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## Safe Harboring Sloppiness: The Scope of, and Available Remedies Under, Sections 363(m) and 364(e)

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## Safe Harboring Sloppiness: The Scope of, and Available Remedies Under, Sections 363(m) and 364(e)

### Cover Page Footnote

For debtors and failing businesses attempting to reorganize through chapter 11, filing for bankruptcy is the first step. Many will need significant financial assistance to make it through the reorganization process. Understandably, few investors are lured by the prospect of lending to insolvent debtors or purchasing distressed assets from bankrupt companies. To address this issue, Congress enacted 11 U.S.C. §§ 363(m) and 364(e) of the Bankruptcy Code to ensure the speed and finality of bankruptcy orders and encourage investment. These “safe harbor provisions” limit the ability of parties in interest to appeal certain authorizations to sell property of the estate or obtain credit. Fortunately, Congress has provided clear and express direction on the function of these critical provisions. Unfortunately, courts have forgone that direction in favor of their own interpretations. The result has been a safe harboring of sloppiness. Courts show little consistency in interpreting these straightforward provisions. Many courts have severely restricted appeals beyond what is provided for in sections 363(m) and 364(e). Some employ other doctrines, such as mootness and jurisdiction, un contemplated within the statutes. This Comment proposes a two-pronged approach to provide for the reliable and consistent application of sections 363(m) and 364(e) and to ensure the proper scope of courts’ review. First, courts should make the validity determination prescribed for within the provisions, without exception. Second, courts should interpret the safe harbor provisions as providing only a statutory defense against certain appeals, rather than providing a mootness doctrine or a limit to appellate jurisdiction.

**SAFE HARBORING SLOPPINESS: THE SCOPE OF, AND AVAILABLE  
REMEDIES UNDER, SECTIONS 363(M) AND 364(E)**

ABSTRACT

*For debtors and failing businesses attempting to reorganize through chapter 11, filing for bankruptcy is the first step. Many will need significant financial assistance to make it through the reorganization process. Understandably, few investors are lured by the prospect of lending to insolvent debtors or purchasing distressed assets from bankrupt companies. To address this issue, Congress enacted 11 U.S.C. §§ 363(m) and 364(e) of the Bankruptcy Code to ensure the speed and finality of bankruptcy orders and encourage investment. These “safe harbor provisions” limit the ability of parties in interest to appeal certain authorizations to sell property of the estate or obtain credit.*

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## INTRODUCTION

Debtors and distressed companies undergoing a chapter 11 reorganization prioritize, above all, securing adequate funding for the estate.<sup>1</sup> Funding is critical for maintaining the debtor’s business operations and covering the costs of the reorganization process itself.<sup>2</sup> Debtors often obtain financing through cash collateral<sup>3</sup> generated from judicial sales and debtor-in-possession financing (“DIP financing”).<sup>4</sup> Without adequate cash flow or DIP financing, many chapter 11 debtors would not be able to avoid premature liquidation before confirming a plan of reorganization, thereby depriving creditors of the going-concern value of the debtor’s business.<sup>5</sup>

The processes for obtaining cash collateral and DIP financing are governed by sections 363 and 364 of the Bankruptcy Code (the “Code”).<sup>6</sup> More specifically, section 363 governs the “use, sale, or lease of property” of the estate while section 364 governs the process by which the estate can obtain credit or

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<sup>1</sup> See Sandeep Dahiya & Korok Ray, *A Theoretical Framework for Evaluating Debtor-in-Possession Financing*, 34 EMORY BANKR. DEV. J. 57, 59–60 (2017).

<sup>2</sup> See *id.* at 59 (“A bankruptcy filing is likely to trigger a liquidity crisis for the firm. For example, most firms depend on credit from their suppliers to keep day-to-day operations running. Typically, few suppliers are willing to ship goods on credit to a firm operating under chapter 11, since their claim will not be secured . . . . If the filing firm can line up a new source of financing . . . it may be able to overcome such liquidity problems.”). Expenses include, but are not limited to, paying company employees and vendors, covering rent, and hiring and maintaining bankruptcy professionals to guide the debtor through reorganization. GREGORY GERMAIN, *BANKRUPTCY LAW AND PRACTICE* 156 (4th ed. 2021).

<sup>3</sup> The Bankruptcy Code defines cash collateral as:

[C]ash, negotiable instruments, documents of title, securities, deposit accounts, or other cash equivalents whenever acquired in which the estate and an entity other than the estate have an interest and includes the proceeds, products, offspring, rents, or profits of property and the fees, charges, accounts or other payments for the use or occupancy of rooms and other public facilities in hotels, motels, or other lodging properties subject to a security interest as provided in section 552(b) of this title, whether existing before or after the commencement of a case under this title.

11 U.S.C. § 363(a).

<sup>4</sup> See Bruce Grohsgal, *Sections 363 and 364—Use, Sale, or Lease of Property and Obtaining Credit*, 2012 NORTON ANN. SURV. BANKR. L. 621, 621–22 (2012).

<sup>5</sup> See Marcia L. Goldstein & Victoria Vron, Chapter 11 Business Reorganizations: Debtor in Possession Financing, (March 2007) (Study Material for ALI-ABA 73) (on file with LexisNexis) (quoting *In re Ames Dep’t Stores, Inc.*, 115 B.R. 34, 36 (Bankr. S.D.N.Y. 1990)) (“[M]ost successful reorganizations require the debtor in possession to obtain new financing simultaneously with or soon after the commencement of the Chapter 11 case.”). Avoiding the need for liquidation and properly rehabilitating the debtor are the fundamental purposes of chapter 11 bankruptcies. *Id.* (citing *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 528 (1984)).

<sup>6</sup> 11 U.S.C. §§ 363–364.

incur debt.<sup>7</sup> These sections govern transactions both in and outside the ordinary course of business.<sup>8</sup>

However, debtors can have a difficult time securing sufficient funding.<sup>9</sup> Understandably, potential lenders or purchasers of the debtors' property may be wary of doing business with a party going through bankruptcy. They are often skeptical of the quality of the debtor's distressed assets or of the debtor's ability to fulfill financial obligations.<sup>10</sup> As a result, Congress implemented specific Code provisions to reduce the risks that potential financiers face and to encourage them to transact with the estate.<sup>11</sup> Two critical examples of such provisions, and those that will be examined in this Comment, are sections 363(m) and 364(e). These provisions make up the "statutory mootness" doctrine in bankruptcy law<sup>12</sup> and are often referred to as the "safe harbor provisions"<sup>13</sup> for their ability to protect investors by suppressing appeals of sales under section 363 and credit financing under section 364.<sup>14</sup>

Sections 363(m) and 364(e) encourage investment by promoting the policy goals of speed and finality. Specifically, section 363(m) protects good faith purchasers from having their purchase overturned on appeal.<sup>15</sup> And section 364(e) provides a similar protection for the estate's creditors that have been granted an authorization to obtain credit or incur debt. 364(e) limits the means

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<sup>7</sup> *Id.*

<sup>8</sup> *Id.* Most courts determine whether a transaction is in the ordinary course of business by assessing either the transactions of similar businesses or the nature of the economic risks assumed by the creditor when transacting with the debtor. *See* Grohsgal, *supra* note 4, at 621–22. Other courts have interpreted "ordinary course of business" to require that transactions be within the ordinary course of business both for the debtor and in the debtor's line of business. *See* P.F. Three Partners v. Emery (*In re* Upland Partners), 208 F. App'x. 533, 534 (9th Cir. 2006). The wide scope of 363(m) and 364(e) allow these provisions to cover all such transactions, regardless of how courts classify them.

<sup>9</sup> *See* Michael T. Driscoll, "(M)" *Is for Mootness: Statutory Mootness Under Section 363(m)*, 23 NORTON J. BANKR. L. & PRAC. 740, 741–42 (2014) (describing the difficulty of selling a debtor's assets); Mark L. Prager, *Financing the Chapter 11 Debtor: The Lenders' Perspective*, 45 BUS. LAW. 2127, 2127 (1990) (explaining that it can be difficult for chapter 11 debtors to secure lenders).

<sup>10</sup> *See* Dahiya & Ray, *supra* note 1, at 60 (discussing how the uncertainty of a bankrupt debtor's future makes potential lenders reluctant to provide financing).

<sup>11</sup> Driscoll, *supra* note 9, at 741–42.

<sup>12</sup> George Kuney & Aleah Reno-Demick, *Evading Effective Review in Bankruptcy?: The Unique Intersection of the Divestiture Doctrine, Interlocutory Orders, and Equitable and Statutory Mootness*, 2021 NORTON ANN. SURV. BANKR. L. 87, 104 (2021).

<sup>13</sup> *See* Lardas v. Grcic, 847 F.3d 561, 567–68 (7th Cir. 2017); Gen. Elec. Cap. Corp. v. Hoerner (*In re* Grand Valley Sport & Marine), 143 B.R. 840, 846 (W.D. Mich. 1992).

<sup>14</sup> 11 U.S.C. §§ 363(m), 364(e).

<sup>15</sup> Driscoll, *supra* note 9, at 741, 747.

for revoking liens or priorities granted to good faith creditors in exchange for their investment.<sup>16</sup>

Although speed and finality reflect the main policy goals of the safe harbor provisions, they must be balanced against appellants' rights to appeal adverse judgements. Sections 363(m) and 364(e) achieve this balance by limiting effective review only for reversals or modifications on appeal that would "affect the validity" of a transaction.<sup>17</sup> This limitation not only balances the relevant policy considerations, but is also consistent with the provisions' overall purpose of encouraging investment in the estate. They do not categorically remove the right to appeal, instead, the provisions protect investors and preserve some measure of legal recourse.

Given the ubiquity of chapter 11 debtors' need for funding, these provisions arise frequently in chapter 11 cases and can significantly impact all the parties involved. Despite this frequency, courts remain confused—and just plain sloppy—in their application of sections 363(m) and 364(e). Courts misinterpret and misapply these provisions in two primary ways. First, many courts enforce these provisions too broadly, limiting a larger range of appeals than provided for in the statutes. This approach nullifies a key element of the safe harbor provisions, the validity determination, and abdicates the responsibilities prescribed therein.<sup>18</sup> Second, almost all courts engage in some discussion of mootness when adjudicating matters regarding sections 363(m) and 364(e). However, neither provision makes any mention of mootness.<sup>19</sup>

Recent decisions have only added to this confusion.<sup>20</sup> The Second Circuit, as reflected by their decision in *In re Sears Holding Corp.*, held that section 363(m)

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<sup>16</sup> Grohsgal, *supra* note 4, at 629–30.

<sup>17</sup> 11 U.S.C. §§ 363(m), 364(e).

<sup>18</sup> See Reynolds v. ServisFirst Bank (*In re Stanford*), 17 F.4th 116, 124 (11th Cir. 2021) (quoting Cargill, Inc. v. Charter Int'l Oil Co. (*In re The Charter Co.*), 829 F.2d 1054, 1056 (11th Cir. 1987)) ("The language of Section 363(m) 'states a flat rule governing all appeals of section 363 authorizations.'"); *In re Verity Health Sys. of Cal.*, No. 2:18-cv-10675-RGK, 2019 WL 7997371, at \*13 (C.D. Cal. Aug. 2, 2019) ("Section 364(e) applies if the order has not been stayed and the lender acted in good faith.").

<sup>19</sup> See Resol. Tr. Corp. v. Swedeland Dev. Grp. (*In re Swedeland Dev. Grp.*), 16 F.3d 552, 559 (3d Cir. 1994) (quoting Church of Scientology v. United States, 506 U.S. 9, 12 (1992)) ("[W]hen a court can fashion 'some form of meaningful relief,' even if it only partially redresses the grievances of the prevailing party, the appeal is not moot.").

<sup>20</sup> Compare MOAC Mall Holdings, LLC v. Transform Holdco, LLC (*In re Sears Holdings Corp.*), Nos. 20-1846-bk, 20-1953-bk, 2021 U.S. App. LEXIS 37358, at \*8 (2d Cir. Dec. 17, 2021) (going beyond mootness to explain that a reviewing court is jurisdictionally barred from hearing an appeal), with Trinity 83 Dev., LLC v.

actually limited an appellate court's *jurisdiction* to hear appeals.<sup>21</sup> The Supreme Court took issue with this jurisdictional interpretation of 363(m) and struck down the Second Circuit's holding.<sup>22</sup> However, the Court's review provides limited clarity, as it is confined to whether section 363(m) limits an appellate court's jurisdiction to hear appeals.<sup>23</sup> The Court did not address the issue of overbroad application of the safe harbor provisions or their usage to moot appeals.<sup>24</sup> In other words, despite the Court's resolution of *Sears*, the underlying tension between lower courts persists: courts continue to forego precise application of the calculated language of sections 363(m) and 364(e), instead favoring their own imprecise interpretations.

Part I.A of this Comment will provide a contextual overview of the statutory mootness doctrine, and will discuss its relationship to other mootness doctrines affecting bankruptcy proceedings. Part I.B will analyze the statutory construction of sections 363(m) and 364(e). Part I.C will articulate the statutory components of sections 363(m) and 364(e). Part I.D will discuss the relevant policy concerns these sections were meant to address.<sup>25</sup> After establishing the construction and purpose of these safe harbor provisions in Part I, Part II of this Comment will explore the inconsistent and imprecise approaches taken by courts when interpreting these provisions.

Finally, in Part III, this Comment will propose that the best way for courts to consistently and reliably enforce the safe harbor provisions is through a two-part approach. First, courts should stop applying sections 363(m) and 364(e) so broadly as to render a significant component of the subsections completely irrelevant. Rather, they should adhere to the clear statutory construction of each

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ColFin Midwest Funding, LLC, 917 F.3d 599, 602 (7th Cir. 2019) (explaining that 363(m) and 364(e) do not implicate mootness at all and merely provide a statutory defense to DIP financiers).

<sup>21</sup> See *MOAC*, 2021 U.S. App. LEXIS 37358.

<sup>22</sup> *MOAC Mall Holdings, LLC v. Transform Holdco, LLC*, 598 U.S. 288, 304 (2023).

<sup>23</sup> The actual question presented was:

Whether Bankruptcy Code Section 363(m) limits the appellate courts' jurisdiction over any sale order or other order deemed "integral" to a sale order, such that it is not subject to waiver, estoppel or forfeiture including when a remedy could be fashioned that does not affect the validity of the sale.

