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Clear Channel Outdoor, Inc. v. Knupfer

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An important and traditional power afforded by the Bankruptcy Code to debtors and trustees is the power to sell encumbered property free and clear of any liens or encumbrances. *See* G COLLIER ON BANKRUPTCY, App. Pt. 44, at 44-529 (Alan N. Resnick et al. eds., 15th ed. rev. 2006). One way in which this power is given to debtors and trustees is through Section 363(f)(3) of the Bankruptcy Code, which provides a mechanism for property to be sold free and clear of any liens. *See* 11 U.S.C. § 363(f)(3) (2006). Yet, the application of Section 363(f)(3) is not entirely clear from the language of the statute, and a split has been created among courts which interpret the statute in different ways. *See* G COLLIER, *supra*, at 44-530. The following discussion outlines the application of Section 363(f)(3), first discussing the statute itself, then discussing the two approaches to the statute, and finally examining the practical consequences of each interpretation.

I. OUTLINE OF SECTION 363(f)(3) AND THE PROBLEM IN INTERPRETATION

A party may sell property free and clear of any liens if it meets any one of the five conditions outlined in 11 U.S.C. § 363(f)(3). *See* 11 U.S.C. § 363(f)(3); G COLLIER, *supra*, at 44-529. One way in which a party may sell property free and clear of liens is if that party meets the requirements outlined in Section 363(f)(3). 11 U.S.C. § 363(f)(3) provides: “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 . . . (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.” 11 U.S.C. § 363(f)(3).

The purpose of the statute is to allow properties sold in bankruptcy to generate higher prices, while still protecting the lienholder. *See* G COLLIER, *supra*, at 44-529. The logic behind the higher sales price can easily be inferred: an individual will likely be willing to pay more for a property if that individual is aware that he or she will then own that property free and clear of any prior liens. Yet, the lienholder is, or remains, protected because it receives compensation for its lien from the sale proceeds. *See id.* Furthermore, the lienholder retains the option of “credit bidd[ing] on the property by bidding in some or all of the value of its lien against the property of the debtor.” *See id.*

Despite the clear purpose of the statute, the wording of the statute has caused some confusion among courts. *See id.* at 44-530. While the language of Section 363(f)(3) seems clear at first, the phrase “the aggregate value of all liens,” 11 U.S.C. § 363(f)(3), has caused confusion and has resulted in two different interpretations of the statute. *See* 3 COLLIER ON BANKRUPTCY, ¶ 363.06[4][a], at 363-52 (Alan N. Resnick et al. eds., 15th ed. rev. 2006); G COLLIER, *supra*, at 44-530

Some courts interpret the language in question to mean the “face value” of the liens. *See Clear Channel Outdoor, Inc. v. Knupfer (In re PW)*, 391 B.R. 25, 39–40 (B.A.P. 9th Cir. 2008). Thus, this interpretation allows a sale free and clear under Section 363(f)(3) only if the sale yields an amount greater than the total amount of all the claims on the property. *See id.* at 41.

Conversely, other courts interpret the phrase to mean the “economic value” of the liens. *See id.* at 39–40. A property may be sold free and clear of any liens if the property sells for an

amount which is greater than the “economic value” of all the liens on the property. *See In re Terrace Gardens Park P’ship*, 96 B.R. 707, 712 (Bankr. W.D. Tex. 1989). Thus, this interpretation allows a sale free and clear of liens under Section 363(f)(3) if the sale yields an amount greater than the value of the liens on the property after they have been discounted to their economic value, even if this value is less than the face value of all the liens.

II. THE 363(f)(3) SPLIT

As discussed above, there are two different views which courts take when determining whether a property may be sold free and clear under Section 363(f)(3). The following is a discussion delineating the reasoning of the courts on either side of the split.

A. Courts which interpret “value” to mean the “economic value” of all the liens

Courts which interpret the phrase “the aggregate value of all liens” to mean economic value rely chiefly on the language of the statute in reference to its context within the Code and the purpose of the statute. *See* 3 COLLIER, ¶ 363.06[4][a], *supra*, at 363-52. These courts note that the word “value” is found in other areas within the code and note that the purpose of the statute would be frustrated if it required property to be sold in excess of the “face value” of all the liens. *See id.*

