), which approves fees only when they are "actually necessary to preserve the value of the estate.").

[28] *See In re* Integrated Res., Inc., 135 B.R. 746, 750 (Bankr. S.D. N.Y. 1992).

[29] *See* Joseph Samet, *Use of Break-Up and Topping Fees in Corporate and Bankruptcy Asset Sales*, *in* A-918 PRACTICING LAW INSTITUTE COMMERCIAL LAW AND PRACTICE COURSE HANDBOOK: NUTS AND BOLTS OF CORPORATE BANKRUPTCY 2009 351, 363 (2009) ("Break-up fees will generally be approved so long as they equal 2-3% of the proposed sale price;" *Use of Break-Up Fees* further analyzed bankruptcy sales occurring between 2003 and 2008 and found that "the average approved break-up fee in the 36 sales was approximately 2.5% of the sale price."); Michael B. Solow & Harold D. Israel, *Buying Assets in Bankruptcy: A Guide to Purchasers*, 10 J. BANKR. L. & PRAC., Nov./Dec. 2000, at 88 (and cases cited therein).

[30] *Compare, e.g.*, *In re* S.N.A. Nut Co., 186 B.R. 98, 105 (Bankr. N.D. Ill. 1995) ("[A]bsent compelling circumstances which clearly indicate that payment of the fee would be in the best interests of the estate, break-up fees should not be awarded in bankruptcy auction sales."), *with In re* Hupp Indus., Inc., 140 B.R. 191, 194, 197 (Bankr. N.D. Ohio

bankruptcy courts will allow reasonable break-up fees and expense reimbursement because to do otherwise would result in a significantly reduced stalking horse bid or no bid at all, thus, harming the estate.

The stalking horse bidder can leverage its position as first bidder to negotiate favorable terms for the overbid procedures. Generally, the debtor will want to encourage overbids to maximize the proceeds realized by the estate; in contrast, the stalking horse will seek to discourage overbids to increase the probability that its initial bid carries the day. If it would be difficult to obtain an initial bid from another party, the stalking horse can negotiate with the debtor for some of the following procedures:

- Requiring significant overages (increases) for each bid subsequent to the initial bid to give overbid protection for the initial bidder;
- Requiring overbids to be in the same form as the initial bid, except for price, to avoid comparing "apples and oranges";
- Permitting the stalking horse to win the auction by matching a subsequent bid instead of exceeding it;
- Requiring a large minimum deposit in order to bid; and
- Imposing stringent financial requirements in order to qualify as a bidder.

Certain procedures, such as establishing the bidder's financial wherewithal or requiring a substantial deposit, may be in the interest of the debtor as well as of the stalking horse. However, the interests of the debtor and the stalking horse clearly are at odds with respect to overbid protection because the stalking horse wishes to discourage overbids while the debtor wishes to encourage them. Courts generally acknowledge that some overbid protection for the stalking horse is warranted because a second bidder, relying on the stalking horse's due diligence, should not be able to take the bid away from the stalking horse for a *de minimis* addition to the initial bid.[31] Nevertheless, the overage requirement must be reasonable because a bankruptcy court will reject excessive overbid protection.[32]

1992) (identifying seven criteria to be considered in determining the propriety of allowing break-up fee provisions and refusing authorization of a 2.1% break-up fee).

[31] *See In re Hupp*, 140 B.R. at 194.

[32] *See id.* at 193 (rejecting a $300,000 overage requirement, amounting to 6.3% of the proposed purchase price, as excessive). Note that the debtor should require that any overbid be greater than the stalking horse's bid plus the break-up fee. Since the break-up fee is due whenever the stalking horse is not the winning bidder, the acceptance of an overbid below this threshold would result in less net proceeds to the bankrupt estate than would a sale to the stalking horse bidder.

Once the stalking horse bidder and the debtor reach an agreement on sale terms, break-up fee, and bidding procedures, the trustee will enter into the conditional asset purchase agreement with the stalking horse bidder and seek bankruptcy court approval of the sale. In many cases, approval is sought in two separate motions: an initial motion (the "bidding procedures motion") requesting approval of the bidding procedure[33] and any break-up fee for the stalking horse and a second motion (the "sale motion") for approval of the sale to the winning bidder. In such cases, the bidders typically perform their due diligence review after the bidding procedures motion is granted and before the auction or deadline for overbids. To bid, a prospective purchaser typically submits an asset purchase agreement, which is a marked-up version of the asset purchase agreement signed by the stalking horse bidder.[34] The hearing on the sale motion is held after the auction or overbid deadline.

