

INSIGHTS

"Fatal Means Fatal": 5th Circuit's Broad Read of 363(m) Continues to Moot Section 363 Appeals after the Sale

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Recent rulings out of the United States Court of Appeals for the Fifth Circuit and its lower bankruptcy courts have emphasized the circuit's broad interpretation of section 363(m) of the Bankruptcy Code, which protects bankruptcy sales from being overturned on appeal.

In her September 23 opinion in *In re Royal Street Bistro, LLC, et al.*, No. 21-2285, District Judge Sarah S. Vance provided a comprehensive summary of the Fifth Circuit case law while mooting a debtor's attempt to appeal a sale under section 363 of the Bankruptcy Code.

The *Royal Street* case arose when the owner of three properties on New Orleans' Royal Street filed for bankruptcy protection in the United States Bankruptcy Court for the Eastern District of Louisiana. The properties were also subject to leases and occupied by tenants. A secured lender also held a lien on each property.

During the case, the court-appointed chapter 11 trustee and the secured lender reached a settlement that required the properties be sold. In response, the tenants sought adequate protection of their interests in the properties and asked the court to require the debtor to explicitly assume or reject the leases. The bankruptcy court granted the trustee's sale and settlement motion and its bidding procedures motion, and it denied the tenants' motion for adequate protection and motion to require the debtor to assume or reject leases. The tenants appealed. They then sought a stay pending appeal of the order from the bankruptcy court, the district court, and ultimately a writ of mandamus from the Fifth Circuit. Each court rejected the request.

The bankruptcy court subsequently entered final orders approving the settlement and proposed sale of the properties, approving the bidding procedures, and setting the auction sale of the property. The tenants appealed those orders to Judge Vance's district court, and the appeals were consolidated.

At the auction, one property was sold to the secured lender and the other two to third parties. The proceeds from the sales were then used to pay off the secured lender and to cover the Trustee's fees.

Judge Vance heard the consolidated appeal at the district court, where the chapter 11 trustee moved for summary judgment dismissing the appeal as moot under section 363(m). That section reads:

(m) 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.

The tenants responded that their appeal was not moot because it sought only to challenge the disposition of the sale proceeds under the settlement agreement, rather than the sale itself. Specifically, as Judge Vance summarized, the tenants sought to “reverse the settlement between the Trustee and the [secured lender], but only as to the Trustee.” [1] The tenants also contended that they were entitled to damages from the trustee in connection with the sale and a lease repudiation.

Judge Vance held that the appeal was moot. The Fifth Circuit's precedent is clear, she reasoned, and failing to obtain a stay is “fatal to a challenge of a bankruptcy court's authorization of the sale of property.” [2] She emphasized that in the 5th Circuit “fatal means fatal: challenges to authorized bankruptcy sales are dismissed when the party challenging the sale fails to obtain a stay,” citing *Matter of Walker Cnty. Hosp. Corp.*, 3 F.4th 229, 234 (5th Cir. 2021).

Appellants' argument that they sought to challenge the settlement and the distribution of sale proceeds rather than the sale itself was insufficient to save their appeal, Judge Vance concluded. The Fifth Circuit considers how closely linked a challenged settlement provision is to a sale itself to determine the applicability of section 363(m), she wrote. When the sale is “integrally linked” to the settlement, both are mooted, she concluded. [3]

Judge Vance noted that other circuits, specifically the Seventh and Ninth, take a more forgiving view of section 363(m), citing to *Trinity 83 Dev., LLC v. ColFin Midwest Funding, LLC*, 917 F.3d 599, 601 (7th Cir. 2019). In *Trinity*, the Seventh Circuit held that “§ 363(m) does not make any dispute moot or prevent a bankruptcy court from deciding what shall be done with the proceeds of a sale or lease.”

Judge Vance also cited to a district court opinion from a court in the Seventh Circuit, *In re X-Treme Bullets, Inc.*, 2020 WL 4455582, at *7 (D. Nev. Aug. 3, 2020), where Judge Miranda Du

collected cases on how courts interpret section 363(m). That opinion notes that the Sixth and Ninth Circuits appear to recognize a “narrower view of section 363(m) mootness” that can preserve certain challenges on appeal after a sale. But *X-Treme Bullets* also recognizes that the “majority of circuits” read section 363(m) to create “a *per se* rule automatically mooting appeals for failure to obtain a stay of the sale at issue.” [4]

The Fifth Circuit’s reading of section 363(m) is broader than the Seventh and Ninth Circuit interpretation, Judge Vance concluded. Ultimately, the distribution of the sale proceeds was “part and parcel of the sale—they ensured that the sale would accomplish its purpose” of satisfying the secured creditor’s claim while allocating funds to the trustee to administer the estate. This disposition of proceeds was “necessary to facilitate the transaction” and thus was “integrally linked to the underlying sale.” [5] Under the Fifth Circuit’s reading, an appeal of this distribution is moot.

Potential purchasers and debtors considering a section 363 sale should take note of this difference when planning the disposition of assets and proceeds. Additionally, commentators have noted that this circuit split may be indirectly addressed when the Supreme Court hears in *MOAC Holdings LLC v. Transform Holdco LLC*, 21-1270 (Sup. Ct.) on December 5, 2022, which will address whether section 363(m) limits the appellate courts’ jurisdiction over any sale order or order deemed “integral” to a sale order. Bracewell is continuing to monitor developments on this issue.

[1] See Opinion at *3 (internal quotations omitted).

[2] See Opinion at *3 (citing *In re Ginther Trs.*, 238 F.3d 686, 689 (5th Cir. 2001)).

[3] See Opinion at *4.

[4] *In re X-Treme Bullets, Inc.*, No. 18-50609-BTB, 2020 WL 4455582, at *7 (D. Nev. Aug. 3, 2020).

[5] See Opinion at *5 (internal quotations omitted).