

December 8, 2003

Barbara A. Schermerhorn
Clerk

NOT FOR PUBLICATION
**UNITED STATES BANKRUPTCY APPELLATE PANEL
OF THE TENTH CIRCUIT**

United States
Bankruptcy Appellate Panel
of the Tenth Circuit

A True Copy

Barbara Schermerhorn, Clerk

IN RE INVESTMENT COMPANY OF
THE SOUTHWEST, INC.,

Debtor.

BAP No.

NM-03-051

Attested by: *[Signature]*
Deputy Clerk

COMPASS BANK,

Appellant,

v.

INVESTMENT COMPANY OF THE
SOUTHWEST, INC.; FOUR HILLS
ASSOCIATES; and UNITED STATES
TRUSTEE,

Appellees.

Bankr. No. 11-02-17878 SA
Chapter 11

ORDER AND JUDGMENT*

Appeal from the United States Bankruptcy Court
for the District of New Mexico

Before CLARK, BOHANON, and THURMAN, Bankruptcy Judges.

PER CURIAM.

The parties did not request oral argument, and after examining the briefs and appellate record, the Court has determined unanimously that oral argument would not materially assist in the determination of this appeal.¹ The case is therefore ordered submitted without oral argument.

* This order and judgment is not binding precedent, except under the doctrines of law of the case, res judicata, and collateral estoppel. 10th Cir. BAP L.R. 8018-6(a).

¹ Fed. R. Bankr. P. 8012.

Compass Bank (Compass) appeals an Order of the United States Bankruptcy Court for the District of New Mexico granting the debtor's Emergency Motion to Compel Compass to Grant Releases. For the reasons stated below, the bankruptcy court's Order is VACATED.

I. Background

The debtor is a corporation that owns or develops real property. One its primary assets is a parcel of land, which has been divided into 70+ lots, known as "Woodland Hills."

It is undisputed that the debtor owes Compass a debt exceeding \$2 million, and that Compass has security interests in most, if not all, of the debtor's assets. Compass commenced an action against the debtor and its principals in New Mexico state court, seeking to foreclose its security interests against the debtor's property. On August 26, 2002, the state court entered a judgment, finding the debtor to be in default on its debts to Compass exceeding \$2.1 million, plus post-judgment interest and fees (State Court Judgment). The state court ordered Compass's mortgages on eight different categories of properties to be foreclosed. Compass filed its State Court Judgment in several New Mexico counties, thus creating a lien against the properties, including Woodland Hills.

On November 6, 2002, prior to the foreclosure of all of the properties subject to the State Court Judgment, the debtor filed its Chapter 11 petition. Twenty days later, Compass moved for relief from stay (Stay Lift Motion), seeking authorization to "complete the foreclosure sale authorized pursuant to the" State Court Judgment.² The debtor opposed Compass's Stay Lift Motion, claiming that Compass was adequately protected because the debtor had over \$2.5 million in equity in the property securing Compass's liens. Alternatively, the debtor offered to pay Compass adequate protection.

² Stay Lift Motion, *in* Appellant's Appendix at 3.

After an evidentiary hearing on the Stay Lift Motion, the bankruptcy court entered an “Order on Compass Bank’s Motion for Relief from Stay” (Stay Lift Order), ordering the debtor to pay Compass monthly adequate protection of \$15,000, and establishing deadlines for the debtor to file a disclosure statement and plan. In addition, the bankruptcy court stated:

Within 15 days of the date of entry of this Order the Movant and Debtor in Possession shall . . . meet and negotiate reasonably in good faith release prices on all assets secured to Compass Bank, in order to permit liquidation of sufficient assets of the Debtor within a reasonable time frame to pay Compass Bank’s claim. If the parties are unable to arrive at release prices, the Court shall make the decision with respect to release prices.³

The debtor filed a proposed Disclosure Statement and Chapter 11 Plan. The proposed Disclosure Statement stated, in relevant part, that:

Sold at foreclosure, the [Woodland Hills] subdivision would unlikely bring enough to pay any creditor other than Compass. If held by the debtor and liquidated by the debtor over a period of years, the debtor estimates that the Woodland Hills Subdivision will produce sufficient profits to pay all of its debt not otherwise being paid from the proceeds of other collateral.⁴

The Disclosure Statement continues with a description of the treatment of Compass’s claim proposed by the debtor in its Plan:

As each parcel of real property secured to Compass is sold, the principal balance owed on such parcel (the release price) shall be paid to Compass and applied to the total principal balance owed to Compass. The release price for each parcel on which Compass has a first lien (except for liens held by secured creditors in classes 14 or 15) shall be the release price as agreed to by Compass and the debtor or as ordered by the Court. The release price of each parcel as to which Compass lien position [is] inferior to the lien position of any other secured creditor shall be the lesser of a) 10% of the net sales price of the parcel . . . or b) 50% of the net proceeds owing to debtor, calculated after subtracting all costs of sale, closing costs, payment of any superior liens, and the payment of any tax liens held by creditors in Classes 14 and 15.

In lieu of the sale of any parcel, the debtor may tender the release

³ Stay Lift Order ¶ 5, *in* Appellant’s Appendix at 39.

⁴ Disclosure Statement, *in* Appellant’s Appendix at 59.

price assigned to such parcel at any time and be entitled to a release of lien from Compass. If no specific release price has been agreed to by Compass and the debtor or established by Court Order, the release price shall be 10% of the value of the parcel as agreed to by Compass and the debtor or as established by the Court if no value can be agreed upon.

....

Compass Bank shall retain its liens on all assets upon which it had a lien as of the filing date of the petition herein, until such asset is sold or until the release price of any such asset is tendered to Compass, or until Compass is fully paid.⁵

This same language is contained in the debtor's proposed Plan.

Compass objected to the debtor's proposed Disclosure Statement, stating:

DIP's Disclosure Statement further contemplates that DIP would establish release prices associated with each parcel of collateral that Compass Bank presumably would receive only the release amount in connection with the sale of the parcel. Compass Bank's judgment has been foreclosed and its lien extends against all property of the DIP. Further, to the extent that funds in excess of the release prices are not paid to Compass but are instead distributed to other creditors, or to principals of DIP, the Disclosure Statement fails to disclose that such a provision violates the absolute priority rule under which the junior classes receive distributions while senior creditors remain unpaid. Since Compass' judgment lien cannot be set aside, to provide less than full payment to Compass from the sales of real property, in effect, sets aside the Compass judgment and releases real property from the operation of the judgment. There is no information contained in the Plan or the Disclosure Statement as to why any funds would need to be retained by DIP if real estate commissions, taxes and other expenses are paid from the sale of real property, and if the DIP is selling real property and not developing real property. In short, the Disclosure Statement provides absolutely no financial plan whatsoever with which a creditor can make any assessment as to the viability of the Plan.⁶

After filing its Disclosure Statement and Plan, the debtor filed a "Motion to Compel Compliance with Court Order to Set Release Prices, and for Expedited Hearing" (First Motion to Compel). In this First Motion to Compel, the debtor stated that it could not easily market its properties for sale without knowing the

⁵ Id. at 61-2.

⁶ Compass's Objection to Disclosure Statement, *in* Appellant's Appendix at 69-70.

price and terms requested to “release the various properties from the lien of Compass Bank.”⁷ The debtor represented that Compass had refused to negotiate these “release prices” as required by the Stay Lift Order, and proposed release prices for each of its properties. The debtor assigned a release price for Woodland Hills at \$14,000 per lot. It also stated that it was marketing and planning to sell the various properties in the ordinary course of its business and, therefore, court approval of the sales was not anticipated.