In any event, the United States Trustee and all creditors and indenture trustees must receive at least twenty-one days' notice of a section 363 sale unless the court orders otherwise.[35] The notice must "include the time and place of any public sale, the terms and conditions of any private sale and the time fixed for filing objections."[36] Some bankruptcy courts have a form for the notice of sale of estate property,[37] and some courts post copies of filed notices of sale of estate property on the Web.[38]

Once the winning bidder is determined, the parties proceed to closing. When the parties have satisfied or waived all of the closing conditions in the asset purchase agreement, the transaction closes, and the sales proceeds (after payment of the seller's share of closing costs including pay-off of any liens) are remitted to the bankruptcy trustee.

2. *Credit Bidding*

A secured party has the right to credit bid in a section 363 sale pursuant to section 363(k), which provides as follows:

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[33] If the winning bidder is to assume an existing mortgage, the bidding procedure typically will require that bidders submit financial information for mortgage lender approval.

[34] *See* Douglas E. Deutsch & Michael G. Distefano, *The Mechanics of a § 363 Sale*, AM. BANKR. INST. J., Feb. 2011, at 48.

[35] *See* FED. R. BANKR. P. 2002(a)(2) (2005 & Supp. 2012).

[36] *Id.* at Rule 2002(c)(1).

[37] *See, e.g.*, Bankr. C.D. Cal. Form 6004-2 *Notice of Sale of Estate Property* (Jan. 2009), http://www.cacb.uscourts.gov/forms/notice-sale-estate-property.

[38] *See, e.g.*, http://www.cacb.uscourts.gov/pacer (allowing the public to access filed court documents).

> At a sale under subsection (b) of this section of property that is subject to a lien that secures an allowed claim, unless the court for cause orders otherwise the holder of such claim may bid at such sale, and, if the holder of such claim purchases such property, such holder may offset such claim against the purchase price of such property.[39]

The right to credit bid at a section 363 sale is not absolute; rather, the right is subject to the approval of the court, which can be withheld "for cause."[40] "'[C]ause' is not defined . . . in the Bankruptcy Code"; it is left to the courts to determine "on a case-by-case basis."[41] However, cases denying secured creditors the right to credit bid in a section 363 sale are rare. Courts have found cause in instances where a secured creditor intended to transfer part of the purchased asset to a third party whose previous misconduct had harmed the debtor[42] and where the secured creditor did not comply with bid procedures.[43]

3. Free and Clear of All Liens

If the moving trustee establishes that the sale meets any one of the five requisites codified in sections 363(f)(1)–(5), the sale is made "free and clear" of liens or other interests in the property.[44] Subsection 363(f) provides as follows:

> The trustee 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—
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> (1) applicable nonbankruptcy law permits sale of such property free and clear of such interest;
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> (2) such entity consents;

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[39] 11 U.S.C. § 363(k) (2006).

[40] *Id.*

[41] *In re* NJ Affordable Homes Corp., No. 05-60442(DHS) 2006 WL 2128624, at *16 (Bankr. D.N.J. June 29, 2006) (cause is "intended to be a flexible concept enabling a court to fashion an appropriate remedy on a case-by-case basis").

[42] *See In re* Aloha Airlines, Inc., No. 08-00337, 2009 WL 1371950, at *8 (Bankr. D. Haw. May 14, 2009).

[43] *See* Greenblatt v. Steinberg, 339 B.R. 458, 463 (Bankr. N.D. Ill. 2006).

[44] 11 U.S.C. § 363(f) (2006).

> (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;
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> (4) such interest is in bona fide dispute; or
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> (5) such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.[45]

Subsections (f)(3) and (f)(5) have been the subject of a significant amount of litigation. As for subsection (f)(3), some courts interpret the phrase "value of all liens" to mean the unpaid balance of such liens,[46] while other courts interpret this phrase to mean the fair market value of such liens.[47] In jurisdictions following the latter interpretation, subsection (f)(3) often will be applicable because the fair market value of all liens on property in bankruptcy will generally be no greater than that of the property itself.[48] Subsection (f)(5) requires that "(1) a proceeding exists or could be brought, in which (2) the nondebtor could be compelled to accept a money satisfaction of [less than the amount of] (3) its interest."[49] Where the winning bidder is the senior lender, virtually all courts have recognized the senior lender's prospective foreclosure sale as a legal proceeding satisfying the requirements of this subsection for a sale free and clear of junior liens.[50] The courts have also recognized specific performance of a contractual release provision as a qualifying proceeding under this subsection.[51]

Section 363(m) protects the purchaser of property sold pursuant to section 363 from the effects of a reversal on appeal of the authorization to sell, as long as the purchaser acted in good faith.[52] It is of no consequence that the purchaser was aware of the pendency of the appeal; to prevent this result, the party appealing the authorization order must obtain a stay of the

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[45] *Id.*

[46] *See* Clear Channel Outdoor, Inc. v. Knupfer (*In re* PW, LLC), 391 B.R. 25, 40 (B.A.P. 9th Cir. 2008) (citing cases that interpret the phrase to mean the unpaid balance of such liens).