Brief for the Petitioner, *MOAC Mall Holdings, LLC v. Transform Holdco, LLC*, 598 U.S. 288 at \*I (2023) (No. 21-1270).

<sup>24</sup> *MOAC*, 598 U.S. 288.

<sup>25</sup> A policy analysis will underscore the purpose of sections 363(m) and 364(e), and will add context to why courts have adopted different approaches for interpreting the safe harbor provisions.



subsection.<sup>26</sup> This requires courts to determine whether each appeal would affect the validity of the transaction, and, consequently, trigger the protection of the safe harbor provisions. Second, courts should also abandon discussions of mootness and jurisdiction when determining the validity of appeals under these safe harbor provisions. Instead, sections 363(m) and 364(e) should be interpreted as providing a statutory defense against appeals seeking to undo sales and transactions for credit financing.<sup>27</sup> Implementing these two changes will ensure that future rulings effectuate the intentional balancing of policy considerations Congress made when drafting sections 363(m) and 364(e).

## I. BACKGROUND

### A. *Mootness (and Friends): An Introduction to the Mootness Doctrines*

The three mootness doctrines that affect bankruptcy proceedings are constitutional mootness, equitable mootness, and statutory mootness.<sup>28</sup> This Comment primarily focuses on the statutory mootness doctrine. However, this Part will introduce the constitutional and equitable mootness doctrines as courts frequently discuss and confuse them with statutory mootness.

Mootness derives from the Supreme Court's interpretation of Article III of the Constitution.<sup>29</sup> Constitutional mootness dictates that where it is impossible for a court to grant any effective relief, the court must dismiss the case.<sup>30</sup> The plaintiff must demonstrate that a live case or controversy exists through all stages of the litigation.<sup>31</sup> A live case or controversy exists where litigants

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<sup>26</sup> The rule against surplusage, a common canon of statutory interpretation, says that interpretations of statutes that render provisions of the statute superfluous or unnecessary should be avoided. Jacob Scott, *Codified Canons and the Common Law of Interpretation*, 98 GEO. L.J. 341, 363 (2010).

<sup>27</sup> Not including those instances where a stay pending appeal was granted or there are issues of good faith.

<sup>28</sup> George Kuney, *Slipping into Mootness*, 2007 NORTON ANN. SURV. BANKR. L. 267, 267–68 (2007).

<sup>29</sup> *Id.* at 268. It is important to mention that Article III establishes and empowers the judicial branch of the federal government. States are free to set up their own judicial systems, even if it is different than what is described in Article III. U.S. CONST. art. III.

<sup>30</sup> *See* Kuney, *supra* note 28, at 268. The historical basis for holding some claims moot is the Supreme Court's longstanding prohibition against issuing advisory opinions. But this prohibition against providing advisory opinions applies only to federal courts. This means that state courts and other specialized courts are perfectly free to issue advisory opinions as they see fit. *See generally* Kuney & Reno-Demick, *supra* note 12, at 103.

<sup>31</sup> *E.g.*, *Decker v. Nw. Env't. Def. Ctr.*, 568 U.S. 597, 609 (2013) (“It is a basic principle of Article III that a justiciable case or controversy must remain extant at all stages of review, not merely at the time the complaint is filed.”).

continue to have an interest in the outcome of the litigation.<sup>32</sup> Therefore, “[t]o avoid mootness [and thus dismissal], a claim must (1) present a real legal controversy, (2) genuinely affect an individual, and (3) have sufficiently adverse parties.”<sup>33</sup>

A court’s absolute inability to provide effective relief is the fundamental aspect of constitutional mootness.<sup>34</sup> Where federal courts do not have federal subject matter jurisdiction, they have no constitutional power to adjudicate cases and provide remedies.<sup>35</sup> Conversely, when courts have the ability to provide some effective relief, such cases cannot be held moot.<sup>36</sup> Additionally, the Supreme Court has consistently held that where federal courts have been given jurisdiction, they have a virtually unflagging obligation to exercise that power.<sup>37</sup>

Bankruptcy proceedings are also governed by equitable mootness and statutory mootness.<sup>38</sup> Here, mootness is something of a misnomer. Equitable mootness and statutory mootness are only vaguely related to the constitutional mootness doctrine and technically do not deal with what is traditionally understood as mootness.<sup>39</sup> Both of the bankruptcy-specific “mootness” doctrines are broader than constitutional mootness, in that they do not address circumstances where it is impossible for a court to fashion effective relief.<sup>40</sup> In fact, equitable mootness applies only in cases where courts expressly *do* have the power to grant an effective remedy, but choose not to exercise it to avoid inequitable outcomes.<sup>41</sup>

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<sup>32</sup> *Cinicola v. Scharffenberger*, 248 F.3d 110, 118–19 (3d Cir. 2001).

<sup>33</sup> *Id.*

<sup>34</sup> *See* *Kuney & Reno-Demick*, *supra* note 12, at 103. In other words, where the court has no power to provide the litigants with a remedy, that case must be constitutionally moot. This includes cases where the dispute has expired or where litigants no longer have an interest in the outcome of the litigation.

<sup>35</sup> *See* *Lightfoot v. Cendant Mortg. Corp.*, 580 U.S. 82, 92 (2017).

<sup>36</sup> *In re UNR Indus., Inc.*, 20 F.3d 766, 768 (7th Cir. 1994).

<sup>37</sup> *Colo. River Water Conservation Dist. v. United States*, 424 U.S. 800, 817 (1976). *See* Robert Miller, *Equitable Mootness: Ignorance Is Bliss and Unconstitutional*, 107 KY. L.J. 269, 290 (2018). Given this clear direction from the Supreme Court, circuit courts generally have looked unfavorably on federal courts declining to hear cases within their jurisdiction. Given this context, the increasing use of the mootness doctrines in bankruptcy is curious.

<sup>38</sup> *See* Driscoll, *supra* note 9, at 741, 743.

<sup>39</sup> *See* Alla Raykin, Comment, *Section 363 Sales: Mooting Due Process?*, 29 EMORY BANKR. DEV. J. 91, 103 n.88 (2012). *See also* ERWIN CHEMERINSKY, *CONSTITUTIONAL LAW: PRINCIPLES AND POLICIES* 160–61 (3d ed. 2006). The critical distinction here is that, in the name of statutory or equitable mootness, courts moot cases with still live controversies. This undercuts the main principle behind constitutional mootness.

<sup>40</sup> *See* *Kuney*, *supra* note 28, at 269, 271.

<sup>41</sup> *UNR Indus.*, 20 F.3d at 769 (highlighting the “big difference between *inability* to alter the outcome (real mootness) and *unwillingness* to alter the outcome (‘equitable mootness’).”).

Despite the clear differences between the bankruptcy specific mootness doctrines, and the constitutional requirement that a case not be moot, courts often fail to delineate them. Frequently, it is hard to determine whether equitable or statutory mootness is the controlling doctrine of a court's decision. Although equitable and constitutional mootness are beyond the scope of this Comment, understanding how courts fuse and confuse the three doctrines helps set the stage for the varying applications of sections 363(m) and 364(e).

The rest of this Comment will discuss the provisions that make up the statutory mootness doctrine and the various controlling interpretations.

*B. The Similar Statutory Constructions of Sections 363(m) and 364(e)*

Sections 363(m) and 364(e) both safeguard bankruptcy transactions from being overturned on appeal.<sup>42</sup> This shared objective is reflected in their nearly identical construction. The practical difference between these sections is that section 364(e) deals with loans, while section 363(m) deals with purchases.<sup>43</sup> The following examination of each provision's statutory framework will provide key insights into the range of judicial positions and the overall sloppiness of judicial interpretations.

To begin, section 363(m) says:

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.<sup>44</sup>

This safe harbor provision controls for appeals that seek to modify or reverse a sale or a lease made under sections 363(b) and 363(c).<sup>45</sup> Such appeals cannot

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<sup>42</sup> See 11 U.S.C. §§ 363(m), 364(e). Further evidence of the similar purpose behind these two provisions can be found in the senate reports for their respective statutes, which state that 364(e) provides the same protection for credit extenders as 363(m) does for purchasers. S. REP. NO. 95-989, at 58 (1978).

<sup>43</sup> The process for obtaining credit or incurring debt is different than the process for selling assets under section 363. However, these differences do not affect the purposes of sections 363(m) and 364(e). This Comment addresses issues that are common to the application of both sections.

<sup>44</sup> 11 U.S.C. § 363(m) (emphasis added).

<sup>45</sup> The significant difference between these sections is that 363(b) provides for sales outside the ordinary course of business, and 363(c) only provides for sales within the ordinary course of business. See 11 U.S.C. §§ 363(b), 363(c). The applicability of these sections has greatly increased as the number of debtors using section

affect the validity of said sale or lease *unless* the court finds there was an absence of good faith or a stay pending appeal was granted.<sup>46</sup>

Now turning to section 364(e). It reads:

The reversal or modification on appeal of an authorization under this section to obtain credit or incur debt, or of a grant under this section of a priority or a lien, *does not affect the validity* of any debt so incurred, or any priority or lien so granted, to an entity that extended such credit in good faith, whether or not such entity knew of the pendency of the appeal, *unless* such authorization and the incurring of such debt, or the granting of such priority or lien, were stayed pending appeal.<sup>47</sup>

This safe harbor provision protects authorizations under section 364 of the Code to obtain credit, incur debt, or grant a priority or lien.<sup>48</sup> Appeals to reverse or modify such authorizations can affect the validity of any debt incurred, or any priority or lien granted, only if there was an absence of good faith or a stay pending appeal was granted.<sup>49</sup>

### C. *The Statutory Components*

A proper understanding of the safe harbor provisions requires knowledge of what constitutes “good faith purchasers,” “stays pending appeal,” and the “validity of a sale.” Although these concepts are common within most bankruptcy proceedings, their scope and functionality are not fully delineated by the Code. Parts I.C.1–3 review case law to illuminate how these statutory components are applied.

#### 1. *Good Faith Purchaser*

Although “good faith” or “good faith purchasers” are not defined by the Code, courts largely focus on the same considerations when identifying good faith purchasers.<sup>50</sup> A typical definition of a good faith purchaser is “one who

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363 sales has continued to go up. Ashley Suarez, *An Analysis of § 363(b) Sales: Justified Deviations or Just Deviations?*, 22 U. PA. J. BUS. L. 988, 990 (2020).

<sup>46</sup> 11 U.S.C. § 363(m).

<sup>47</sup> 11 U.S.C. § 364(e) (emphasis added).

<sup>48</sup> *See id.*

<sup>49</sup> *Id.*

<sup>50</sup> *See* James Lockhart, *Construction and Application of 11 U.S.C.A. § 363(m), Protecting Good Faith Purchaser or Lessee Under Bankruptcy Code—Issues Other Than Status as “Good Faith” Purchaser or Lessee*, 51 A.L.R. FED. 2d 471, 487–88 (2022).

buys in good faith, that is, free of any fraud or misconduct and for value and without knowledge of any adverse claim.”<sup>51</sup> Counterintuitively, courts conclude a party is a “good faith” purchaser not by finding “good faith” but instead by finding the absence of “bad faith.”

The party trying to show good faith bears the burden of proof.<sup>52</sup> Good faith determinations may not be presumed.<sup>53</sup> Instead, good faith determinations require an analysis of case-specific facts to make out whether some form of fraudulent behavior was present.<sup>54</sup> Courts find bad faith when there is evidence of “fraud, [or] collusion between the purchaser and other bidders or the trustee, or an attempt to take grossly unfair advantage of other bidders.”<sup>55</sup> The bankruptcy court must make these determinations at the postpetition financing hearing, before parties agree to enter into any purchase or financing agreement.<sup>56</sup> On appeal, reviewing courts will decide questions of fact regarding good faith determinations on a “clearly erroneous” standard.<sup>57</sup> This deferential standard prevents reviewing courts from overturning good faith determinations unless the court is “left with the definite and firm conviction that a mistake has been made.”<sup>58</sup>

Courts are fairly consistent with their determinations of good faith, which stands in contrast to their haphazard application of the safe harbor provisions. As a result, good faith determinations play only a minor part in the current sloppiness surrounding sections 363(m) and 364(e).

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<sup>51</sup> *Mia. Ctr. Ltd. P’ship v. Bank of N.Y.*, 838 F.2d 1547, 1554 (11th Cir. 1988). Although courts recognize the same definition for “good faith,” there is some discrepancy amongst the courts regarding when determinations on, or objections to, good faith can be made. Lockhart, *supra* note 50, at 488. However, courts have frequently held that where questions of good faith could and should have been raised prior to the confirmation of a sale, such issues will be barred from being raised for the first time on appeal. Lockhart, *supra* note 50, at 491.

<sup>52</sup> 3 COLLIER ON BANKRUPTCY ¶ 363.11 (16th ed. 2022).

<sup>53</sup> *Id.*

<sup>54</sup> *See, e.g., Reynolds v. ServisFirst Bank (In re Stanford)*, 17 F.4th 116, 124 (11th Cir. 2021).

<sup>55</sup> *Ewell v. Diebert (In re Ewell)*, 958 F.2d 276, 281 (9th Cir. 1992); *see also In re Abbotts Dairies of Pa., Inc.*, 788 F.2d 143, 147 (3d Cir. 1986); *Hoes Corp. v. Vetter Corp. (In re Vetter Corp.)*, 724 F.2d 52, 56 (7th Cir. 1983); *In re Gen. Motors Corp.*, 407 B.R. 463, 494 (Bankr. S.D.N.Y. 2009); *Badami v. Burgess (In re Burgess)*, 246 B.R. 352, 356 (B.A.P. 8th Cir. 2000).

<sup>56</sup> *See Gen. Elec. Cap. Corp. v. Hoerner (In re Grand Valley Sport & Marine, Inc.)*, 143 B.R. 840, 848 (Bankr. W.D. Mich. 1992).

<sup>57</sup> *461 7th Ave. Mkt., Inc. v. Delshah 461 Seventh Ave., LLC (In re 461 7th Ave. Mkt., Inc.)*, No. 20-3555, 2021 U.S. App. LEXIS 36995, at \*3 (2d Cir. Dec. 15, 2021).