For instance, in *In re Beker Industries Corporation*, 63 B.R. 474 (Bankr. S.D.N.Y. 1986), the court noted that other sections of the Code also use the word “value” in ways comparable to section 363(f)(3). *See id.* at 475. *Beker* involved a bankruptcy proceeding in which a debtor sought to sell his property free and clear of liens under § 363(f). *Id.* However, it was clear that the property would not be able to sell for an amount greater than the “face value” of all the liens. *Id.* Sale of the property was postponed so that the *Beker* court could interpret the meaning of

Section 363(f)(3). *Id.* Thus, the question before the court was whether the property could be sold free and clear of the liens if the property sold for an amount greater than the economic value of the liens, but not the face value of the liens. *See id.*

The court in *Beker* concluded that the word “value” meant the “economic value” of the liens. *See id.* at 476. The *Beker* court relied primarily on 11 U.S.C. § 506(a), where the word “value” is used in a way comparable to Section 363(f)(3). *See id.* at 575–76. Section 506(a) is a provision which allows a bankruptcy court to take a secured creditors lien and separate it into two different liens, one secured and one unsecured. *See* 11 U.S.C. § 506(a) note (2006) (Historical and Statutory Notes). The secured creditor will remain secured up to the “economic value” of the property; the remaining amount of his claim, namely, the amount adding up to the “face value,” will become unsecured. *See id.* Thus, the *Beker* court concluded, it would be consistent with the use of the word “value” in section 506(a), to read the word “value” in section 363(f)(3) as the “economic value” of the lien. *See Beker*, 63 B.R. at 476.

The *Beker* court dismissed what seemed to be a contrary intent that could be gleaned from congressional records. *See id.* The *Beker* court did so by giving primacy to the language of the statute itself, and the use of the word “value” in other places throughout the Bankruptcy Code. *See id.* As a brief final point in its Section 363(f)(3) discussion, the *Beker* court referenced the ability to sell property free and clear of liens pursuant to Section 1129(b)(2)(A)(i) of the Bankruptcy Code, without having to sell the property in an amount greater than the face value of all the liens. *See In re Beker*, 63 at 477; *see also* 11 U.S.C. § 1129(b)(2)(A)(i) (2006). Thus, the *Beker* court interpreted the word “value” in Section 363(f)(3) to mean only the “economic value” of the liens. *See In re Beker*, 63 at 476.

Another example of a court which concluded that “value,” as used in Section 363(f)(3), meant “economic value” is *In re Terrace Gardens Park Partnership*, 96 B.R. 707 (Bankr. W.D. Tex.1989), a decision which added further clarity and support to the *Beker* decision. *Terrace Gardens* is a somewhat intricate case involving an office building complex. *Id.* at 708. The debtor in the case amassed a debt in excess of the value of its property secured by a senior and junior lien. *Id.* at 709–10. The debtor sought to sell two of the buildings in the complex free and clear of the liens as part of its plan of reorganization. *Id.* at 708. While the debtor was able to arrange for the sale of the buildings at a rate that was greater than the court determined market value of the buildings, the sale would not be greater than the face value of the liens. *Id.* at 710–11. The question before the court was whether the debtor could sell the two buildings free and clear of any liens notwithstanding the fact that the sale would not equal the face value of the liens. *Id.* at 713.

The court in *Terrace Gardens*, further clarified and supported the *Beker* decision while expressly agreeing with the *Beker* court’s rationale, and concluded that “value,” as used in Section 363(f)(3), meant “economic value.” *See id.* As in *Beker*, the *Terrace Gardens* court examined Section 363(f)(3) via an examination of its context. *See id.* It noted that the underlying focus of Sections 361-364 is on adequate protection of the creditor’s interest. *See id.* With adequate protection as the focus, defining “value” as “face value” would interpret Section 363(f)(3) in a way inconsistent with the surrounding sections. *See id.* Thus, in light of the surrounding statutes and their underlying focus, the *Terrace Gardens* court held that “value” means “economic value” and allowed the buildings to be sold free and clear of liens. *See id.*

B. Courts which interpret “value” to mean the “face value” of all the liens

Courts which interpret “value” to mean the “face value” of all the liens rely on the legislative history of the statute as well as the statute’s plain language. *See* 3 COLLIER, ¶ 363.06[4][a], *supra*, at 363-52. These courts focus on a 1984 amendment to Section 363(f)(3) and a plain language reading of the statute in relation to the purpose behind Section 363(f)(3). *See id.*

Richardson v. Pitt County (In re Stroud Wholesale, Inc.), 47 B.R. 999 (E.D.N.C. 1985), is one of the preeminent examples of a case in which a court held that word “value” as used in Section 363(f)(3) to mean “face value.” *In re Stroud* involved a debtor who was allowed to sell property free and clear of liens, including the tax liens of Pitt County. *Id.* at 1001. The value of the property was far less than the value of the liens on it, but, in the face of an objection by Pitt County, the bankruptcy court authorized the sale free and clear of liens under Section 363(f). *Id.* Pitt County appealed this judgment, and the appellate court addressed the issue of whether the bankruptcy court’s approval of the sale of the property free and clear of liens was proper. *Id.* This issue required the court to interpret Section 363(f)(3). *See id.* at 1001–02.