[47] *See id.* (citing cases that interpret the same phrase to mean the fair market value of such liens).

[48] *See id.*

[49] *Id.*

[50] *See, e.g.*, *In re* Jolan, Inc., 403 B.R. 866, 869–70 (Bankr. W.D. Wash. 2009).

[51] *See, e.g.*, Pac. Capital Bancorp., N.A. v. E. Airport Dev., LLC (*In re* E. Airport Dev., LLC), 443 B.R. 823 (B.A.P. 9th Cir. 2011).

[52] *See* 11 U.S.C. § 363(m) (2006).

sale pending the hearing on its appeal.[53] Paraphrased in relevant part, section 363(m) states that a "reversal or modification on appeal of an authorization . . . of a sale . . . of property does not affect the validity of a sale . . . under such authorization" to a "good faith" purchaser, "unless [the] authorization and . . . sale . . . were stayed pending appeal."[54] The courts are split on whether a finding of "good faith" should always be made as part of the initial sale process or, in the bankruptcy court's discretion, may be made upon remand after the filing of an appeal.[55] However, it is good practice in all courts to present evidence of "good faith" at or prior to the hearing on the motion for approval of the sale and to obtain a finding of good faith in the approval order.[56]

a. The Clear Channel *Decision*

In *Clear Channel Outdoor, Inc. v. Knupfer* (*In re* PW, L.L.C),[57] the Ninth Circuit Bankruptcy Appellate Panel (B.A.P.) called into question the protections afforded the purchaser under a section 363 sale. *Clear Channel* warns a potential purchaser not to rely on a bankruptcy court free and clear authorization order, notwithstanding the protection ostensibly afforded by section 363(m), when the sale price is less than the aggregate amount of the claims of secured creditors.[58]

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[53] *See id.*

[54] 11 U.S.C. 363(m). The Bankruptcy Code does not define "good faith." A good faith purchaser is commonly described as one who buys property for value, without knowledge of adverse claims. More frequently, "good faith" is described as the absence of disqualifying factors. For example, "misconduct that would destroy a purchaser's good faith status at a judicial sale typically involves fraud, collusion between the purchaser and the other bidders or the trustee, or an attempt to take grossly unfair advantage of other bidders." *In re* Abbotts Dairies of Pa., Inc., 788 F.2d 143, 147 (3rd Cir.1986). *See generally* Daniel H. Slate, *Consideration of Some of the Broader Applications of the Good Faith Requirement of Sales of Assets Under Section 363*, 27 CAL. BANKR. J. 243 (2004).

[55] *Compare* Onouli-Kona Land Co. v. Richards, 846 F.2d 1170, 1174 (9th Cir. 1988) (finding of good faith is not required to be made at time of sale), *with Abbotts Dairies of Pa.*, 788 F.2d at 149–50 (adopts contrary rule but remands case to bankruptcy court for a determination of "good faith").

[56] Even in the Ninth Circuit where "good faith" need not be shown at the time of sale, "[a] bankruptcy court that does have a proper evidentiary basis for a finding of "good faith" is, of course, entitled to do so as part of the sale process." *In re* Shari L. Thomas, 287 B.R. 287 (B.A.P. 9th Cir. 2002).

[57] 391 B.R. 25 (B.A.P. 9th Cir. 2008).

[58] *See id.* at 40–41.

In *Clear Channel*, the bankruptcy court authorized the sale of the debtor's property free and clear of liens.[59] The senior lender credit bid for its real estate collateral, and the junior lender asserted that its lien could not be stripped because none of the conditions enumerated in section 363(f) had been satisfied.[60] Over the junior lender's objection, the bankruptcy court authorized the sale free and clear of the junior lien.[61] The junior lender appealed without obtaining a stay of the sale order pending the appeal.[62] The sale to the senior lender closed before the appeal was heard, with the senior lender purchasing the debtor's property through a credit bid.[63]