<sup>58</sup> *Rasmussen v. Two Harbors Fish Co.*, 832 N.W.2d 790, 797 (Minn. 2013) (quoting *Rogers v. Moore*, 603 N.W.2d 650, 656 (Minn. 1999)).

## 2. *Validity of the Transaction*

The main culprit fueling the confusion is how to determine what affects the “validity of the transaction.” Unlike “good faith purchasers,” courts have adopted various determinations of what affects the “validity of the sale” and “validity of any debt so incurred, or any priority or lien so granted.”<sup>59</sup> The chief reason for courts’ imprecision in applying the safe harbor provisions is their erratic construal of what affects the validity of a transaction.

Some courts employ a broad interpretation of what affects the validity of the sale thereby triggering the protection of the safe harbor provisions.<sup>60</sup> Under this approach, appeals that affect *any* component of a transaction—such as sales price, where the proceeds go, or through which form a purchase is made—also affect the validity of the transaction.<sup>61</sup> These courts often cite an effort to promote finality as the reason underlying their broad interpretation.<sup>62</sup> These courts’ liberal construction of which appeals affect the validity of a transaction leads to frequent use of the safe harbors’ protection and therefore makes it very unlikely that appeals will be granted where there is no absence of good faith or where no stay pending appeal has been granted.<sup>63</sup> Indeed, some courts make such appeals impossible by employing *per se* rules that assume if an appeal is granted the validity of the transaction must be affected.<sup>64</sup>

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<sup>59</sup> Compare *Cargill, Inc. v. Charter Int’l Oil Co. (In re The Charter Co.)*, 829 F.2d 1054, 1055–56 (11th Cir. 1987) (holding that refunding a portion of the sales price would affect the validity of the sale), with *In re Palmer Equip., LLC*, 623 B.R. 804, 808 (Bankr. D. Utah 2020) (holding that appeals regarding the proceeds of the sale do not affect the validity of the transaction).

<sup>60</sup> See, e.g., *Charter*, 829 F.2d 1054; *Reynolds v. ServisFirst Bank (In re Stanford)*, 17 F.4th 116, 124 (11th Cir. 2021); *Burchinal v. Cent. Wash. Bank (In re Adams Apple, Inc.)*, 829 F.2d 1484 (9th Cir. 1987); *In re Verity Health Sys. of Cal.*, No. 2:18-cv-10675-RGK, 2019 WL 7997371 (C.D. Cal. Aug. 2, 2019).

<sup>61</sup> See, e.g., *Charter*, 829 F.2d at 1055 (finding that a refund of the portion of the sales price—\$5 million out of \$112 million—would affect the validity of the sale); *Reynolds*, 17 F.4th at 124 (holding that converting a credit bid to a cash offer affected the validity of the sale); *Verity*, 2019 WL 7997371, at \*5 (ruling that an appeal to remove certain waivers from a financing package would have affected the validity of the debt incurred).

<sup>62</sup> See *Off. Comm. Unsecured Creditors v. Walker Cnty. Hosp. Dist. (In re Walker Cnty. Hosp. Corp.)*, 3 F.4th 230, 233–234 (5th Cir. 2021) (“The purpose of § 363 is to ‘promote the finality of bankruptcy sales . . . .’”); *Reynolds*, 17 F.4th at 127 (11th Cir. 2021) (Jordan, J., concurring) (“Our opinion in *Charter Company* correctly cited the language of § 363(m) to highlight why principles of equity demand finality once a sale is approved . . . .”).

<sup>63</sup> See, e.g., *supra* note 61.

<sup>64</sup> See *In re Sax*, 796 F.2d 994, 997 (7th Cir. 1986) (“We hold this appeal moot because the sale of the Yacht was authorized under § 363(b) and Three Rivers failed to obtain a stay of the sale . . . . This Court and others have repeatedly held that an appeal of a bankruptcy sale is moot if the stay required by § 363(m) is not obtained.”) Although *In re Sax* helped to set the precedent for similar *per se* rules employed by many circuits today, the Seventh Circuit reversed their position in 2019, with their ruling in *Trinity. Trinity 83 Dev., LLC v. ColFin Midwest Funding, LLC*, 917 F.3d 599 (7th Cir. 2019).

Other courts take a narrower approach, focusing their decision on the practical implications of granting the appeal and whether any effective relief can be granted.<sup>65</sup> For appeals of section 363 sales, courts that follow the narrow approach center their determination on whether, after granting the appeal, the sale remains in effect and whether the buyer keeps what they purchased.<sup>66</sup> Similarly, for appeals of authorizations under section 364, courts following this narrow approach consider whether priorities or liens granted remain in effect for parties that have extended credit to the estate.<sup>67</sup>

In direct contrast to jurisdictions using the *per se* rules, courts opting for the narrow approach do not categorically dismiss appeals of good faith transactions or hold them as moot.<sup>68</sup> Instead, these courts make an inquiry into whether the relief requested on appeal will affect the validity of a transaction.<sup>69</sup> These courts restrict the protection of the safe harbor provisions to only appeals where no form of meaningful relief can be granted without affecting the validity of the transaction.<sup>70</sup> As a result, appellants in these jurisdictions have a greater opportunity to show that their appeal does not affect the overall validity of a transaction, even where it does affect a discrete component of it.<sup>71</sup>

### 3. *Stay Pending Appeal*

The Federal Rules of Bankruptcy Procedure define a stay pending appeal as: “a stay of a judgment, order, or decree of the bankruptcy court pending appeal.”<sup>72</sup> Stays pending appeal serve as injunctions on the completion of a sale by halting transactions from proceeding before an appeal is heard.<sup>73</sup> These orders frequently arise in the context of enjoining a sale from being confirmed so that

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<sup>65</sup> See, e.g., *In re Lloyd*, 37 F.3d 271, 273 (7th Cir. 1994); *In re Palmer Equip., LLC*, 623 B.R. 804, 810 (Bankr. D. Utah 2020).

<sup>66</sup> See *Palmer*, 623 B.R. at 808 (“The remedies requested do not affect the validity of the sale because the bona fide purchaser of the equipment will not be disturbed in its ownership.”).

<sup>67</sup> See *Resol. Tr. Corp. v. Swedeland Dev. Grp. (In re Swedeland Dev. Grp.)*, 16 F.3d 552, 562 (3d Cir. 1994) (“[V]oiding the reserve would impair the security for which [the creditor] bargained and thus would be inconsistent with the protection afforded it by section 364(e).”).

<sup>68</sup> See *Lloyd*, 37 F.3d at 273.

<sup>69</sup> See *Swedeland*, 16 F.3d at 559–60.

<sup>70</sup> *Id.* at 560 (citing *Church of Scientology of Cal. v. United States*, 506 U.S. 9, 12–13 (1992)) (“Rather, when a court can fashion ‘some form of meaningful relief,’ even if it only partially redresses the grievances of the prevailing party, the appeal is not moot.”).

<sup>71</sup> See *Palmer*, 623 B.R. at 808. Ultimately, appellants in these jurisdictions have a greater chance of having their appeals heard and granted because the scope of 363(m) and 364(e) is more limited.

<sup>72</sup> FED. R. BANKR. P. 8007(a)(1)(A).

<sup>73</sup> See *id.*

challenges to that sale can be heard.<sup>74</sup> Sections 363(m) and 364(e) are the only provisions in the Code that formally require a party to seek a stay pending appeal.<sup>75</sup> Stays pending appeal are considered an extraordinary remedy and are only granted in limited circumstances.<sup>76</sup>

Stays pending appeal serve an important function in bankruptcy's fast-paced environment by freezing transactions in place. The Seventh Circuit succinctly explained the significance of stays pending appeal:

The significance of an application for a stay lies in the opportunity it affords to hold things in stasis, to prevent reliance on the plan of reorganization while the appeal proceeds. A stay not sought, and a stay sought and denied, lead equally to the implementation of the plan of reorganization.<sup>77</sup>

If a transaction is not stayed while an appeal is considered, the transaction may progress past the point where effective relief can be provided.<sup>78</sup> This problem is often likened to trying to “unscramble an egg.”<sup>79</sup>

Rule 8007 of the Federal Rules of Bankruptcy Procedure governs the procedures for obtaining a stay pending appeal.<sup>80</sup> Notably, the party requesting the stay must post a supersedeas bond.<sup>81</sup> One court notes, “[t]he bond essentially acts as a security for the judgment holder’s contingent right to pursue the judgment, which is conditioned on successfully pursuing the appeal.”<sup>82</sup> In other words, supersedeas bonds indemnify appellees from damages that may accrue from an unsuccessful appeal. To cover for such harm, the price of the supersedeas bond is often proportional to the size of the transaction, making the

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<sup>74</sup> *E.g.*, *Reynolds v. ServisFirst Bank (In re Stanford)*, 17 F.4th 116, 120 (11th Cir. 2021).

<sup>75</sup> This fact highlights Congress’ intention that these appeals not be made lightly.

<sup>76</sup> See Jake Jumbeck, Comment, “Complexity” as the Gatekeeper to Equitable Mootness, 33 EMORY BANKR. DEV. J. 171, 180 (2016).

<sup>77</sup> *In re UNR Indus., Inc.*, 20 F.3d 766, 769–70 (7th Cir. 1994).

<sup>78</sup> *Id.* at 769 (“Since the plan went into effect, more than 15 million shares of New UNR have been distributed . . . Warrants for additional stock have been issued and are trading . . . Corporate acquisitions and divestitures . . . have occurred; tax consequences . . . have been realized; large insurance settlements have been disbursed; lawsuits have been dismissed. Undoing all of this is impossible.”).

<sup>79</sup> *Id.*

<sup>80</sup> FED. R. BANKR. P. 8007.

<sup>81</sup> *Id.*

<sup>82</sup> *In re Palmer Equip., LLC*, 623 B.R. 804, 810 (Bankr. D. Utah 2020).



bonds practically infeasible for a major transaction.<sup>83</sup> Inability to afford the required supersedeas bond is a significant barrier for an appellant seeking to obtain a stay pending appeal.<sup>84</sup> Indeed, most parties engaged in bankruptcy proceedings do not have substantial assets and “posting such a bond [can] be devastating for the company and its employees.”<sup>85</sup>

Although rule 8007 outlines the necessary procedures for obtaining a stay, neither rule 8007 nor the Code explain when a court *should grant* a stay. In lieu of Congressional direction, courts have developed a four-prong test that places the burden of proof on the party moving for a stay.<sup>86</sup> Courts look at:

- (1) whether the movant will suffer irreparable injury absent a stay, (2) whether a party will suffer substantial injury if a stay is issued, (3) whether the movant has demonstrated ‘a substantial possibility, although less than a likelihood, of success’ on appeal, and (4) the public interests that may be affected.<sup>87</sup>

Although these four factors are well-established, their application is “far from uniform.”<sup>88</sup> This lack of uniformity makes it hard for appellants to predict the likelihood of being granted stays pending appeal.<sup>89</sup>

#### *D. The Relevant Policy Considerations Underpinning the Safe Harbor Provisions*

The safe harbor provisions are meant to encourage potential investors to transact with the estate<sup>90</sup> by codifying “Congress’s strong preference for finality

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<sup>83</sup> See Driscoll, *supra* note 9, at 742. In some instances, there can be other additional costs to obtaining a stay pending appeal. Alan J. Friedman & Michael P. McMahon, *Bonding Against Bankruptcy: Protecting Judgments Pending Appeal*, 22 AM. BANKR. INST. L. REV. 307, 308 (2014) (“[T]he bonding company may require the appellant to post a letter of credit to secure the bond, adding a second layer of expense.”).

<sup>84</sup> See Kuney & Reno-Demick, *supra* note 12, at 109–10.

<sup>85</sup> See *id.* at 110 (quoting Richard G. Stuhan & Sean P. Costello, *The Appeal Bond—What It Is, How It Works, and Why It Needs To Be Factored Into Your Litigation Strategy*, JONES DAY (Mar. 2008), <http://www.jonesday.com/files/Publication/983c1326-51c1-4ebc-9e6e-001ef4268418>).

<sup>86</sup> See *In re Taub*, 470 B.R. 273, 277 (E.D.N.Y. 2012).

<sup>87</sup> *Id.*

<sup>88</sup> Richard S. Kanowitz & Michael A. Klein, *The Divergent Interpretation of the Standard Governing Motions for Stay Pending Appeal of Bankruptcy Court Orders*, 17 NORTON J. BANKR. L. & PRAC. 1, 2 (2008) (“[S]ome courts have, without significant analysis, found that an appellant’s failure to persuade the court regarding any one of the four factors is sufficient to deny a motion for a stay. Other courts, however, have ruled that the court may balance all four factors . . .”).

<sup>89</sup> *Id.*

<sup>90</sup> See Off. Comm. Unsecured Creditors v. Walker Cnty. Hosp. Dist. (*In re Walker Cnty. Hosp. Corp.*), 3 F.4th 230, 234 (5th Cir. 2021).

and efficiency.”<sup>91</sup> These policy goals serve the best interests of creditors and the estate by maximizing the value of estate assets and thus maximizing the purchase price by reducing uncertainty and increasing reliability.<sup>92</sup> However, these policy goals are balanced against a third critical policy consideration—the right of aggrieved parties to appellate review of adverse decisions. Each policy consideration is addressed in turn below.

### 1. Finality

Finality enhances a debtor’s prospects of successful reorganization by promoting trust and confidence in the certainty of confirmed plans.<sup>93</sup> Generally, parties will pay less for assets that may be snatched back or otherwise affected by subsequent events.<sup>94</sup> Courts recognize that if parties cannot rely on a deed of purchase resulting from a bankruptcy sale, “it will be difficult to liquidate bankrupt estates at positive prices.”<sup>95</sup> Conversely, if purchasers and lenders can faithfully depend on a plan of reorganization when transacting with the estate, then higher prices and more favorable lending deals are possible.<sup>96</sup> This benefits both the estate and creditors.<sup>97</sup>

Finality also furthers judicial efficiency and addresses financiers’ fears of being entangled in extended litigation.<sup>98</sup> By barring relitigation of the sale, the parties involved, including the court, can move on without the fear of future legal proceedings.<sup>99</sup> For potential investors, increased finality reduces the chance that confirmation orders will be dragged out through extended litigation to determine the rights and interests of each party.<sup>100</sup> This helps increase an estate’s realized

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<sup>91</sup> *Hazelbaker v. Hope Gas, Inc. (In re Rare Earth Minerals)*, 445 F.3d 359, 363 (4th Cir. 2006).

