

Supreme Court Ponders Bankruptcy Code's Good-Faith Purchaser Exception

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In *MOAC Mall Holdings LLC v. Transform Holdco LLC (MOAC)*, the Supreme Court will determine whether [Section 363\(m\)](#) of the Bankruptcy Code limits appellate courts' jurisdiction to reverse a sale to an entity that purchased property in good faith during a bankruptcy. *MOAC* also implicates [Section 363\(b\)](#) of the Code, which allows debtors to sell assets prior to or instead of confirming a bankruptcy plan, and [Section 365](#) of the Code, which allows for the assumption and assignment of leases.

This Sidebar proceeds in five sections. First, it introduces Section 363 and the sale process under Section 363(b). Second, it discusses [Section 363\(m\)](#), which limits appellate review of a Section 363(b) sale to a good-faith purchaser, and analyzes how courts interpret this Code provision. Third, it summarizes the factual and procedural history of *MOAC*. Fourth, it recounts the parties' arguments before the Supreme Court. Fifth, it offers considerations for Congress.

Section 363 Overview

Section 363 applies to proceedings under both Chapter 7 of the Bankruptcy Code, in which a debtor seeks a fresh start through liquidation, and Chapter 11, in which a debtor seeks to confirm a reorganization plan. Section 363 is available to both a [trustee](#) in a Chapter 7 bankruptcy—a court-appointed official who administers the debtor's estate to maximize recovery for creditors—and a [debtor-in-possession](#) in a Chapter 11 bankruptcy, who has the [same rights and obligations](#) as a trustee. For convenience, this Sidebar hereinafter refers to the entity availing itself of Section 363 as the “trustee.”

Section 363 empowers a trustee to use, sell, or lease property of the debtor's estate, both in the ordinary course of business and outside the ordinary course of business. Courts have fashioned [two tests](#) to determine whether a transaction is in the ordinary course of business, the “horizontal dimension” test and the “vertical dimension” test, also known as the “creditor's expectation” test. Under the former, the court asks whether the transaction is the type that similar businesses would engage in as ordinary business. Under the latter, the court views the transaction from the perspective of a hypothetical creditor and asks whether the transaction subjects the creditor to different economic risks than the ones he accepted when he initially extended credit.

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Use of estate assets outside the ordinary course of business is governed by [Section 363\(b\)](#), and the use of assets within the ordinary course of business is governed by [Section 363\(c\)](#). The key distinction between these two sections is that the trustee or debtor-in-possession may sell, use, or lease estate property outside the ordinary course of business (1) only after giving notice to several parties with a stake in the bankruptcy, described in greater detail below, and (2) in the event of an objection to the sale, only after a hearing before the bankruptcy court.

In the context of a Chapter 11 bankruptcy, the [Section 363\(b\)](#) process creates an alternative to the standard path to reorganization. Rather than confirming a reorganization plan, [Section 363\(b\)](#) permits debtors to [sell their assets](#) and then proceed to either filing a plan of liquidation or converting their case to Chapter 7.

When the trustee wishes to conduct a sale of estate property under [Section 363\(b\)](#), the trustee must give notice of the proposed sale, leaving an opportunity for objections and for a hearing if there are objections. Under [Section 102\(1\)](#) of the Bankruptcy Code, a court need not hold a hearing absent a request by a party in interest. The notice of a sale must also satisfy [Rule 2002](#) and [Rule 6004](#) of the Federal Rules of Bankruptcy Procedure. Rule 2002 notice must go to several parties in interest, including the debtor; the trustee; all creditors (or, if a creditors' committee has been appointed, that committee); and the U.S. Trustee. Rule 6004(b) requires that parties file objections within seven days before the date set for the proposed action. Both secured creditors and unsecured creditors may object to a proposed sale, though a prospective purchaser may not object. An objection leads to a contested matter under [Rule 9014](#). A contested matter is a [dispute in bankruptcy](#) that requires resolution but does not result in a separate adversary proceeding. In the event of a proposed sale of property free and clear of adverse interests, the trustee must give notice to creditors and begin a contested matter under Rule 9014.

While a court order approving a [Section 363\(b\)](#) sale is not required under the Bankruptcy Code, many sellers and purchasers request a formal hearing and “comfort order” from the bankruptcy court. When determining whether to approve a [Section 363\(b\)](#) sale, courts apply a [business judgment rule](#), considering whether a sound business reason and sound business judgment support the sale.

Section 363(m) and the Good Faith Purchaser

[Section 363\(m\)](#) of the Bankruptcy Code provides that the reversal or modification of a [Section 363\(b\)](#) sale on appeal does not affect the sale's validity to an entity that purchased estate property in good faith. This preservation of the sale applies whether or not such entity knew of a pending appeal, unless the bankruptcy court stayed its authorization of the sale pending appeal.

This restriction on reversing a sale order on appeal [generates a rule of statutory mootness](#). It serves the Bankruptcy Code's [goals of finality](#) and efficiency and encourages participation in bankruptcy sales by protecting good-faith purchasers from a later modification of those sales.

[Section 363\(m\)](#)'s statutory mootness rule does not take effect immediately upon the entry of the order authorizing the sale, however. Rule 6004 [stays the effectiveness](#) of [Section 363\(m\)](#) for fourteen days after entry of the sale order, during which time a litigant may seek a stay pending an appeal of a sale's authorization. If the sale of estate assets has not been stayed, any appeal of that sale [will become moot](#) because the appellate court has no power to provide a remedy under [Section 363\(m\)](#).