On appeal, the trustee and the purchaser argued that (1) the junior lender's appeal was moot pursuant to section 363(m), and (2) even if the appeal was not moot the sale was free and clear of the junior lender's lien pursuant to section 363(f).[64] Addressing the mootness issue first, the B.A.P. held that section 363(m) barred only reversal of the sale itself but did not bar a reinstatement of the junior lien.[65] On the second issue, the merits of the free and clear aspect of the sale, the B.A.P. held that there had been no showing that any of the provisions of section 363(f) had been satisfied and remanded the issue back to the bankruptcy court for further proceedings.[66] As for subsection 363(f)(3), the B.A.P. followed the "majority" rule, interpreting the term "value of all liens" to refer to their unpaid balance.[67] Because the sale price of the property did not exceed the unpaid balance of all liens, it held that this subsection did not apply.[68] As for subsection 363(f)(5), the trustee did not raise the pending senior foreclosure sale as a qualifying legal proceeding, and the B.A.P. did not consider the proceeding in its opinion.[69] Ultimately, the parties settled, obviating the need for the remand.[70]

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[59] *See id.* at 30.

[60] *See id.* at 46.

[61] *See id.* at 32.

[62] *See id.* at 35.

[63] *See id.* at 32.

[64] *See id.* at n.6.

[65] *See id.* at 34.

[66] *See id.* at 47.

[67] *See id.* at 40.

[68] *See id.* at 41.

[69] *See id.* at 47.

[70] *See* Stephen B. Kuhn, David M. Dunn & Scott L. Alberino, *Free and Clear Asset Sales Through Section 363*, n.2 (Portfolio Media, Inc. 2008), http://www.akingump.com/files/Publication/c7c6eea2-4b16-436d-9bcf-05bdf30cf367/Presentation/PublicationAttachment/5

The Sixth Circuit B.A.P. rejected the *Clear Channel* holding on mootness in *In re Nashville Senior Living, L.L.C.*,[71] allowing an appeal of the free and clear order without a stay. The court noted that "the overwhelming weight of authority disagrees with [*Clear Channel*'s] holding that the § 363(m) stay does not apply to the 'free and clear' aspect of a sale under § 363(f)."[72] The eighth Circuit also followed the reasoning set forth in *Nashville* and declined to follow *Clear Channel*.[73] Similarly, in *In re Thorpe Insulation Co.*,[74] the bankruptcy court in the Central District of California declined to follow *Clear Channel* and stated the following: "[*Clear Channel*] has been widely criticized by courts and commentators and is generally unpersuasive. . . . [a]nd [it is] in strong tension with a Ninth Circuit opinion that dismissed an appeal of a sale of estate property as moot even where a lien was removed from the property as part of the sale."[75]

However, rejection of *Clear Channel* has not been unanimous. In *In re Lehigh Coal and Navigation Company*,[76] an unpublished Pennsylvania district court opinion, the court followed *Clear Channel*'s holding on mootness. In *Lehigh Coal*, the senior lender purchased virtually all of the debtor's property at a section 363 sale free and clear of all liens.[77] Because the senior lender credit bid its lien, there were no sale proceeds available to pay the junior lender.[78] On appeal, the district court disallowed lien stripping of the junior lien without consideration of the applicability of section 363(f).[79] Instead, the court invoked the adequate protection requirement of section 363(e) as its sole ground for denial of lien stripping.[80] Thus, the court in *Lehigh Coal* not only follows *Clear Channel* with respect to section 363(m) but also extends *Clear Channel* by holding that section 363(f) cannot be used to strip a junior lien when the sale generates no proceeds that

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66c714d-bfdc-4137-8a92-1471c895dafc/Free%20And%20Clear%20Asset%20Sales%20Through%20Section%20363.pdf.

[71] 407 B.R. 222 (B.A.P. 6th Cir. 2009).

[72] *Id.* at 231.

[73] *See* United States v. Asset Based Res. Grp., 612 F.3d 1017, 1019 n.2 (8th Cir. 2010).

[74] No. CV11-668 DSF, 2011 WL 1378537, at *1 (C.D. Cal. Apr. 11, 2011).

[75] *Id.* (citations omitted).

[76] No. 5-08-bk-51957, 2012 WL 27465 (Bankr. M.D. Pa. Jan. 5, 2012) (discussing the district court's opinion).

[77] *See id.*

[78] *See id.* at *3.

[79] *See id.* at *2.

[80] *See id.* at *4.

can be applied in satisfaction of the junior lien.[81] While the decision is unpublished, *Lehigh Coal* nonetheless serves as a caution of the potential peril that can befall a section 363 purchaser, particularly one who (as in both *Lehigh Coal* and *Clear Channel*) purchases through credit bidding.