The *Stroud* court held that the word “value” in Section 363(f)(3) meant the “face value” of all the liens on the property, relying predominantly on congressional intent behind the statute. *See id.* The *Stroud* court outright rejected the trustees’ contention that the sale should be allowed because it exceeded the economic value of the liens. *See id.* at 1001. The court instead relied on the congressional intent behind the, then new, 1984 amendment to the statute. *See id.* The *Stroud* court was particularly influenced by the fact that “Congress replaced ‘such interest’ at the end of the sentence with ‘all liens on such property.’” *Id.* Thus, the *Stroud* court interpreted this

amendment as an indication that Congress sought to convey its intent for word “value” in Section 363(f)(3) to mean “face value” rather than “economic value.” *See id.* at 1001–1002.

The *Stroud* court also relied on the fact that a sale should not be authorized as free and clear “unless the court is satisfied that the sale proceeds will fully compensate the secured lienholders and produce some equity for the estate.” *See id.* at 1002. Thus, taking into account the Congressional intent manifested by the 1984 amendment, and the traditional principles behind sales of property free and clear of liens, the *Stroud* court held that the term “value” in Section 363(f)(3) means “face value.” *See id.* at 1001–1002. This interpretation precluded the sale of the property in *Stroud* under Section 363(f)(3), and the *Stroud* court went on to conclude that the property could not be sold free and clear under Section 363(f)(3) and the other Section 363(f) subsections. *See id.* at 1003–04.

A more recent example of a case in which a court interpreted “value” to mean the “face value” is *Clear Channel Outdoor, Inc. v. Knupfer (In re PW)*, 391 B.R. 25 (B.A.P. 9th Cir. 2008). In *Clear Channel DB Burbank, LLC (DB)*, “held a first-priority lien on substantially all of PW’s assets[,]” *id.* at 31, amounting to more than forty million dollars. *Id.* at 29. The Trustee and DB reached an agreement in which DB would purchase the property for an amount equal to its lien “if there were no qualified overbidders.” *Id.* at 31. Clear Channel, holding a two point five million dollar junior lien, *id.* at 30, opposed the trustee’s motion “to approve the sale free and clear of liens,” *id.* at 32, but the bankruptcy court, nonetheless, authorized the sale free and clear of liens under § 363(f)(5). *Id.* There were no qualified overbidders, and the bankruptcy court confirmed the sale to DB, finding the sale to be a good faith purchase. *Id.* Clear Channel filed an appeal, challenging, *inter alia*, the authorization of the sale, free and clear of its lien and the confirmation of the sale to DB. *Id.*

The *Clear Channel* court interpreted “value” to mean the “face value” of all the liens relying on the plain meaning of the statute and the purpose behind it. *See id.* at 40. The *Clear Channel* court theorized that reading “value” to mean “economic value” would expand Section 363(f)(3) so that it would encompass nearly all bankruptcy sales, effectively allowing every sale to be authorized free and clear of liens. *See id.* The court further noted that reading “value” to mean “economic value” might make little sense in situations where the value of the property has dropped, which, in turn, caused the economic value of the liens to also drop. *See id.* However, the court noted that the value of the liens would necessarily be equal to the value of the property, because they are no longer valued at their “face value” but rather governed by the sales price of the property. *See In re PW*, 391 at 40; *c.f.* 3 COLLIER, ¶ 363.06[4][a], *supra*, at 363-52 (noting that other courts have used similar reasoning). The court then reasoned that a situation like this would not fall within the express language of Section 363(f)(3) which requires the property to be sold for an amount “‘greater than’ the ‘value of all liens.’” *See In re PW*, 391 at 40; *c.f.* 3 COLLIER, ¶ 363.06[4][a], *supra*, at 363-52.