<sup>92</sup> *Walker Cnty. Hosp.*, 3 F.4th at 234.

<sup>93</sup> *Jumbeck*, *supra* note 76, at 172–73 (citing *In re Phila. Newspapers, LLC*, 690 F.3d 161, 169 (3d Cir. 2012)).

<sup>94</sup> *In re UNR Indus., Inc.*, 20 F.3d 766, 770 (7th Cir. 1994).

<sup>95</sup> *In re Edwards*, 962 F.2d 641, 643 (7th Cir. 1992); *see also In re Met-L-Wood Corp.*, 861 F.2d 1012, 1019 (7th Cir. 1988); *In re Andy Frain Servs., Inc.*, 798 F.2d 1113, 1125 (7th Cir. 1986); *Bleaufontaine, Inc. v. Roland Int’l (In re Bleaufontaine, Inc.)*, 634 F.2d 1383, 1389 n.10, 12 (5th Cir. 1981); *cf. Taylor v. Lake (In re CADA Invs., Inc.)*, 664 F.2d 1158, 1162 (9th Cir. 1981) (discussing that without finality it would be more difficult to sell estate assets). *See generally In re Chung King, Inc.*, 753 F.2d 547, 550–52 (7th Cir. 1985).

<sup>96</sup> *See UNR Indus.*, 20 F.3d at 770.

<sup>97</sup> *See id.*

<sup>98</sup> *See Sulmeyer v. Karbach Enters. (In re Exennium)*, 715 F.2d 1401, 1403 (9th Cir. 1983).

<sup>99</sup> *See id.*

<sup>100</sup> *In re Sax*, 796 F.2d 994, 998 (7th Cir. 1986).

returns through sales and investments.<sup>101</sup> Reducing the possibility of further time-consuming and expensive litigation allows the court to move onto other pending litigation. In short, finality further promotes judicial efficiency.<sup>102</sup>

Finality also serves an important equitable function by protecting non-parties from the adverse effects of a reversal or modification on appeal.<sup>103</sup> Although reversals can always affect third parties, the problem is amplified by the sheer number of parties that a bankruptcy appeal could potentially impact.<sup>104</sup> Courts are ill-equipped to corral back resources and property from various third parties, and rely on finality to avoid such costly determinations.<sup>105</sup>

## 2. *Speed and Efficiency*

Much like finality, speed and efficiency provide the estate with the best available deals regarding sales and credit. This is because financially distressed companies are continuously losing money.<sup>106</sup> Courts often refer to these struggling debtors as “melting ice cubes,” meaning that “the value of the debtor’s assets is certain to decrease in the future.”<sup>107</sup> In the famous example of Chrysler’s chapter 11 bankruptcy, the court determined that Chrysler was losing \$100 million every day.<sup>108</sup> Much like actual melting ice cubes, financially distressed companies have only a limited amount of time before all their assets melt away. Courts use the “melting ice cube” scenario to justify the notion that sales need to be made quickly to get the highest possible bid while the business still has assets to sell.<sup>109</sup>

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<sup>101</sup> See *id.* (“Without the degree of finality provided by the stay requirement purchasers are likely to demand a steep discount for investing in the property [of the estate].”).

<sup>102</sup> See ACC Bondholder Grp. v. Adelpia Commc’ns Corp. (*In re Adelpia Commc’ns Corp.*), 361 B.R. 337, 367–68 (S.D.N.Y. 2007).

<sup>103</sup> Jumbeck, *supra* note 76, at 212.

<sup>104</sup> See Miller, *supra* note 37, at 272.

<sup>105</sup> E.g., *supra* note 78 and accompanying text.

<sup>106</sup> See generally Redouane Elkamhi et al., *How Large Are Pre-Default Costs of Financial Distress? Estimates from a Dynamic Model*, SSRN 23 (Dec. 19, 2022), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3553063](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3553063) (articulating that the pre-default costs for financially distressed companies are, on average, 6.5% of the business’s value per year, accounting for approximately 68.5% of the total distress costs; for companies near or in default, the average distress costs are 15–30%).

<sup>107</sup> Raykin, *supra* note 39, at 96.

<sup>108</sup> Melissa B. Jacoby & Edward J. Janger, *Ice Cube Bonds: Allocating the Price of Process in Chapter 11 Bankruptcy*, 123 YALE L.J. 862, 862 (quoting *In re Chrysler LLC*, No. 09-50002, 2009 WL 5131534, at \*7 (Bankr. S.D.N.Y. June 1, 2009)) (“Currently, the Debtors are losing over \$100 million dollars per day.”).

<sup>109</sup> See Raykin, *supra* note 39, at 96.

The woes of melting ice cube companies are compounded by the expenses attendant to bankruptcy. The bankruptcy process inhibits a business's ability to operate normally.<sup>110</sup> Each day a business spends in bankruptcy is "a day when it will have a hard time attracting the investors, employees, and, in some industries, customers that it needs to exist and prosper."<sup>111</sup> By acting swiftly and limiting the negative impact on the debtor's business, bankruptcy courts can best maintain the viability of the business as a going concern.

### 3. *Right to Effective Review of Adverse Judgments*

According to the United States Courts, "[t]he appeals process is a defining feature of an independent and impartial judiciary."<sup>112</sup> While speed and finality are useful to bankruptcy proceedings, a functional appellate review process is essential to maintain faith in judicial proceedings.<sup>113</sup> Appeals allow litigants who are dissatisfied with the legality or propriety of an outcome to have their case reviewed for possible errors. In short, appeals bolster perceived fairness.<sup>114</sup>

Sections 363(m) and 364(e) limit the scope of appeals in the context of bankruptcy proceedings. However, limits should be distinguished from absolute denial of the right to appeal. As previously discussed, the purpose of the safe harbor provisions is to encourage investment.<sup>115</sup> Speed and finality support this purpose, but not to the extent that they quash a party's right to effective review. Thus, any application of the safe harbor provisions must balance the goal of speed and finality with the necessity of effective review.

### 4. *How Are These Policy Considerations Reflected in Sections 363(m) and 364(e)?*

Sections 363(m) and 364(e) uphold the policies of speed and finality through the procedural requirements they place on parties seeking an appeal—namely

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<sup>110</sup> See *Trib. Media Co. v. Aurelius Cap. Mgmt., L.P.* (*In re Trib. Media Co.*), 799 F.3d 272, 289 (3d Cir. 2015) (Ambro, J., concurring).

<sup>111</sup> *Id.*

<sup>112</sup> *U.S. Courts of Appeals and Their Impact on Your Life*, UNITED STATES COURTS, <https://www.uscourts.gov/educational-resources/educational-activities/us-courts-appeals-and-their-impact-your-life> (last visited Dec. 15, 2023).

<sup>113</sup> *People v. Thomas*, 34 N.E. 545, 594 (N.Y. 2019) (Garcia, J., dissenting) (laying out a clear picture of the importance of appellate review and the effect it has on maintaining the judicial system).

<sup>114</sup> *Id.*

<sup>115</sup> See *Off. Comm. Unsecured Creditors v. Walker Cnty. Hosp. Dist.* (*In re Walker Cnty. Hosp. Corp.*), 3 F.4th 230, 234 (5th Cir. 2021).

through the stay pending appeal and good faith purchaser requirements. While the stay pending appeal is a tool for appellants to preserve their opportunity to appeal, in practice it also furthers the goals of speed and finality. To be granted a stay, the movant must pass the judicially created four-prong test.<sup>116</sup> This places a significant burden on appellants. They must prove, among other things, irreparable injury and that the stay is in the overall public interest.<sup>117</sup> Even in the limited circumstance where the movant can make the required showing, the granting of the stay pending appeal is conditioned on large supersedeas bonds that distressed companies often cannot afford.<sup>118</sup>

Additionally, if a party is unable to obtain a stay pending appeal, the only other way to affect the validity of the transaction on appeal is to show the transaction was made in bad faith.<sup>119</sup> As this typically requires some showing of fraud, the proponent must show not only that there was a misrepresentation, but also that it was knowingly made.<sup>120</sup> Direct evidence of fraudulent intent is rare, leaving appellants to stitch together an argument from available circumstantial evidence.

These procedural barriers prevent appeals from affecting the validity of transactions, making it more likely that the transaction will proceed undisturbed. To make matters worse for appellants, appellate courts review determinations regarding good faith purchasers and stays pending appeal on a clearly erroneous basis.<sup>121</sup> This high standard of review, in conjunction with the aforementioned procedural requirements, helps maximize the speed and finality of bankruptcy transactions through the safe harbor provisions.

Sections 363(m) and 364(e) mitigate the risks of bankruptcy sales by limiting courts' review, which enhances the sales' speed and finality. Simultaneously, these sections protect parties' right to effective review on matters that do not

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<sup>116</sup> *In re Taub*, 470 B.R. 273, 277 (E.D.N.Y. 2012).

<sup>117</sup> *Lang v. Lang (In re Lang)*, 414 F.3d 1191, 1201 (10th Cir. 2005); *In re Forty-Eight Insulations, Inc.*, 115 F.3d 1294, 1300 (7th Cir. 1997).

<sup>118</sup> *See Driscoll*, *supra* note 9, at 744.

<sup>119</sup> *See* 11 U.S.C. §§ 363(m), 364(e).

<sup>120</sup> *See Evans v. Ottimo*, 469 F.3d 278, 283 (2d Cir. 2006).

<sup>121</sup> *See Mission Prod. Holdings v. Old Cold, LLC (In re Old Cold, LLC)*, 558 B.R. 500, 515 (B.A.P. 1st Cir. 2016); *461 7th Ave. Mkt., Inc. v. Delshah 461 Seventh Ave., LLC (In re 461 7th Ave. Mkt., Inc.)*, No. 20-3555, 2021 U.S. App. LEXIS 36995, at \*3 (2d Cir. Dec. 15, 2021).

affect the validity of the transaction.<sup>122</sup> A careful parsing of the safe harbor provisions respects Congress's intended balance of these critical policy considerations and leaves no room for misadministration. Yet, as Part II will illustrate, courts are both inconsistent and imprecise in their application of these provisions. As a result, appellants in some jurisdictions have little hope of securing the effective review Congress purposely installed in the safe harbor provisions.

## II. ANALYSIS: DIFFERING INTERPRETATIONS OF THE SAFE HARBOR PROVISIONS

Having delineated the relevant concepts present in both sections 363(m) and 364(e), to fully understand the scope of judicial sloppiness requires an exploration of the case law. Parts II.A and II.B will explore the traditional split in the courts' approaches to interpreting and applying sections 363(m) and 364(e). Part II.A will discuss the "Per Se Approach," where courts have adopted an expansive view of the safe harbor provisions and the types of appeals that affect the validity of transactions. Part II.B will outline the "Validity Exception Approach," where courts have focused on available remedies. Finally, Part II.C will examine more recent decisions that go beyond the traditional split.

The cases below provide paradigms for how these differing approaches have led to inconsistent results for similar issues. While reviewing these cases, keep in mind the discussion above about statutory construction, the purpose of the safe harbor provisions, and how courts have effectuated each.

### A. *The Per Se Approach*

Assuming no issues of good faith, courts following the Per Se Approach have effectively held that all appeals affect the validity of the sale, debt, or priority, and such appeals are therefore moot in the absence of a stay pending appeal.<sup>123</sup>

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<sup>122</sup> See 11 U.S.C. §§ 363(m), 364(e). These sections expressly preclude only those appeals that would affect the validity of the transaction. Therefore, courts should only apply sections 363(m) and 364(e) after making this validity determination.

<sup>123</sup> See, e.g., *Cargill, Inc. v. Charter Int'l. Oil Co. (In re The Charter Co.)*, 829 F.2d 1054, 1056 (11th Cir. 1987); *Reynolds v. ServisFirst Bank (In re Stanford)*, 17 F.4th 116, 122–24 (11th Cir. 2021); *Burchinal v. Cent. Wash. Bank (In re Adams Apple, Inc.)*, 829 F.2d 1484, 1487–89 (9th Cir. 1987); *In re Verity Health Sys. of Cal. Inc.*, No. 2:18-cv-10675-RGK, 2019 WL 7997371, at \*3–5 (C.D. Cal. Aug. 2, 2019), *aff'd sub nom.* Off. Comm. Unsecured Creditors v. Verity Health Sys. of Cal., Inc. (*In re Verity Health Sys. of Cal.*), 814 F. App'x 275 (9th Cir. 2020).

Courts frequently have reasoned that deference to finality necessitates adopting this approach.<sup>124</sup>

*1. Section 363(m)*

In the Charter Company’s chapter 11 bankruptcy, Cargill, the appellant, and Charter International Oil Company, the appellee debtor (“Charter”), entered into a sealed bidding process with NPI, one of Charter’s wholly owned subsidiaries.<sup>125</sup> Cargill, Charter, and NPI negotiated the purchase of NPI’s assets for \$107,803,000.<sup>126</sup> Once the parties agreed to a contract, the bankruptcy court established a deadline for other offers or objections to the contract.<sup>127</sup> The court received none by the deadline.<sup>128</sup> However, after the deadline, another buyer, Atlantic, requested an extension.<sup>129</sup> The bankruptcy court approved the request and ordered Cargill and Atlantic to enter into competitive bidding.<sup>130</sup> Cargill won, but with a price over \$5 million above the originally agreed upon price.<sup>131</sup>

Although Cargill won and closed the sale, it appealed the sale approval and the propriety of the bankruptcy court’s actions because it had to pay more than what was agreed to in the original sealed bidding process.<sup>132</sup> As relief, Cargill requested a refund of the portion of the sales price—the extra \$5 million.<sup>133</sup> However, because Cargill did not obtain a stay pending appeal, the Eleventh Circuit found the appeal moot and thus never addressed any issues on appeal.<sup>134</sup> The court held that section 363(m) prevents the authorization of the sale from being altered on appeal, meaning appellate courts are precluded from granting

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<sup>124</sup> See Off. Comm. Unsecured Creditors v. Walker Cnty. Hosp. Dist. (*In re Walker Cnty. Hosp. Corp.*), 3 F.4th 230, 234 (5th Cir. 2021) (“The purpose of § 363 is to ‘promote the finality of bankruptcy sales . . . .’”); *Reynolds*, 17 F.4th at 126 (“Our opinion in *Charter Company* correctly cited the language of § 363(m) to highlight why principles of equity demand finality once a sale is approved . . . .”).