Following *Clear Chann*el's publication, a number of commentators warned that if *Clear Channel* is followed by other courts, "it *will* become extraordinarily difficult for bankruptcy trustees and chapter 11 debtors . . . to arrange sales of assets free and clear of liens."[82] Fortunately, in every subsequent published decision involving lien stripping in a section 363 sale, the courts have either refused to follow *Clear Channel* or purchasers have presented them with sufficient facts to enable them to determine whether the purchasers satisfied the requirements of section 363(f). Nonetheless, in any jurisdiction not explicitly rejecting *Clear Channel*, a prudent bidder should require that the closing of its section 363 purchase be postponed until after either (1) the time for appeal of the bankruptcy court's sale order has passed with no appeal filed, or (2) the bankruptcy court has issued a favorable ruling on such an appeal. The bidder might consider an earlier closing if it is able to obtain title insurance coverage without exception for the stripped lien. However, like the prudent bidder, the title company probably would condition issuance of its policy on expiration of the appeal period with no appeal having been filed or on a favorable ruling in any such appeal.

III. DUE DILIGENCE AND CLOSING

In a foreclosure sale, a prospective purchaser will have little, if any, opportunity to conduct due diligence before the sale. For this reason, an investor interested in a particular distressed property may wish to negotiate a purchase of the mortgage rather than wait for the foreclosure sale. In a negotiated purchase of the mortgage, the investor may condition the closing of its purchase of the mortgage on a thorough due diligence review of the property and the mortgage. If the due diligence review is acceptable, the investor may close on the purchase of the mortgage, foreclose on the property, and acquire the property at the foreclosure sale by credit bidding the mortgage balance. If the due diligence review proves unacceptable, the investor may simply cancel the purchase and avoid acquiring a property that had a material defect or issue revealed in the due diligence process.

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[81] *See id.*

[82] Lawrence Peitzman, Clear Channel*: An Appeal for Reinterpretation*, 30 CAL. BANKR. J. 287 (2010).

In a bankruptcy sale, the stalking horse bidder likely will be able to conduct a reasonably thorough due diligence review of the property, including a site visit and title and survey review, and such other due diligence reports that it requires. Other bidders likely will have less opportunity to perform a thorough due diligence review, but often will be able to visit the property and review title and other due diligence reports that the trustee provided to the stalking horse bidder, but not necessarily those due diligence reports that the stalking horse bidder obtained on its own.

Except in cases of foreclosure, the parties usually will conduct the closing of a real property purchase from a bankrupt seller pursuant to a purchase agreement, as is typically the case in a sale outside of bankruptcy. However, a bankruptcy sale typically involves two characteristics which usually are not applicable in a conventional real estate sale: the possible absence of customary title affidavits, which presents certain challenges to the buyer and the title insurance company; and a transfer tax exemption, which often redounds to the buyer's benefit.

A. Title Insurance

Because foreclosure sales are not completed in accordance with a contract of sale, the bidders may not condition the sale on the issuance of title insurance. As a result, the winning bidder rarely receives a title insurance policy at the sale. However, the foreclosing lender will typically obtain a trustee's sale guaranty (or similar title guaranty) that sets forth the name of the owner of the property and those entitled to notice of the foreclosure and insures the lender and its trustee against loss resulting from errors in such information. In addition, if the foreclosing lender acquires the property at the foreclosure sale, its loan title policy, which it received when it made or acquired the loan, will continue to provide it with coverage.[83] Thus, while the foreclosing lender generally will have title coverage if it is the winning bidder, other parties generally will find it impractical to obtain title coverage at the time of the foreclosure.

By contrast, section 363 sales and sales under confirmed plans typically are made pursuant to purchase agreements, and such agreements usually condition closing on the issuance of a title insurance policy to the buyer. There is one obstacle to issuance of such policies that is usually not encoun-

[83] *See generally* JOYCE PALOMAR, 1 TITLE INS. LAW § 8:21 (2012). Some lenders go a step further and obtain owner's coverage after the foreclosure. An owner's policy will insure that the foreclosure was properly conducted and that title was transferred to the lender subject only to the exceptions shown in the policy. Neither a loan policy nor a trustee's sale guarantee will protect the lender against every possible defect in the foreclosure process.