History of *MOAC*

The issues in *MOAC* flow from the Chapter 11 bankruptcy of [Sears Holding Corporation](#) (Sears), the parent entity for Sears, Roebuck and Co. Transform Holdco LLC (Transform) is an entity formed by Sears' CEO for purposes of acquiring substantially all of Sears' assets in bankruptcy.

Prior to filing for bankruptcy, Sears had entered into a lease agreement with MOAC to serve as an anchor tenant for a portion of the Mall of America (the MOAC Lease). The United States Bankruptcy Court for the Southern District of New York issued an order (the [Sale Order](#)) approving a [Section 363\(b\)](#) sale of many of Sears' assets to Transform. Although the MOAC Lease was not included in the Sale Order, Transform had acquired as part of the sale the right to select that lease and seek to have it assumed by Sears and assigned to Transform under [Section 365](#) of the Bankruptcy Code, which governs assignments.

Months after the entry of the Sale Order, Transform filed a notice of additional leases for assignment, including the MOAC Lease. The bankruptcy court approved the assignment of the MOAC Lease under Section 365 (the Assignment Order). MOAC moved in bankruptcy court to stay the Assignment Order pending appeal, contending that, under [Section 363\(m\)](#), it needed a stay to protect its right to appellate review. The court denied the stay motion, ruling the Assignment Order was immediately enforceable.

MOAC then appealed, absent the stay, to the U.S. District Court for the Southern District of New York. The district court first vacated the assignment order for failing to meet the requirements of Section 365, but on rehearing the [district court ruled](#) that MOAC's appeal was statutorily moot. The district court reasoned that, under Second Circuit precedent, [Section 363\(m\)](#) is jurisdictional, meaning that absent a stay of a sale order, an appellate court may only review challenges to the "good faith" aspect of a sale, and good faith was not at issue in the appeal. The court ruled that, although the order being challenged was an assignment, it still constituted a "sale" under [Section 363\(m\)](#) because first, it was a transfer of an interest in property for consideration, and second, the order's text repeatedly referenced both Section 363 and Section 365 as providing authority for the assignment. The [Second Circuit affirmed](#) the decision, reasoning that the Assignment Order was integral to the Sale Order.

Arguments before the Supreme Court

The Supreme Court granted MOAC's petition for a writ of certiorari to resolve a [circuit split](#) over whether [Section 363\(m\)](#)'s limitations on judicial relief are jurisdictional and not subject to waiver, estoppel, or forfeiture. The Court also seeks to address whether the statute strips appellate courts of jurisdiction to review an order deemed integral to a sale, even where a court could fashion a remedy that does not affect the validity of the sale. The Court granted leave for the Office of the Solicitor General to participate in oral argument as *amicus curiae*, in support of MOAC.

Petitioner MOAC offers two [alternative arguments](#). First, it contends that Congress [did not clearly state](#) that [Section 363\(m\)](#) is jurisdictional, which the [Supreme Court](#) has on [multiple occasions](#) deemed [necessary for a statute](#) to be jurisdictional. Second, MOAC asserts that, even if [Section 363\(m\)](#) is jurisdictional, the statute [did not bar](#) MOAC's challenge to the Assignment Order, because that would not undermine the validity of the Sale Order.

Respondent Transform [makes two arguments](#) in response. First, it argues that the Court should dismiss the case under the Constitution's [case-or-controversy requirement](#) because [no relief is available](#) to MOAC. Second, it [espouses the positions](#) of the Second Circuit that [Section 363\(m\)](#) applies to the Assignment Order and that the statute is jurisdictional.

MOAC provides the Court with an opportunity to clarify the meaning of [Section 363\(m\)](#) and its limitation on appellate courts' power to review sales under Section 363, along with assignments [under Section 365](#). In particular, the case brings before the Court the question of whether [Section 363\(m\)](#) is jurisdictional. In the Supreme Court's April 2022 decision in *Boechler, PC v. Commission of Internal Revenue* and earlier decisions, the Court has ruled it will treat a statute as jurisdictional if Congress "clearly states" it is jurisdictional. The Court will abide by "traditional tools of statutory construction" to determine whether Congress has made that clear statement.

The distinction between a statute with a jurisdictional rule and a rule that is non-jurisdictional (i.e., a “claim-processing” rule), is critical. Jurisdictional rules [cannot be waived or forfeited](#), they must be raised by courts on their own, and they don’t allow for equitable exceptions. Non-jurisdictional rules must be enforced if properly invoked, but they may be waived or forfeited. Based on how the Court interprets the statute, that ruling could provide Congress with an opportunity to issue a clear statement on whether [Section 363\(m\)](#) is jurisdictional.

Regardless of the outcome, *MOAC* will affect a critical Bankruptcy Code provision. Oral Argument is scheduled for [December 5, 2022](#).

Considerations for Congress

The *MOAC* decision will offer guidance to Congress on how the Court determines a statute to be jurisdictional. Although the Court recently issued *Boechler*, the statute at issue in that case was a time bar, whereas in *MOAC* the Court is interpreting a more substantive provision.

Should Congress agree with the Court’s ruling on the jurisdictional status of [Section 363\(m\)](#), Congress need not take any additional steps. If it disagrees with the ruling, then it may amend [Section 363\(m\)](#) to reflect its position on whether the statute is jurisdictional. The Court’s potential expounding on what constitutes a “clear statement” will be informative for both this and future statutes.

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