<sup>125</sup> *Charter*, 829 F.2d at 1055.

<sup>126</sup> See *id.* Technically, the assets belonged to NPC, NPI’s wholly owned subsidiary.

<sup>127</sup> *Id.*

<sup>128</sup> *Id.*

<sup>129</sup> *Id.*

<sup>130</sup> *Id.*

<sup>131</sup> *Id.* In fact, Atlantic won the first round of competitive bidding with Cargill. However, Cargill requested that the competitive bidding hearing be reopened, and the bankruptcy court agreed. Cargill then gave the highest bid in this second round of competitive bidding. That exchange occurred before Atlantic reentered the fray with their request for an extension.

<sup>132</sup> See *id.* Cargill specifically appealed the bankruptcy courts’ approval order to extend the bidding deadline. The district court affirmed the bankruptcy court’s order and Cargill appealed to the Eleventh Circuit.

<sup>133</sup> See *id.* at 1056.

<sup>134</sup> See *id.*

effective relief on appeal where a stay pending appeal was not granted.<sup>135</sup> The court also held that a refund for a portion of the sales price (here \$5 million out of \$112 million) affects the validity of the sale because challenging a “central element of the purchase” challenges the validity of the sale itself.<sup>136</sup>

There are two major takeaways from the *Charter* court’s interpretation of section 363(m). First, section 363(m) categorically prevents appellate courts from granting relief to appellants where a stay pending appeal has not been granted. Second, the court broadly defined what actions affect the validity of a sale.

The *In re Stanford* court expanded on the precedent set in *Charter* by determining that other discrete actions also affect the validity of a sale.<sup>137</sup> The chapter 11 debtors in *Stanford* were authorized to acquire a DIP loan from ServisFirst bank, the appellee.<sup>138</sup> The loan rolled-up \$12 million the debtors already owed to ServisFirst and provided an additional \$1 million of working capital.<sup>139</sup> The debtors then filed a motion to sell ServisFirst the collateral it held against the debtors.<sup>140</sup> The bankruptcy court approved the sale of the collateral via a credit bid against the debtors’ obligations to ServisFirst.<sup>141</sup>

After the approval, the debtors moved to amend the sale order and stay the sale on the grounds that ServisFirst was not a good faith purchaser and was not legally allowed to make the credit bid.<sup>142</sup> The bankruptcy court denied the motion.<sup>143</sup> The debtors appealed to the district court and requested a stay pending appeal.<sup>144</sup> Although the court agreed to the stay, it was ultimately not granted because the debtors could not afford the large supersedeas bond.<sup>145</sup> The district

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<sup>135</sup> *Id.* (“Appellant failed to obtain a stay as required under section 363(m). The bankruptcy court’s approval was issued, the assets were transferred, and the sale was completed . . . . This renders the appeal in this court, as well as the initial appeal to the district court, moot.”).

<sup>136</sup> *Id.*

<sup>137</sup> Reynolds v. ServisFirst Bank (*In re Stanford*), 17 F.4th 116 (11th Cir. 2021).

<sup>138</sup> *Id.* at 119.

<sup>139</sup> *Id.*

<sup>140</sup> *Id.*

<sup>141</sup> *Id.* at 120.

<sup>142</sup> *See id.* Here the Stanfords are requesting to appeal a ruling that they initially asked for. This is not something that courts generally look favorably upon, and the concurrence even states that the appeal should have been precluded by the “invited error doctrine.” The invited error doctrine dictates that parties cannot appeal decisions that they had originally invited or encouraged.

<sup>143</sup> *Id.*

<sup>144</sup> *Id.* at 120–21.

<sup>145</sup> *See id.* at 121.



court subsequently held that the debtor's appeal was moot under section 363(m) and the debtors appealed to the Eleventh Circuit.<sup>146</sup>

The Eleventh Circuit affirmed the district court's interpretation.<sup>147</sup> Section 363(m) was to be interpreted as a "flat rule" mooting any appeal of a sale that was authorized by the bankruptcy court, not stayed, and consummated."<sup>148</sup> The court also held the relief sought, that appellees pay \$3.5 million in cash as opposed to the credit bid, would undo the sale itself.<sup>149</sup> Accordingly, as there was no stay pending appeal, the debtor's appeal was necessarily moot.<sup>150</sup>

*Stanford* advanced the Per Se Approach by including *form* of payment as something that could not only affect the validity of the sale, but undo it altogether.<sup>151</sup> These Eleventh Circuit decisions indicate that no component of a sale can be affected by appeal under section 363(m).<sup>152</sup> As a result, appellants in that jurisdiction who are unable to obtain a stay have virtually no recourse to amend a sale after it has been consummated.

## 2. Section 364(e)

In *In re Adams Apple*, CWB, a prepetition creditor, entered into a prepetition financing agreement with a debtor in a chapter 11 case.<sup>153</sup> In exchange, CWB was to receive a security interest over other creditors in the debtor's crops for that year as collateral.<sup>154</sup> The agreement provided that, "[t]he first lien security interest would secure CWB's pre-petition loan . . . as well as post-petition advances."<sup>155</sup> Bank of California and other lenders, whose security interests were subordinated, objected to the financing agreement.<sup>156</sup> Although the bankruptcy court ultimately approved the plan over these objections, CWB began financing before the final order was made.<sup>157</sup>

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<sup>146</sup> *Id.*

<sup>147</sup> *Id.* at 122.

<sup>148</sup> *Id.*

<sup>149</sup> *Id.* at 125–26. This ruling expands the ruling from *Charter* by also including that the form of payment, if reversed or modified, would undoubtedly affect the validity of the sale.

<sup>150</sup> *See id.*

<sup>151</sup> *See id.* at 116.

<sup>152</sup> *See id.*; *Cargill, Inc. v. Charter Int'l Oil Co. (In re The Charter Co.)*, 829 F.2d 1054 (11th Cir. 1987).

<sup>153</sup> *Burchinal v. Cent. Wash. Bank (In re Adams Apple, Inc.)*, 829 F.2d 1484, 1486 (9th Cir. 1987).

<sup>154</sup> *Id.*

<sup>155</sup> *Id.*

<sup>156</sup> *See id.*

<sup>157</sup> *Id.*

Bank of California appealed the bankruptcy court's approval of the prepetition financing agreement, and the district court affirmed the decision.<sup>158</sup> Bank of California then appealed to the Ninth Circuit.<sup>159</sup> CWB argued the appeal was moot under section 364(e) because the appellants had failed to obtain a stay pending appeal.<sup>160</sup> The Ninth Circuit agreed and held that, "[a]n appellate court may not reverse the authorization to obtain credit or incur debts under section 364 if the authorization was not stayed pending appeal unless the lender did not act in good faith."<sup>161</sup> Additionally, the court discussed the policies underpinning section 364(e) and argued that said policies support the assertion that a claim is moot as soon as a lender has relied on an authorization under section 364(e).<sup>162</sup> Therefore, since Appellants did not obtain a stay pending appeal and CWB had some reliance on the authorization, the appeals were moot.<sup>163</sup>

When considering a separate issue centered on the terms of a financing agreement, the *In re Verity Health Systems* court took an analogous position to the approach applied by the *Adams Apple* court by employing section 364(e) as a flat rule.<sup>164</sup> In *Verity*, the court ruled on an appeal by the unsecured creditors committee to remove certain waivers from a final DIP order.<sup>165</sup> The district court held the appeal was moot under section 364(e), stating that "any provisions of the financing agreement that [the lender] might have bargained for or that helped motivate its extension of credit are protected by § 364(e)."<sup>166</sup>

Parallel to the results seen in *Charter* and *Stanford*, these cases effectively hold any reversal or modification on appeal of an authorization to obtain credit or incur debt, or of a grant of a priority or a lien, will affect the validity of the

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<sup>158</sup> *Id.* at 1486–87.

<sup>159</sup> *Id.*

<sup>160</sup> *See id.* at 1487.

<sup>161</sup> *Id.* at 1487–88.

<sup>162</sup> *Id.* at 1489.

<sup>163</sup> *See id.* at 1489–91.

<sup>164</sup> *In re Verity Health Sys. of Cal. Inc.*, No. 2:18-cv-10675-RGK, 2019 WL 7997371, \*3–4 (C.D. Cal. Aug. 2, 2019), *aff'd sub nom.* Off. Comm. Unsecured Creditors v. Verity Health Sys. of Cal., Inc. (*In re Verity Health Sys. of Cal., Inc.*), 814 F. App'x 275 (9th Cir. 2020); *see Adams Apple*, 829 F.2d 1484.

<sup>165</sup> *Verity*, 2019 WL 7997371. The debtor in this case entered into a DIP financing agreement that included waivers of rights, under 11 U.S.C. § 506(c) and 11 U.S.C. § 552(b), meant to induce the DIP to enter the financing agreement. The committee of unsecured creditors objected to the inclusion of these waivers on the grounds that they were "unduly beneficial to the secured creditors" at the expense of the unsecured creditors. *Id.*

<sup>166</sup> *Id.* at \*4–5 (quoting *Weinstein, Eisen, & Weiss, LLP v. Gill (In re Cooper Commons, LLC)*, 430 F.3d 1215, 1219–20 (9th Cir. 2005)).

transaction.<sup>167</sup> This is exemplified by the mention of reliance in both *Verity* and *Adams Apple*.<sup>168</sup> Both courts held that where a lender has any reliance on certain specifications of a lending agreement, an appeal addressing those specifications will be moot. However, the lender will always claim reliance, which will be evidenced by the mere inclusion of the specifications in the agreement. Therefore, an appellant that does not challenge good faith must be granted a stay pending appeal, otherwise their appeal will be moot.<sup>169</sup>

These cases clearly demonstrate that the Per Se Approach is not appellant friendly, but it does provide strong protection to good faith investors. Under this approach, sections 363(m) and 364(e) provide absolute deference to finality at the expense of the right to effective appellate review. In other jurisdictions, the balance between these two policy concerns is less asymmetrical.

### B. *The Validity Exception Approach*

Unlike the Per Se Approach, courts applying the Validity Exception Approach focus their analysis on the specific relief sought by the appellants and the effects of granting such relief. These courts reject the notion that the safe harbor provisions moot all appeals of authorizations under sections 363(m) and 364(e).<sup>170</sup> Instead, these courts emphasize ensuring that the transaction survives and is not substantially undone.<sup>171</sup> Only appeals that substantially unwind the transaction affect its validity and are, thus, rendered moot.<sup>172</sup> As a result of rebuffing the Per Se Approach, these courts must meaningfully analyze whether the relief requested would affect the validity of the transaction.<sup>173</sup>

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<sup>167</sup> Compare *Verity*, 2019 WL 7997371 at \*4, with *Adams Apple*, 829 F.2d 1484, and *Reynolds v. ServisFirst Bank (In re Stanford)*, 17 F.4th 116 (11th Cir. 2021), and *Cargill, Inc. v. Charter Int'l Oil Co. (In re The Charter Co.)*, 829 F.2d 1054 (11th Cir. 1987).

<sup>168</sup> *Verity*, 2019 WL 7997371, at \*4–5 (quoting *Gill*, 430 F.3d at 1219–20); *Adams Apple*, 829 F.2d at 1487.

<sup>169</sup> See *Verity*, 2019 WL 7997371, at \*4.

<sup>170</sup> See, e.g., *Trinity 83 Dev., LLC v. ColFin Midwest Funding, LLC*, 917 F.3d 599, 602–03 (7th Cir. 2019); *Resol. Tr. Corp. v. Swedeland Dev. Grp. (In re Swedeland Dev. Grp.)*, 16 F.3d 552, 558–59 (3d Cir. 1994); *In re UNR Indus., Inc.*, 20 F.3d 766, 769–70 (7th Cir. 1994); *In re Palmer Equip., LLC*, 623 B.R. 804, 808 (Bankr. D. Utah 2020).

<sup>171</sup> See, e.g., *UNR Indus.*, 20 F.3d at 769.

<sup>172</sup> See *Swedeland*, 16 F.3d at 557–59.

<sup>173</sup> This is the clear contrast between courts taking the Validity Exception Approach and the Per Se Approach. Courts employing the Validity Exception Approach analyze whether the specific relief requested would affect the validity of the sale. Compare that to the flat rules under the Per Se Approach.

1. *Section 363(m)*

In *In re Lloyd*, Faye Lloyd, the debtor, was entitled to a homestead exemption<sup>174</sup> in her chapter 7 case.<sup>175</sup> Lloyd was allowed to select a three-acre parcel out of 113 total acres.<sup>176</sup> After she made the selection, the bankruptcy court approved the sale of the remainder of the property to Lloyd's neighbor.<sup>177</sup> Lloyd appealed the bankruptcy court's approval order but did not request a stay pending appeal of the sale.<sup>178</sup> The district court affirmed the bankruptcy court's ruling.<sup>179</sup> It held that Lloyd's claim was moot because she failed to obtain a stay pending appeal and her neighbor was a bona fide purchaser.<sup>180</sup>

Lloyd then appealed the district court's affirming order, specifically challenging the bankruptcy court's approval of the sale "arguing that the bankruptcy court did not have the right to sever the 'homestead' land or to order the trustee to have it rezoned."<sup>181</sup> The Seventh Circuit affirmed that Lloyd could not recover the land that was already sold.<sup>182</sup> Yet, the court held that Lloyd's appeal was not moot because relief could still be granted through the proceeds of the sale, and further clarified, "Lloyd's inability to recover the land sold did not render the entire appeal moot."<sup>183</sup>

In this case, the court concluded that a redistribution of the proceeds of a sale would not have the effect of undoing the sale.<sup>184</sup> Conversely, recovering property that was already sold to a good faith purchaser *would* undo the sale and therefore any appeal requesting such relief would be moot.<sup>185</sup> But, because the proceeds had not been distributed, it was not inappropriate for the proceeds to

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<sup>174</sup> Bankruptcy exemptions allow debtors to keep certain property that is necessary for the debtor to start fresh. Gary E. Sullivan, *A Fresh Start to Bankruptcy Exemptions*, 2018 BYU L. REV. 335, 337–38 (2018). Homestead exemptions allow the debtor to retain equity in their home dwelling. The specific homestead exemption relevant to this case is the Wisconsin Homestead Exemption. WIS. STAT. § 990.01(13).