tered outside of the bankruptcy court: a customary seller's title affidavit (by a solvent entity) may be difficult to obtain. Title companies typically require a seller title affidavit as a condition to issuance of a title policy. In a title affidavit, the seller makes certain assertions to the title company regarding the state of title and agrees to indemnify the title company for losses due to the falsity of any such assertions. Frequently, the seller makes assertions in the title affidavits subject to a "best of knowledge" qualification. These affidavits provide assurances covering two major risks. First, they cover filings in the "'gap' period between the date of the title commitment" or title search and the date of closing through an assurance by the seller that it has not transferred or encumbered its title during the gap;[84] second, they cover off-record matters through assurances by the seller that, for example, there are no unrecorded leases, mechanics' liens, or unrecorded easements.[85]

If the debtor or seller is liquidating, an indemnity from the debtor or seller obviously would offer little protection to a title insurance company. Although title companies usually accept an affidavit from the bankruptcy trustee or liquidator, such persons may be unwilling to sign any title affidavit, even one subject to a best of knowledge qualification. In these cases, the title company often will accept a title affidavit from another professional with knowledge of the property, such as a receiver or property manager. Even if there is no one familiar with the property that is willing to sign a title affidavit, the buyer should still be able to obtain satisfactory title insurance coverage. First, with a distressed or bankrupt seller, the buyer should require the disbursement of the sales proceeds only after recording the deed transferring title to the buyer. In this way, a gap indemnity will not be required. Instead, the title company can confirm at the time of recordation that the seller has not encumbered or transferred title, except to the buyer. Second, if the buyer wishes to obtain extended coverage (insuring against encroachments not shown in a survey, for example), the title company often will be willing to supply such coverage based on the title company's own inspection of the property and without a seller affidavit, so long as the state in which the property is located allows the title company to charge for such an inspection, and such an inspection is feasible under the circumstances.

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[84] 15 SOLOMAN GUTSTEIN & EILEEN MURPHY, ILLINOIS PRACTICE SERIES: REAL ESTATE § 9:202 (3d ed. 2006).

[85] *See id.*

B. Transfer Taxes

While title insurance coverage presents challenges to the buyer of distressed property, favorable transfer tax treatment often provides a substantial benefit. Most states impose a tax on the transfer of real estate; in such states, the counties and cities are typically empowered to impose an additional transfer tax. In some cities and counties, the total transfer tax is substantial. For example, in New York City the transfer tax is currently 3.025% on transfers of commercial real estate where the consideration exceeds $500,000;[86] in Philadelphia 4%;[87] in Baltimore 3%;[88] and in San Francisco for transactions over $10 million, the transfer tax is currently 2.5%.[89] In each of these jurisdictions (except San Francisco), the tax applies to the entire purchase price, including that portion of the price represented by the assumption of, or taking subject to, mortgage debt.[90] As a result, these transfer taxes may represent a significant portion of the cash component of the purchase price.

1. Direct Acquisition

The Bankruptcy Code provides an exemption from transfer tax for any transfer of property made under a confirmed Chapter 11 plan.[91] Such exemption is referred to in this Article as the "Bankruptcy Exemption." According to the U.S. Supreme Court, the Bankruptcy Exemption applies only to a transfer made "under the authority of" or "pursuant to" a Chapter 11 plan and only to transfers made after plan confirmation.[92] Accordingly, the

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[86] Consisting of a 0.4% tax by the State of New York and a 2.625% tax by the City of New York. *See* N.Y. TAX LAW § 1402(a) (McKinney 2008); N.Y.C., N.Y., 19 RCNY § 23-03(a)(10) (1991).

[87] Consisting of a 1% tax by the Commonwealth of Pennsylvania and a 3% tax by the City of Philadelphia. *See* 61 PA. CODE § 91.111 (2008); PHILA., PA., CODE § 19-1403(1)(g) (2011).

[88] Consisting of a 0.5% transfer tax by the State of Maryland and a 1% recording and 1.5% transfer tax by the City of Baltimore. *See* MD. CODE ANN., TAX-PROP. § 13-203(a) (LexisNexis 2012); BALT., MD., CODE art. 28, §§ 16-1(1), 17-2(a)(1).

[89] *See* S.F., CAL., BUS. & TAX. REGS. CODES art. 12-C § 1102 (2012).

[90] *See* statutory references cited *supra* notes 86–89. As for Pennsylvania, *see also* 61 PA. CODE § 91.132(b) (2007). As for Maryland recordation tax, *see also* MD. CODE ANN. TAX-PROP. § 12-103(a)(2)(i) (LexisNexis 2012).

[91] *See* 11 U.S.C. § 1146(a) (2006) ("The issuance, transfer, or exchange of a security, or the making or delivery of an instrument of transfer under a plan confirmed under section 1129 of this title, may not be taxed under any law imposing a stamp tax or similar tax.").