The *Clear Channel* court also noted that a broad interpretation which interprets “value” to mean “economic value” would require a clearer congressional mandate in the form of a statute worded in a way which clearly requires that the statute be read such that “value” means “economic value.” *See id.* Not finding any congressional intent to the contrary and looking at the purpose of the statute, the *Clear Channel* court found the term “value” in Section 363(f)(3) to mean “face value.” *See id.* at 41. The court determined that the property could not have been sold free and clear of any liens under any of the subsections of Section 363(f). *See id.* at 47.

III. THE PRACTICAL CONSEQUENCES OF EACH APPROACH

The consequences of the split as to the meaning of the word “value” in Section 363(f)(3) has an effect that reaches beyond mere academic discussion. Whether a court determines the word “value” to mean “economic value” or “face value” has real world consequences for both debtors and creditors in Bankruptcy Courts of Equity.

A court’s decision to regard “value” as meaning “economic value” can result in real world problems. *Collier* seems to suggest that “economic value” is the correct reading of Section 363(f)(3) as it would yield a higher price at a bankruptcy sale, while still preserving a creditor’s rights through the creditor’s ability to credit bid the value of its lien. *See* G COLLIER, *supra*, at 44-532. Yet the court in *Clear Channel* raises a valid point when it questions when a property could not be sold free and clear under Section 363(f)(3). *See In re PW*, 391 at 40.

Thus, what seems to result when a court defines “value” as “economic value” is a situation which favors debtors. As long as a debtor is able to sell the property above its market value, he or she will be able to sell the property free and clear of any liens. *See id.* The creditor’s recourse is to credit bid the value of its lien which would cause it to take possession of the land rather than receiving cash for the value of its lien. *See* G COLLIER, *supra*, at 44-532. While this seems to be an equitable resolution, the result of *Clear Channel* is illustrative of the inequity which can result to a creditor. There, DB was able to credit bid the value of its lien, effectively depriving Clear Channel of the same recourse. *See In re PW*, 391 at 31–32. While having the ability to credit bid the value of a creditor’s lien may, at first blush, sound like a valid recourse, one must remember that only one creditor has the ability to do this, resulting in a somewhat inequitable situation for other lien holders if the value of the property is depressed. *See, e.g., id.*

Interpreting “value” to mean “face value” can also result in a number of real world problems. As *Collier* recognizes, a property which cannot be sold free and clear of liens may be difficult to sell at all, and if the property does sell, it will be at a much lower price. See G COLLIER, *supra*, at 44-530–31. This unfortunate situation can come to fruition when a piece of property cannot satisfy the face value of all the liens on it, and one lien holder can withhold consent to and block what would otherwise be a valid sale. See *In re Terrace Gardens Park Partnership*, 96 B.R. 707, 712 (Bankr. W.D. Tex.1989); G COLLIER, *supra*, at 44-530–31. While the property still has the ability to be sold, it is not likely to garner the same price as if it had it been sold free and clear of liens at a bankruptcy sale. See G COLLIER, *supra*, at 44-529.

Thus, what seems to be created when a court defines “value” as “face value” is an inequitable situation where no player in the bankruptcy system benefits. A debtor or trustee would not benefit from this reading of Section 363(f)(3) as it would be more difficult to sell a piece of property. See *id.*, at 44-530–31. The majority of creditors are unlikely to benefit as well. When a property sells at a low price, the entire pool of money which creditors may recover in a bankruptcy shrinks. See *id.* at 44-531. With less money available, these creditors will recover even less from a debtor. See *id.* Being that the property is usually one of the major assets of the debtor, see, e.g., *In re PW*, 391 at 31, this could mean that many creditors may walk away from a bankruptcy only marginally compensated. Thus, interpreting “value” to mean “face value” has far reaching effects throughout the bankruptcy system which touches almost all the parties involved in a bankruptcy proceeding.

CONCLUSION

There is a sharp split among courts when interpreting the word “value” in Section 363(f)(3) of the Bankruptcy Code. Both sides of the split have well-reasoned arguments with some courts relying on the statutory context of Section 363(f)(3), and others relying on the congressional intent behind the enactment of Section 363(f)(3). Whatever a court’s rationale, it is also evident that the way a court interprets the word “value” in Section 363(f)(3) can result in real world consequences for debtors and creditors. With the threat of these consequences and the fact that the sharp split in courts does not seem likely to be resolved in the near future, bankruptcy attorneys should be vigilant in ascertaining the law in their jurisdiction and protecting the rights of their client accordingly.