<sup>175</sup> *In re Lloyd*, 37 F.3d 271, 272–73 (7th Cir. 1994). Although this is a chapter 7 bankruptcy, the principles apply equally to chapter 11 cases.

<sup>176</sup> *Id.* at 273.

<sup>177</sup> *Id.*

<sup>178</sup> *Id.*

<sup>179</sup> *Id.*

<sup>180</sup> *See id.*

<sup>181</sup> *Id.*

<sup>182</sup> *Id.*

<sup>183</sup> *Id.*

<sup>184</sup> *See id.*

<sup>185</sup> *See id.*

be awarded to Lloyd.<sup>186</sup> On that basis, the Seventh Circuit adopted a contrary position to the Eleventh Circuit, holding that a redistribution of the proceeds of a sale is not an action that affects the validity of the sale.<sup>187</sup>

More recently in *In re Palmer*, the Bankruptcy Court for the District of Utah engaged in a similar determination of whether the relief requested would affect the validity of the sale under subsection 363(m).<sup>188</sup> The court held that the validity of a sale is not affected where “the bona fide purchaser of the [property] will not be disturbed in its ownership.”<sup>189</sup> The appellants in *Palmer* specifically requested that the court void the settlement agreement and order a reevaluation of who should receive the proceeds.<sup>190</sup> Because neither voiding the settlement agreement nor reallocating the proceeds would affect the bona fide purchaser’s ownership of the sold property, the appeal was not moot under subsection 363(m).<sup>191</sup>

## 2. Section 364(e)

In *In re Swedeland Development Group*, Carteret, the prepetition creditor appellant, provided Swedeland, the debtor, with financing for a construction project.<sup>192</sup> As security, “Carteret obtained a first mortgage on Swedeland’s real estate in the Crystal Springs project, personal guarantees from Swedeland’s principals, and a mortgage” on other Swedeland real estate.<sup>193</sup> When Swedeland filed under chapter 11, the bankruptcy court allowed Swedeland to use Carteret’s cash collateral for operating expenses.<sup>194</sup> Swedeland then filed a motion to “obtain working capital and construction financing on a superpriority basis from

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<sup>186</sup> *Id.* This case is significant in that it follows the precedent set by *In re Edwards* to follow the Validity Exception Approach and rejects the Per Se Approach that had been made popular by the decision in *In re Sax*. Compare *In re Edwards*, 962 F.2d 641, 643–44 (7th Cir. 1992), with *In re Sax*, 796 F.2d 994, 997 (7th Cir. 1986).

<sup>187</sup> See Lloyd, 37 F.3d 271. *Contra* Cargill, Inc. v. Charter Int’l Oil Co. (*In re The Charter Co.*), 829 F.2d 1054 (11th Cir. 1987) (holding that the same action, redistributing sale proceeds, did affect the validity of the sale).

<sup>188</sup> *In re Palmer Equip., LLC*, 623 B.R. 804 (Bankr. D. Utah 2020). In this case, the debtor in a chapter 11 case sold certain property that the appellant had a security interest in. The appellant was not given notice of the sale and was not a party to the agreement. Once the appellant learned about the sale, it filed a motion to reconsider, and requested as relief that the settlement agreement be void. The appellants specified that they did not want to unwind the sale, just redetermine exactly to whom the proceeds of the sale should go. *Id.*

<sup>189</sup> *Id.* at 808.

<sup>190</sup> *Id.*

<sup>191</sup> See *id.*

<sup>192</sup> Resol. Tr. Corp. v. Swedeland Dev. Grp. (*In re Swedeland Dev. Grp.*), 16 F.3d 552, 556 (3d Cir. 1994).

<sup>193</sup> *Id.*

<sup>194</sup> *Id.*

Haylex Acquisition Company.”<sup>195</sup> Dismissing Carteret’s objections and request for relief from the automatic stay to foreclose on its mortgage, the bankruptcy court authorized Swedeland’s motion and Haylex disbursed its loan in full.<sup>196</sup> Swedeland also requested superpriority financing, this time from First Fidelity Bank (FFB).<sup>197</sup> The bankruptcy court again approved.<sup>198</sup> However, before FFB could fully disburse its loan, Carteret appealed.<sup>199</sup>

Carteret appealed the orders granting Haylex and FFB superpriority status over Carteret’s claims.<sup>200</sup> In defense, Swedeland claimed that 364(e) moots all appeals in the absence of a stay pending appeal, and because Carteret did not obtain a stay pending appeal the court could not alter the priority of postpetition lenders’ liens.<sup>201</sup> The district court rejected Swedeland’s mootness argument on the grounds that 364(e) expressly provides that some appeals may be permissible in the absence of a stay pending appeal—those that do not affect the validity of the transaction.<sup>202</sup> Swedeland then appealed the district court’s order to the Third Circuit.<sup>203</sup> The Third Circuit also held 364(e) should not be understood to protect a lender with respect to money that has not yet been distributed, as lenders do not need protection for retained funds.<sup>204</sup> However, where relief would impair a security for which a lender bargained, that relief is barred under 364(e).<sup>205</sup> Regarding Carteret’s appeals, 364(e) had no preclusive effect on Carteret’s appeal of FFB’s loan as it had not yet been fully distributed.<sup>206</sup> Conversely, because Haylex had fully distributed its loan, any appeal to redistribute those funds would impair Haylex’s security and was rightfully moot.<sup>207</sup>

In *In re Fontainebleau Las Vegas*, the Statutory Lienholders appealed the bankruptcy court’s approval of certain financing orders that would provide other

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<sup>195</sup> *Id.* at 556–57.

<sup>196</sup> *Id.* at 557.

<sup>197</sup> *Id.*

<sup>198</sup> *Id.*

<sup>199</sup> *Id.*

<sup>200</sup> *Id.*

<sup>201</sup> *See id.*

<sup>202</sup> *Id.* at 557–58.

<sup>203</sup> *Id.* at 558.

<sup>204</sup> *Id.* at 561.

<sup>205</sup> *Id.* at 563.

<sup>206</sup> *See id.* 561–64.

<sup>207</sup> *Id.* at 562–63.

parties with priming liens over the Statutory Lienholders.<sup>208</sup> Icahn Nevada was one of the parties that agreed to provide DIP financing; they did so in exchange for a lien that would prime the other liens on the project.<sup>209</sup> Icahn Nevada claimed that the Statutory Lienholders' appeals were moot under section 364(e) because Icahn Nevada acted in good faith and because the Statutory Lienholders were not granted a stay pending appeal.<sup>210</sup>

The District Court for the Southern District of Florida disagreed and emphasized that section 364(e) "does not preclude reversal but merely limits the effect of a reversal."<sup>211</sup> Although Icahn Nevada, as a good faith lender, would be carved out from any relief granted, that does not make the Statutory Lienholders' appeal statutorily moot.<sup>212</sup> Section 364(e) does not "restrict the Court from reviewing a central question relating to the financing orders: whether the bankruptcy court provided the Statutory Lienholders with adequate protection."<sup>213</sup> If the court concluded that the Statutory Lienholders were not afforded adequate protection, it retained the authority to grant appropriate remedies.<sup>214</sup> Here, the Statutory Lienholders contended that their security interests in the debtors' property had been improperly devalued by the priming liens and, as a result, the final distribution of proceeds from the DIP facility was unlawful.<sup>215</sup> The court saw "no obvious impediment to being able to recover those funds."<sup>216</sup>

Both *Swedeland* and *Fontainebleau* hold that section 364(e) does not preclude reversal or modification of authorizations under section 364, but only limits them.<sup>217</sup> *Swedeland* held where a loan had not yet been distributed, section 364(e) would not apply.<sup>218</sup> And *Fontainebleau* took it one step further in holding

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<sup>208</sup> *Desert Fire Prot. v. Fontainebleau Las Vegas Holdings, LLC (In re Fontainebleau Las Vegas Holdings, LLC)*, 434 B.R. 716, 722 (S.D. Fla. 2010). The Statutory Lienholders were the workers involved in constructing the project. As part of their payment, they were granted liens on the project.

<sup>209</sup> *See id.* at 729–30.

<sup>210</sup> *Id.* at 746.

<sup>211</sup> *Id.* at 746 (quoting 3 COLLIER ON BANKRUPTCY ¶ 364.06 (16th 2023)).

<sup>212</sup> *Id.*

<sup>213</sup> *Id.*

<sup>214</sup> *Id.*

<sup>215</sup> *Id.*

<sup>216</sup> *Id.*

<sup>217</sup> *Resol. Tr. Corp. v. Swedeland Dev. Grp. (In re Swedeland Dev. Grp.)*, 16 F.3d 552, 557–58 (3d Cir. 1994); *Fontainebleau*, 434 B.R. at 746.

<sup>218</sup> *Id.* at 561.

that, where proceeds from a loan were distributed unlawfully, they could be recovered.<sup>219</sup>

These cases applying the Validity Exception Approach interpret the safe harbor provisions as precluding only appeals that affect the validity of the transaction. This interpretation implies that not all appeals will affect the validity of the transaction. Accordingly, these courts analyze the effects of granting the appeal to determine whether the safe harbor provisions should be triggered.

*C. Beyond the Traditional Split: Recent Cases That Have Deviated from the Per Se and Validity Exception Approaches*

The foregoing cases represent the traditional circuit split regarding application of the safe harbor provisions. However, courts on both sides of the split agree that the safe harbor provisions moot certain appeals, regardless of how they define the validity of the transaction.<sup>220</sup> More recently, courts have moved beyond making determinations of mootness, but in opposite directions. The Second Circuit moved beyond mootness by holding that the safe harbor provisions not only moot appeals, but also provide a jurisdictional bar for appellate courts to even hear the appeal.<sup>221</sup> On the other hand, the Seventh Circuit has held that the safe harbor provisions do not implicate mootness at all. Instead, they merely provide a statutory defense to the claims on appeal.<sup>222</sup>

*1. Jurisdictional Bar on Appellate Review*

In the most recent fissure from the traditional split, the Second Circuit began interpreting the safe harbor provisions as jurisdictional bars on appellate courts' authority to hear appeals.<sup>223</sup> The issues arising under Sears' chapter 11 bankruptcy illustrate the effects and consequences of adopting this approach.<sup>224</sup>

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<sup>219</sup> See *Fontainebleau*, 434 B.R. at 746.

<sup>220</sup> *Compare Cargill, Inc. v. Charter Int'l Oil Co. (In re The Charter Co.)*, 829 F.2d 1054, 1056 (11th Cir. 1987) ("Because this provision prevents an appellate court from granting effective relief if a sale is not stayed, the failure to obtain a stay renders the appeal moot."), with *In re Palmer Equip., LLC*, 623 B.R. 804, 808 (Bankr. D. Utah 2020) (discussing whether 363(m)'s protections were implicated, and therefore mooted the appeal).

<sup>221</sup> See *MOAC Mall Holdings, LLC v. Transform Holdco, LLC (In re Sears Holdings Corp.)*, Nos. 20-1846-bk, 20-1953-bk, 2021 U.S. App. LEXIS 37358, at \*8 (2d Cir. Dec. 17, 2021).

<sup>222</sup> *Trinity 83 Dev., LLC v. ColFin Midwest Funding, LLC*, 917 F.3d 599, 602–03 (7th Cir. 2019).

<sup>223</sup> *MOAC*, 2021 U.S. App. LEXIS 37358, at \*8.

<sup>224</sup> See *MOAC Mall Holdings, LLC v. Transform Holdco, LLC*, 598 U.S. 288 (2023).



In *Sears*, the bankruptcy court approved an order giving Transform Holdco designation rights to many of Sears' leases.<sup>225</sup> Sears and Transform chose to designate Sears' lease with Mall of America for assignment to Transform.<sup>226</sup> MOAC Mall Holdings LLC objected to the lease assignment, claiming Transform did not meet the requirements under section 365(b)(3).<sup>227</sup> When the bankruptcy court overruled the objection, MOAC appealed to the district court.<sup>228</sup> After the district court ruled for MOAC, Transform argued that section 363(m) deprived the court of jurisdiction to hear the appeal.<sup>229</sup> Because MOAC did not request a stay pending appeal, the district court agreed that section 363(m) jurisdictionally barred them from hearing MOAC's appeal.<sup>230</sup> The Second Circuit affirmed, stating appellate courts have the jurisdiction to review an issue of good faith only if the order is not stayed.<sup>231</sup>

The Second Circuit's decision represents an extreme version of the traditional Per Se Approach. Instead of claiming the appeal was moot, the district court held that it did not have the jurisdiction to hear such an appeal.<sup>232</sup> This is a profound change. Jurisdiction is a serious question and, unlike statutory mootness, cannot be waived at any point in a case.<sup>233</sup> The consequences of such an extreme interpretation are made clear by *Sears*. MOAC was not granted a stay pending appeal explicitly because Transform agreed it would not make an argument under section 363(m).<sup>234</sup> However, because of the Second Circuit's position that section 363(m) bars the court from having the jurisdiction to hear

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<sup>225</sup> See *MOAC*, 2021 U.S. App. LEXIS 37358, at \*3.

<sup>226</sup> See *MOAC Mall Holdings, LLC v. Transform Holdco, LLC (In re Sears Holdings Corp.)*, 616 B.R. 615, 620 (S.D.N.Y. 2020).

<sup>227</sup> *Id.* This section of the Code provides requirements for adequate assurance of future performance in connection with the assignment of a shopping center lease. 11 U.S.C. § 365(b)(3)(A). MOAC argued that Transform's financial condition and operating performance were not similar to the financial condition and operating performance of the debtor at the time the debtor became the lessee under the lease. *MOAC*, 616 B.R. at 620.

<sup>228</sup> *Id.* at 622.