[92] Fla. Dep't of Rev. v. Piccadilly Cafeterias, Inc., 554 U.S. 33, 33 (2008); *see also*, John C. Murray, *No Transfer-Tax Exemption for Preconfirmation Transfers of Assets in*

exemption does not apply in Chapter 7 cases[93] or to preconfirmation transfers.[94] Moreover, because the transfer must be made under the authority of the plan to qualify for the Bankruptcy Exemption, it would appear that the parties must complete the transfer before the estate has been fully administered and before the bankruptcy case has been closed.[95] Aside from these temporal restrictions, however, as a practical matter the Bankruptcy Exemption should generally cover any postconfirmation sale of property by the Chapter 11 trustee or debtor in possession. The Bankruptcy Code requires a Chapter 11 plan to "provide adequate means for the plan's implementation"[96] and generally includes a detailed description of the timing and procedure for the sale of assets. As a result, as long as a sale of property is made in accordance with these provisions, it appears that the parties made the sale "pursuant to" or "under the authority of" the plan.[97] Thus, one court held that the Bankruptcy Exemption does not require the plan to mention the specific transfer.[98] In short, the Bankruptcy Exemption from transfer tax applies broadly to those transfers made after Chapter 11 plan confirmation and in accordance with the plan.[99]

Many states and cities have enacted a corresponding exemption,[100] some of which are broader than the federal Bankruptcy Exemption.[101] Transfer taxes are typically collected by the county recorder's office at the time of recording the deed. As a result, it is good practice to claim both the state exemption (if applicable) and federal Bankruptcy Exemption on the

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Chapter 11 Bankruptcies—the Supreme Court Rules in Piccadilly, 43 REAL PROP. TR. & EST. L.J. 685 (2009) (discussing the applicability of Bankruptcy Code § 1146(a), the decisions that led up to *Piccadilly*, and the *Piccadilly* decision itself).

[93] *See* Hoffman v. R&E Builders, Inc. (*In re* Woodland Builders, Inc.), 87 B.R. 774, 779 (Bankr. D. Conn. 1988).

[94] *See Piccadilly*, 554 U.S. at 52.

[95] 11 U.S.C. 350(a) (2006) ("After an estate is fully administered and the court has discharged the trustee, the court shall close the case.").

[96] *Id.* § 1123(a)(5).

[97] *Piccadilly*, 554 U.S. at 33.

[98] *See* City of N.Y. v. Jacoby-Bender, Inc., (*In re* Jacoby-Bender, Inc.), 758 F.2d 840, 841 (2d Cir. 1985). *But see* 61 PA. CODE § 91.193(b)(2)(i) (2008) ("A transfer is made under a plan confirmed under section 1129 only when the transfer is authorized by the specific terms of a previously confirmed Chapter 11 plan.").

[99] *See In re Jacoby-Bender, Inc.*, 758 F.2d at 842.

[100] *See, e.g.*, CAL. REV. & TAX CODE, § 11923(a)(1) (West 2010); N.J. STAT. ANN. § 46:15-10(g) (West 2003); N.Y.C., N.Y. 19 RCNY § 23-03(j)(8) (2006); 61 PA. CODE § 91.193(b)(2)(i) (2008).

[101] *See* N.J. STAT. ANN. 46:15–10(g).

deed or other transfer tax filing documents. If the recorder requires documentation supporting the claim of exemption, the parties should provide a copy of the confirmation order. Such document will show the date of confirmation; under the federal Bankruptcy Exemption, the date of confirmation must predate the delivery of the deed.[102] Often, the order explicitly provides that transfers made pursuant to the plan are exempt from transfer tax. In order to claim the exemption in Pennsylvania, the recording office must be provided with "a copy of the order and confirmed plan highlighting the specific provision in the plan authorizing the transaction and proof that the deed to be recorded was executed by the parties to the transaction subsequent to the plan confirmation."[103]

2. Indirect Acquisition

After acquiring the debt that encumbers the property, the buyer may now acquire the property either inside the bankruptcy through a section 363 sale or pursuant to a plan of reorganization or outside the bankruptcy by foreclosure.

a. Inside the Bankruptcy

As discussed above, if the acquisition is made after Chapter 11 plan confirmation and in accordance with the plan, no transfer tax may be assessed because of the Bankruptcy Exemption.[104] If the seller is in a Chapter 7 proceeding, the Bankruptcy Exemption does not apply,[105] but a state exemption may apply, depending on the circumstances.[106] Finally, if the buyer acquires property in a section 363 sale, the Bankruptcy Exemption will not apply because section 363 applies to sales outside of a plan.[107]

b. Outside the Bankruptcy

If the lender obtains relief from the automatic stay and acquires the property at its own foreclosure sale, the parties will not have made the transfer pursuant to a confirmed plan. As a result, the Bankruptcy Exemption

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[102] *See* 11 U.S.C. § 1146(b) (2006).