<sup>229</sup> *Id.* at 623. When the district court ruled in favor of MOAC's appeal, it remanded the case back to the bankruptcy court. However, the day after the district court made its order, Transform submitted a motion arguing that the district court lacked jurisdiction under 363(m). The district court then ruled in favor of Transform, and the case was *not* remanded to the bankruptcy court.

<sup>230</sup> *Id.* at 624.

<sup>231</sup> See *MOAC Mall Holdings, LLC v. Transform Holdco, LLC (In re Sears Holdings Corp.)*, Nos. 20-1846-bk, 20-1953-bk, 2021 U.S. App. LEXIS 37358, at \*9-10 (2d Cir. Dec. 17, 2021).

<sup>232</sup> See *MOAC*, 616 B.R. at 624 ("Because the Second Circuit takes the position that § 363(m) is 'jurisdictional,' neither waiver nor judicial estoppel can be relied on to overcome it.").

<sup>233</sup> See FED. R. CIV. P. 12(h)(3).

<sup>234</sup> See *MOAC*, 616 B.R. at 624.

the appeal, when Transform turned-face and did in fact make an argument under section 363(m), the court had no ability to overrule it.<sup>235</sup>

MOAC appealed the Second Circuit's decision and the Supreme Court granted certiorari.<sup>236</sup> The Court held that section 363(m) does not serve as a jurisdictional bar to appeals as nothing in the statutory construction nor legislative history support such an extreme finding.<sup>237</sup> Additionally, the Court held that MOAC's appeal under section 363(m) was not moot because MOAC merely sought "typical appellate relief: that the Court of Appeals reverse the District Court and that the District Court undo what it has done."<sup>238</sup>

The Court's decision will preclude lower courts from reading the safe harbor provisions as jurisdictional. However, either by choice or a lack of precision, the Court did not provide a clear outline for how the safe harbor provisions should be applied. The Seventh Circuit has also concluded that section 363(m) does not involve a question of mootness or jurisdiction, but, unlike the Supreme Court, it also provides definite guidance on the safe harbor provision's proper application.<sup>239</sup>

## 2. *Statutory Defense*

In *Trinity 83 Dev., LLC v. ColFin Midwest Funding*, ColFin Midwest Funding purchased a mortgage that made it a creditor of Trinity, the debtor. A third-party mortgage servicer later incorrectly recorded the mortgage as being satisfied.<sup>240</sup> Soon after, Trinity stopped paying the mortgage, leading ColFin to initiate the foreclosure process.<sup>241</sup> Trinity filed for bankruptcy and filed an action against ColFin claiming their debt was extinguished.<sup>242</sup> Both the bankruptcy

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<sup>235</sup> *See id.*

<sup>236</sup> *MOAC Mall Holdings, LLC v. Transform Holdco, LLC*, 598 U.S. 288, 294–95 (2023).

<sup>237</sup> *Id.* at 299.

<sup>238</sup> *Id.* at 296 (quoting *Chafin v. Chafin*, 568 U.S. 165, 173 (2013)).

<sup>239</sup> *Trinity 83 Dev., LLC v. ColFin Midwest Funding, LLC*, 917 F.3d 599 (7th Cir. 2019).

<sup>240</sup> *Id.* at 601. ColFin Midwest Funding was relying on Midland Loan Services to collect the loan payments from Trinity. Midland incorrectly recorded a document saying that the loan had been paid off and the mortgage was released. Two years later, over which time Trinity had continued to pay the loan payments, Colfin realized the mistake and canceled Midland's incorrect record. At this point, Trinity realized Midland's mistake and stopped making loan payments. *Id.*

<sup>241</sup> *Id.*

<sup>242</sup> *Id.* Trinity filed for bankruptcy to take advantage of the automatic stay and stop the foreclosure proceedings.

court and district court rejected Trinity's arguments and sided with ColFin.<sup>243</sup> Then, before the Seventh Circuit could hear Trinity's appeal regarding satisfaction of the prepetition loan, the property was sold and the proceeds went to ColFin.<sup>244</sup>

Trinity appealed the sale, requesting the proceeds of the sale as relief.<sup>245</sup> ColFin argued that section 363(m) mooted the appeal because no stay had been granted and Trinity did not contest that ColFin was a good faith purchaser.<sup>246</sup> Furthermore, ColFin relied on the precedent set in *In re River West Plaza*, which held "[section] 363(m) blocks not only a request to upset the sale but also any possibility of ordering the recipient of the sale's proceeds to turn that money over to the bankruptcy estate."<sup>247</sup> This time, the Seventh Circuit disagreed with ColFin's interpretation of section 363(m) and expressly overturned the decision in *River West*.<sup>248</sup> The Seventh Circuit stated:

We now hold 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 . . . . Any other decision in this circuit that treats § 363(m) as making a controversy moot, rather than giving the purchaser or lessee a defense to a request to upset the sale or lease, is disapproved.<sup>249</sup>

This decision presents two major takeaways. First, section 363(m) should only be interpreted as providing a statutory defense—it cannot make claims moot.<sup>250</sup> This is true even when the requested relief on appeal would affect the validity of the transaction.<sup>251</sup> The Seventh Circuit supported this claim by analogizing the safe harbor provisions with the Norris-LaGuardia Act.<sup>252</sup> Like sections 363(m) and 364(e), the Norris-LaGuardia Act forecloses certain relief

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<sup>243</sup> *See id.* The court relied on Illinois precedent which holds "a mistaken release of a mortgage as ineffective between the mortgagor and mortgagee." *Id.* at 603.

<sup>244</sup> *See id.* at 601.

<sup>245</sup> *Id.* at 603.

<sup>246</sup> *See id.* at 601.

<sup>247</sup> *Id.* (citing *In re River West Plaza—Chi., LLC*, 664 F.3d 668 (7th Cir. 2011)).

<sup>248</sup> *Id.* at 603. The court also overturned Part III of *In re Sax*, which was one of the original cases that helped set the precedent for treating all disputes within the scope of 363(m) as moot.

<sup>249</sup> *Id.*

<sup>250</sup> *See id.* at 602–603.

<sup>251</sup> *See id.* at 602 ("That request may be inconsistent with a statute, but a defense to payment concerns the merits, not mootness. Courts do not say, when a defendant wins on the law, that the case is moot.")

<sup>252</sup> *Id.* at 602 (discussing the Norris-LaGuardia Act, 29 U.S.C. § 101, titled "Issuance of restraining orders and injunctions; limitation; public policy").

by limiting the use of injunctions in certain labor disputes.<sup>253</sup> When plaintiffs make the proper showing under the Norris-LaGuardia Act, the appropriate action for courts is to dismiss the suit, not because of mootness but because of the statutory protections enumerated under the Act.<sup>254</sup> Therefore, the Seventh Circuit suggests that the Norris-LaGuardia Act, and the safe harbor provisions, should be understood as providing a statutory defense, and not limiting the jurisdiction of courts to hear certain issues.<sup>255</sup> Second, the Seventh Circuit clarified issues regarding proceeds of the sale by holding unambiguously that redistributing proceeds—as well as other ancillary components of a sale—do not affect the validity of the sale.<sup>256</sup> The court noted that section 363(m) does not address the allocation of proceeds from a sale, and any decisions regarding such are within its discretion.<sup>257</sup>

### III. SOLUTION: CLARITY AND PRECISION

To be effective as safe harbor provisions, sections 363(m) and 364(e) must balance the interests of good faith lenders and purchasers through finality and reliability of the bankruptcy process, with the right of parties to appeal adverse judgments.<sup>258</sup> The sections' construction elucidates how Congress intended to strike the appropriate balance. Sections 363(m) and 364(e) heavily limit the occasions when an appeal may affect the validity of a transaction: requiring that either appellants pay the costly price of obtaining a stay pending appeal, or make a successful showing of a lack of good faith.<sup>259</sup> However, by limiting only those appeals that have an effect on the validity of the transaction, Congress also provides for effective appellate review of issues collateral to the transaction or for matters that will not have the effect of unwinding the transaction.<sup>260</sup> Given

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<sup>253</sup> *Id.*

<sup>254</sup> *Id.*

<sup>255</sup> *Id.*

<sup>256</sup> *Id.* at 602–03. Although the court ultimately ruled that the appeal should be dismissed on the merits, what is important is that they clarified that proceeds are not categorically protected under section 363(m).

<sup>257</sup> *Id.* at 602.

<sup>258</sup> See *Desert Fire Prot. v. Fontainebleau Las Vegas Holdings, LLC (In re Fontainebleau Las Vegas Holdings, LLC)*, 434 B.R. 716, 742 (S.D. Fla. 2010) (making a general statement on these opposing policy perspectives in bankruptcy, but in the context of equitable mootness).

<sup>259</sup> See 11 U.S.C. §§ 363(m), 364(e).

<sup>260</sup> See *Resol. Tr. Corp. v. Swedeland Dev. Grp. (In re Swedeland Dev. Grp.)*, 16 F.3d 552, 557–58 (3d Cir. 1994) (pointing to its plain language, the court concluded that section 364(e) provides for some orders to be subject to reversal or modification). Specifically, where a court can provide effective relief on matters collateral to the transaction, section 364(e) does not apply.

how Congress effectively incorporated and balanced these relevant policy concerns within the statutes, courts should honor the express wording of the statutes. Yet, as the case law illustrates, courts' applications of the safe harbor provisions have been far from systematic.

The following Parts will dissect the ways courts misconstrue the safe harbor provisions and will provide alternative approaches that more effectively carry out the purposes of sections 363(m) and 364(e). Part III.A will examine how courts overbroadly construe which appeals are controlled by these provisions. Part III.B will argue courts should not arbitrarily implicate matters of mootness, or jurisdiction, when the sections merely provide for statutory defenses.

#### A. *Not All Appeals*

Courts in jurisdictions that follow the Per Se Approach commit the most common interpretive error in applying the safe harbor provisions: holding that they limit all appeals of authorizations under sections 363(m) and 364(e).<sup>261</sup> Careful analysis of the statutory construction directly refutes this interpretation. While Per Se jurisdictions provide a strong deference to finality, such a broad application can lead to results at odds with the overarching purposes of reducing risk and encouraging investment.

The text of the safe harbor provisions provides the strongest support against the view that all appeals of good faith transactions should be precluded.<sup>262</sup> The express language of sections 363(m) and 364(e) addresses only reversals or modifications on appeal that affect the validity of the sale or of the credit or

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[T]he district court stated that relief might be granted enjoining Swedeland from utilizing any proceeds of the loans, ordering it to return funds it borrowed, prohibiting First Fidelity from making additional advances, voiding the interest reserves established under the financing orders, voiding Haylex's and First Fidelity's future obligations, granting Carteret relief from the automatic stay, and granting any further relief as may be just and proper.

*Id.* at 558.

<sup>261</sup> See *Cargill, Inc. v. Charter Int'l Oil Co. (In re The Charter Co.)*, 829 F.2d 1054, 1056 (11th Cir. 1987) ("Appellant failed to obtain a stay as required under section 363(m). The bankruptcy court's approval was issued, the assets were transferred, and the sale was completed . . . This renders the appeal in this court, as well as the initial appeal to the district court, moot.").

<sup>262</sup> See 11 U.S.C. §§ 363(m), 364(e).

priority so incurred.<sup>263</sup> If the validity of the transaction is left unaffected, the safe harbor provisions are of no use.<sup>264</sup>

Given this clear statutory direction, the frequency with which courts hold that sections 363(m) and 364(e) govern all appeals—regardless of their effect on the validity of the transaction—is particularly ponderous.<sup>265</sup> The court in *Charter* provided an example of this imprecision by stating that section 363(m) moots all appeals of authorizations under section 363 that are not stayed.<sup>266</sup> Although the court quoted the entire section 363(m) provision in its decision, it still held that 363(m) “states a flat rule governing all appeals.”<sup>267</sup> This interpretation ignores the statute’s express parameter that only appeals that affect the validity of the transaction be limited by the good faith and stay requirements. By following the Per Se Approach, courts effectively render a significant part of the statute meaningless, breaking the commonly accepted canon of surplusage.<sup>268</sup>

Some courts do recognize that overbroad interpretations of the safe harbor provisions cut against express statutory direction. In *Swedeland*, the court acknowledged that the plain language of section 364(e) provides there must be some authorizations under section 364 that are subject to reversal or modification on appeal. The court stated, “it is impossible to conclude that section 364(e) in itself requires that an appeal be dismissed if a stay is not

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<sup>263</sup> *Id.* Both statutes state that reversals and modifications on appeal do not affect the validity of the transaction, unless a stay pending appeal was granted or there is an issue of good faith. The logical corollary is that if the validity of the transaction is affected, there can be no reversal or modification on appeal. Neither statute mentions appeals that do not affect the validity of the transaction, nor any special treatment they should receive by the courts. As such, the safe harbor provisions do not categorically prevent all review. *See id.*

<sup>264</sup> *See id.*

<sup>265</sup> *See, e.g., Parker v. Goodman (In re Parker)*, 499 F.3d 616, 621 (6th Cir. 2007) (“A majority of our sister circuits construe § 363(m) as creating a *per se* rule automatically mootting appeals for failure to obtain a stay of the sale at issue.”). Although some jurisdictions have altered their stance on this position since the ruling in *Parker*, the Per Se Approach remains popular to this day. Given the Supreme Court’s recent resolution of *Sears*, it is difficult to say whether the trend will continue. However, as this Comment argues, the Per Se Approach is unlikely to wane without clear affirmative direction from the Court on how the safe harbor provisions ought to be applied.

<sup>266</sup> *Cargill, Inc. v. Charter Int’l Oil Co. (In re The Charter Co.)*, 829 F.2d 1054, 1056 (11th Cir. 1987) (“Because this provision prevents an appellate court from granting effective relief if a sale is not stayed, the failure to obtain a stay renders the appeal moot.”).

<sup>267</sup> *Id.*

<sup>268</sup> The rule against surplusage holds that courts should avoid interpretations of provisions that in any way render other provisions from the same act superfluous or unnecessary. “Ten states have codified the rule against surplusage, and none have rejected it.” Scott, *supra* note 26, at 365.

obtained.”<sup>269</sup> Indeed, if Congress had intended for the safe harbor provisions to limit all appeals, why include the validity determination at all?<sup>270</sup> Although there is disagreement over Congress’s aptitude to write effective legislation, by choosing to add further complexity to the safe harbor provisions, Congress is heavily indicating some appeals should not be covered under sections 363(m) and 364(e).