[103] 61 PA. CODE § 91.193(b)(2)(i).

[104] *See* 11 U.S.C. § 1146(a) (2006).

[105] *See In re* Woodland Builders, Inc., 87 B.R. at 779.

[106] For example, in New Jersey, transfer tax does not apply to any deed from a "trustee in bankruptcy or liquidation." N.J. STAT. ANN. § 46:15–10(g).

[107] *See* 11 U.S.C. § 363 (Supp. 2012); *see, e.g.*, Bankr. N.D. Cal., Office of the Clerk, Guidelines Re Sales Orders § B(6)(b), http://www.canb.uscourts.gov/procedures/dist/guidelines/order-re-sale-orders (last rev. Mar. 11, 2009).

will not apply. However, in many cases, a state or local exemption may apply; for example, California does not impose transfer tax on any deed to the lender given upon or in lieu of foreclosure except to the extent the lender pays an amount "exceed[ing] the unpaid debt, including accrued interest and cost of foreclosure."[108] Similarly, in Pennsylvania, no tax is due on "[a] transfer to a holder of a bona fide mortgage in default if the transfer is made in lieu of foreclosure or the transfer is made under a judicial sale in which the mortgage holder is the purchaser."[109]

IV. CONCLUSION

Buying real property from a bankrupt seller often provides not only a discounted price but also an exemption from transfer tax. It also presents the buyer with several important strategic decisions. First, the prospective buyer must decide whether to acquire the property directly or through acquisition of a mortgage on the property. If there is little or no value in the property above the outstanding mortgage balance, an indirect acquisition offers several advantages. Because of the absence of a significant equity cushion, the mortgage might be available at an advantageous price. In addition, the lack of a significant equity cushion should enable the holder of the mortgage to obtain relief from the automatic stay to foreclose on the property. The prospective buyer as mortgage holder may then acquire the property at the foreclosure sale through credit bidding. In certain states, such a sale is exempt from transfer tax. Furthermore, if the mortgage holder has a loan title insurance policy, such policy will continue to cover the mortgage holder after it acquires the property at the foreclosure sale. Finally, as part of its acquisition of the mortgage, the prospective buyer should be able to complete a thorough due diligence review of the property. By contrast, if the prospective buyer simply waited for the existing lender to foreclose and then tried to acquire the property at the foreclosure sale, it would be precluded from performing a thorough due diligence review.

If there is a significant equity cushion in the property, the holder of the mortgage probably will be unable to obtain relief from the automatic stay in order to foreclose. As a result, the prospective buyer would have to acquire the property through a sale within the bankruptcy. Even in this case, an indi-

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[108] CAL. REV. & TAX. CODE § 11926 (West 2010); *accord* S.F., CAL., BUS. & TAX REGS. CODE, art. 12-C § 1108.2 (2012). However, one California court interpreted section 11926 to require the purchaser of property at foreclosure who is not the lender to pay transfer tax based on the purchase price paid at the sale, excluding any unpaid debt remaining on the property after the sale. *See* Brown v. County of L.A., 85 Cal. Rptr. 2d 414, 416 (1999).

[109] 61 PA. CODE § 91.193(b)(16) (2007).

rect acquisition offers potential advantages to the prospective buyer. First, being a mortgage holder would entitle the prospective buyer to credit bid at the bankruptcy sale of the property. Second, as in the case of a foreclosure sale, the prospective buyer may be able to perform a more thorough due diligence review in connection with its acquisition of the mortgage than it would as a third-party bidder at the bankruptcy sale.

If the prospective buyer wishes to acquire the property at a section 363 sale, either directly or as a holder of a mortgage, it must decide whether it wishes to act as the stalking horse bidder and on what terms. As discussed above, the stalking horse bidder should enter into an asset purchase agreement that includes a significant break-up fee, and the bankruptcy court should approve such fee. If the purchase price is less than the total outstanding balance of the mortgages on the property and the sale is dependent on lien stripping, the buyer must determine whether the court in that jurisdiction allows appeal of a lien stripping order as did the court in *Clear Channel*.[110] If the court does, the asset purchase agreement should condition closing upon either expiration of the time for appeal of the bankruptcy court's sale order without the seller having filed an appeal or, in the event of appeal, a favorable appellate ruling.

[110] *See* 391 B.R. 25 (B.A.P. 9th Cir. 2008).