In addition to ignoring the clear statutory direction, courts applying the Per Se Approach overlook the underlying policy goal of stimulating investment. These courts frequently cite a deference to finality, an undeniably important characteristic of bankruptcy sales for its ability to foster confidence in the bankruptcy process. However, these courts fail to consider that finality is a means to encourage investors and is not an end in and of itself.<sup>271</sup> An absolute deference to finality, and a neglect of its purpose, can actually lead to unfavorable circumstances for potential lenders or purchasers. This is exactly what happened in *Charter*, when Cargill appealed for a refund of a portion of the sales price.<sup>272</sup> After going through the appropriate and agreed-upon sealed-bidding process, Cargill’s deal to purchase assets from Charter was undermined when the bankruptcy court accepted another bid, made after the final deadline for additional bids.<sup>273</sup> When Cargill sought restitution of the extra \$5 million it had to pay due to the bankruptcy court’s improper actions, the reviewing court held that Cargill was precluded from appealing because of the importance of upholding finality.<sup>274</sup>

The decision in *Charter* reflects a lack of appreciation for why sections 363(m) and 364(e) protect finality.<sup>275</sup> According to the statutory construction and purpose underlying the safe harbor provisions, parties like Cargill are exactly whom the statutes were meant to protect and encourage. Cargill was a

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<sup>269</sup> Resol. Tr. Corp. v. Swedeland Dev. Grp. (*In re Swedeland Dev. Grp.*), 16 F.3d 552, 559 (3d Cir. 1994).

<sup>270</sup> For example, Congress could have easily said, “All appeals of authorizations under 363 or 364, where good faith is not being challenged and the movant fails to attain a stay pending appeal, are moot.” Notably, this requires reducing the complexity of the statutes.

<sup>271</sup> See generally Raykin, *supra* note 39 (discussing the importance of finality in section 363 sales).

<sup>272</sup> Cargill, Inc. v. Charter Int’l Oil Co. (*In re The Charter Co.*), 829 F.2d 1054, 1056 (11th Cir. 1987).

<sup>273</sup> *Id.* at 1055.

<sup>274</sup> See *id.* at 1055–56. Courts seem to forget that the purpose of furthering finality is to encourage investment. Any actions to uphold finality that hurt chances for investment are against the stated purpose of the statutes.

<sup>275</sup> In fact, the ruling in *Charter* altogether neglects to mention the importance of section 363(m) to encouraging investors. The court instead mentions the importance of protecting those who have purchased property of the bankruptcy estate. Ironically, that statement was used to justify mooted Cargill’s appeal to protect the transaction it had bargained for. See *id.* at 1054.

willing, good-faith investor, who had gone through the proper sealed-bidding processes, and was ready to purchase assets of the estate.<sup>276</sup> Further, Cargill explicitly stated that their desire in appealing was not to undo the sale; Cargill wanted to keep the assets they purchased.<sup>277</sup> Potential investors familiar with what happened to Cargill, instead of being encouraged, would become more cautious when considering whether to purchase assets of the estate.

To best effectuate the statutory construction of the safe harbor provisions and their intended purpose, courts should make the required validity determination by analyzing with specificity what is being appealed, and determine whether the validity of the transaction would be affected if the court granted the appeal. By adopting a flat rule approach, courts in *Per Se* jurisdictions ultimately abdicate their responsibility of making this validity determination prescribed for by the statutes.<sup>278</sup> The *Stanford* court did just this when it applied a flat rule and held that the debtor's appeal was automatically moot.<sup>279</sup> Instead, the court should have taken the time to make a determination on whether changing the purchase method from a credit bid to all cash would have affected the validity of the sale. Similarly, the *Verity* court should have considered whether modifying or eliminating the waivers from the DIP financing package would have undermined the validity of the credit or debt so incurred.<sup>280</sup>

The actual ruling in these cases is less relevant than the process taken to reach that conclusion. It may very well be a proper ruling that a post hoc change to a DIP financing agreement through removal of certain waivers does affect the validity of the transaction. But courts should explicitly name and explain the reasoning supporting their determination. By expressly making this validity determination, in addition to upholding the clear statutory direction of the safe harbor provisions and remembering the purpose of their adoption, courts can fulfill their statutory duty, and best effectuate the intended and balanced functions of the safe harbor provisions.

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<sup>276</sup> See *id.* at 1055.

<sup>277</sup> *Id.* at 1056.

<sup>278</sup> See 11 U.S.C. §§ 363(m), 364(e). By providing that reversals and modifications on appeal cannot affect the validity of the transaction, the safe harbor provisions inherently require a determination be made as to whether the appeal will affect the validity of the transaction.

<sup>279</sup> See *Reynolds v. ServisFirst Bank (In re Stanford)*, 17 F.4th 116, 126 (11th Cir. 2021).

<sup>280</sup> See *In re Verity Health Sys. of Cal.*, No. 2:18-cv-10675-RGK, 2019 WL 7997371 (C.D. Cal. Aug. 2, 2019).



*B. Leaving Mootness (and Jurisdiction) out of It*

In conjunction with the first prong—adhering to the express statutory direction of the safe harbor provisions by making the required validity determination—courts should add a second prong to their treatment of the safe harbor provisions: refrain from engaging in unnecessary discussions of mootness. Courts on both sides of the traditional split commonly engage in mootness discussions.<sup>281</sup> Instead, courts should find that cases are moot only when it is impossible for the court to provide a remedy,<sup>282</sup> to the extent “that there is no longer a case or controversy within the scope of Article III.”<sup>283</sup> Sections 363(m) and 364(e) limit the scope of a proper appeal of authorization under sections 363 and 364, but they do not limit a court’s ability to hear appeals and provide relief. Whether a court should provide relief, according to the facts of the case and the controlling law, is a matter separate from the issues of mootness.<sup>284</sup> Therefore, courts should interpret sections 363(m) and 364(e) as providing a statutory defense against certain appeals, and not rendering appeals moot or limiting the jurisdiction of reviewing courts.

The Seventh Circuit formally recognized the safe harbor provisions as merely statutory defenses in *Trinity*, holding that “[a]ny other decision in this circuit that treats § 363(m) as making a controversy moot, rather than giving the purchaser or lessee a defense to a request to upset the sale or lease, is disapproved.”<sup>285</sup> The court rejected the contention that an appeal to redistribute the proceeds of a section 363 sale was moot under section 363(m), even when the appellant failed to obtain a stay pending appeal and was not challenging good faith.<sup>286</sup> It held that an appeal is moot only where it is impossible to grant

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<sup>281</sup> Compare *Verity*, 2019 WL 7997371 at \*5 (“[T]he Court finds that the elements of § 364(e) have been satisfied. The Appeal is moot under § 364(e.”), with *In re Palmer Equip., LLC*, 623 B.R. 804, 808 (Bankr. D. Utah 2020) (“[T]here are at least two courses of action that have been identified by the parties which do not disturb the sale whatsoever and the motion is not moot.”).

<sup>282</sup> *In re UNR Indus., Inc.*, 20 F.3d 766, 768 (7th Cir. 1994) (citing *Church of Scientology of Cal. v. United States*, 506 U.S. 9, 12–13 (1992)) (“Even when it is no longer possible to restore the parties to the positions they used to occupy, the case remains live while ‘a court can fashion some form of meaningful relief.’”).

<sup>283</sup> *UNR Indus.*, 20 F.3d at 768.

<sup>284</sup> See *Trinity 83 Dev., LLC v. ColFin Midwest Funding, LLC*, 917 F.3d 599, 602 (7th Cir. 2019). Recall the court’s example of the Norris-LaGuardia Act, which prohibits the use of injunctions in certain situations. If the Act applies to a request for an injunction, the request and the suit will be dismissed, *but it will not be declared moot*. The safe harbor provisions should be read and applied in the same manner.

<sup>285</sup> *Id.* at 603. Prior decisions in the Seventh Circuit had outlined this approach of not applying mootness to sections 363(m) and 364(e). See *UNR Indus.*, 20 F.3d at 769. However, the court in *Trinity* made an unequivocal decree for all future cases. *Trinity*, 917 F.3d at 602.

<sup>286</sup> See *Trinity*, 917 F.3d at 602–03.

effective relief.<sup>287</sup> Sections 363(m) and 364(e), like many other statutes, foreclose only particular forms of relief.<sup>288</sup> Thus, appeals that are inconsistent with these statutes should be dismissed on the merits. However, a successful statutory defense does not render an underlying appeal moot.<sup>289</sup> Accordingly, although the court denied Trinity's appeal based on the merits, because the court had the ability to redistribute the proceeds, the appeal could not be moot.<sup>290</sup>

This approach by the Seventh Circuit remains the minority position, as most courts still hold that sections 363(m) and 364(e) implicate mootness.<sup>291</sup> The Supreme Court's recent decision provides a step in the right direction, but ultimately stops short of providing full clarity.<sup>292</sup> Critically, the Court shut down the Second Circuit's interpretation of the safe harbor provisions as being jurisdictional.<sup>293</sup> Because the text of section 363(m) lacks the clear jurisdictional language that the Supreme Court's precedent mandates, the Court held—in no ambiguous terms—that section 363(m) is not a jurisdictional provision.<sup>294</sup> Also, the Court found that the mootness argument was invalid because the Court was capable of providing effective relief. It could provide relief by reversing the district court's decision, much like in *Trinity*.<sup>295</sup>

These clarifications from the Supreme Court should direct courts to not implicate mootness or jurisdiction in their dealings with the safe harbor provisions. However, the Court's decision still invites room for error. Nowhere in the Court's decision is there any mention of “statutory mootness.”<sup>296</sup> This is significant because, although the court seemingly precludes all mootness arguments outside of constitutional mootness,<sup>297</sup> it fails to make the connection that section 363(m) does not moot appeals. This lack of precision is exactly why courts have been confused. Furthermore, although the Court recognizes that not all appeals affect the validity of the transaction, it fails to prescribe that courts

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<sup>287</sup> *Id.* at 602.

<sup>288</sup> *Cf., e.g., id.* (analogizing section 363(m) to the Norris-LaGuardia Act).

<sup>289</sup> *Id.* (“Courts do not say, when a defendant wins on the law, that the case is moot.”).

<sup>290</sup> *See id.* at 599.

<sup>291</sup> *See* Kuney & Reno-Demick, *supra* note 12, at 103–05 (discussing the current state of the mootness doctrine within the bankruptcy context, and how the growth of the concept of equitable mootness hints at the Supreme Court's susceptibility to expanding the mootness doctrine even further).

<sup>292</sup> MOAC Mall Holdings, LLC v. Transform Holdco, LLC, 598 U.S. 288 (2023).

<sup>293</sup> *See id.* at 297–99.

<sup>294</sup> *Id.*

<sup>295</sup> *See id.* at 296.

<sup>296</sup> *See generally id.*

<sup>297</sup> *See id.* (assessing the statutory mootness claims under 363(m) with the constitutional mootness standard set in place by *Chafin*).

should make the required validity determination before applying section 363(m). Without explicit direction from the Supreme Court, the problems associated with the varied applications of the safe harbor provisions' plain language are likely to remain. For courts to best effectuate the safe harbor provisions, sections 363(m) and 364(e) should be understood as providing a statutory defense against certain appeals, not rendering appeals moot or limiting the jurisdiction of reviewing courts.

#### CONCLUSION

The safe harbor provisions of sections 363(m) and 364(e) serve a vital bankruptcy function by helping debtors afford the bankruptcy process while also maintaining important business operations. The provisions accomplish this through encouraging investors to transact with the estate by increasing the finality and speed of bankruptcy deals. Without the protection of the safe harbor provisions, good faith purchasers would be hesitant to purchase distressed assets of the estate for fear they may lose the ownership rights they purchased. Lenders, in the inherently risky position of lending to financially unstable debtors, are understandably nervous about not being paid back or losing a priority that was bargained for.

Encouraging investment, albeit an important function, must be balanced with the competing interests of a party's right to challenge adverse decisions. Congress struck this balance through careful and deliberate wording of the safe harbor provisions. Sections 363(m) and 364(e) heavily limit appeals of bankruptcy orders by requiring either an issue of good faith or that the appellant obtain a stay pending appeal. But these requirements are only for appeals that seek to affect the validity of the transaction. Appeals that do not affect the validity of a transaction are excluded from the protection of the safe harbor provisions. Congress encourages investment without completely sacrificing parties' right to effective review by allowing for appeals on matters collateral to the transaction.

Unfortunately, courts have been sloppy in their application of sections 363(m) and 364(e), creating significant precedent that is inconsistent with the statutory construction and express purpose of the safe harbor provisions. First, some jurisdictions apply these sections more broadly than intended by holding that sections 363(m) and 364(e) preclude all appeals where the appellant has not obtained a stay pending appeal. These courts disregard the safe harbor specification of precluding only those appeals that affect the validity of the

transaction. Second, most other courts continue to prop up the safe harbor provisions as implicating mootness or reducing federal court jurisdiction. Yet, these provisions lack any mention of mootness or jurisdiction, and such a reading postulates a greater scope for the provisions than Congress intended.

Courts should follow a two-pronged approach to avoid these errors of interpretation. First, courts must recognize that sections 363(m) and 364(e) are not relevant to all appeals of authorizations under sections 363 and 364. To determine whether sections 363(m) and 364(e) are controlling for a given appeal, a court must determine whether the appeal would affect the validity of the transaction or if it is merely collateral to the transaction. For appeals regarding the proceeds of a bankruptcy sale and other such collateral matters, the safe harbor provisions do not apply and courts should decide the appeals based on their merits. Second, courts should understand the safe harbor provisions as providing a statutory defense against certain appeals and stop implicating matters of mootness and jurisdiction. Appeals that affect the validity of the transaction should be dismissed on the merits, but not held moot or beyond an appellate court's jurisdiction.

The courts' sloppy and imprecise application of sections 363(m) and 364(e) is unfortunate, not least because of how rarely Congress provides such clear and effective direction. The application of these safe harbor provisions is sure to rise, especially with the continuing growth of chapter 11 reorganizations. For this reason, Courts should adopt the two-pronged approach outlined in this Comment to preserve the integrity of bankruptcy appeals while also maintaining the viability of debtors to attract investors.

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