Compass responded to the First Motion to Compel, stating that it did not agree with the debtor’s proposed release prices. Rather, the proper release prices, Compass argued, should be the appraisal prices stated at the hearing on the Stay Lift Motion. It concluded:

Compass Bank requests the Court to order release prices as the appraisal price of each tract as the minimum amount for sale, with all excess funds for tracts secured to Compass Bank to be paid to Compass Bank with such excess funds to be charged first to interest and then to principal.⁸

A preliminary hearing was held on the First Motion to Compel. Prior to a final hearing, however, the debtor filed its “Emergency Motion to Compel Compass to Grant Releases and for Expedited Hearing” (Second Motion to Compel), arguing that it could not wait until a final hearing on the First Motion to Compel to determine the release prices. It represented that it had cash buyers for three of the Woodland Hills lots, and a buyer who wished to purchase another lot on credit terms, at prices ranging from \$28,000 to \$32,000 per lot. It then represented that: “Compass Bank has refused to issue a release of its mortgage and judgment unless it is paid not less than 90% of the net sales proceeds of the cash sale. It has refused to issue releases at all for any extended term contract

⁷ First Motion to Compel, *in* Appellant’s Appendix at 77.

⁸ Response, *in* Appellant’s Appendix at 86.

sales.”⁹ The debtor concluded: “[T]he debtor prays for an emergency hearing to be held upon this Motion, and for the Order of this Court requiring Compass Bank to grant releases of the three lots which are the subject of the pending sales for a principal reduction release price of \$14,000 per lot.”¹⁰

Compass responded to the Second Motion to Compel, stating:

Compass Bank prays that the [Second Motion to Compel] be granted to extent that the cash sale closing be authorized to move forward with appropriate documentation being provided to the title company from Compass Bank, and that all net proceeds of sale, . . . be held in an interest bearing account pending resolution [of the First Motion to Compel] on May 13, 2003.¹¹

After a hearing, the bankruptcy court entered an order granting the Second Motion to Compel (Preliminary Order). Compass was ordered to issue releases of its lien interests on three Woodland Hills lots in exchange for \$14,000 per lot. On the fourth lot, the one proposed for credit sale, the court stated that the Compass was required to release its lien interest on the lot, but that the releases would not be delivered to the purchaser until \$14,000 was delivered to Compass (which was to take place within six months of the closing). All sale proceeds exceeding the \$14,000 per lot were to be held by the debtor’s attorney in trust pending the further order. The court stated that the trust funds could be used as adequate protection payments to Compass.

A final hearing was later held on the First Motion to Compel or, perhaps, the Second Motion to Compel. Oral testimony and exhibits were presented. At the close of the hearing, the bankruptcy court requested the parties to submit charts identifying the real properties in question, the debt secured by the properties and the proposed release prices.

⁹ Second Motion to Compel, *in* Appellant’s Appendix at 98.

¹⁰ Id.

¹¹ Response, *in* Appellant’s Appendix at 105.

Based on the evidence and the post-hearing charts, the bankruptcy court issued a “Ruling on Debtor’s Emergency Motion to Compel Compass to Grant Releases and for Expedited Hearing” (Release Order). In the Release Order, the bankruptcy court set release prices for each parcel of real property owned by the debtor, including the Woodland Hills lots dealt with in the Preliminary Order. Compass was ordered to release its encumbrances on any Woodland Hills lot sold by the debtor upon payment of \$14,865. The bankruptcy court made clear that the debtor was entitled to keep whatever excess sale proceeds existed after paying Compass the release price and any costs of sale. The court also stated:

In setting these release prices, the Court has taken into consideration the following: once the Bank is receiving adequate protection for its secured interests, the Debtor-in possession should be free to use all the estate assets (including encumbered properties) as it deems best for the estate (consistent with its fiduciary obligations to the creditors and parties in interest); while the Debtor provided testimony about categories of expenses that the estate is incurring in operating and reorganizing, there was no testimony about the size of those expenses; contrary to the Bank’s assertions, there is nothing in the Code or other applicable law that says that a secured claim must be paid before⁸ the estate or even unsecured creditors can receive a distribution from the proceeds of collateral in which the Bank holds an interest – *that is, not only can the estate or other creditors be paid pari passu with the secured creditor, but indeed in some circumstances the proceeds of the secured creditor’s collateral could be distributed entirely to parties other than the secured creditor, even without the secured creditor’s consent, as long as the secured creditor’s interest is “adequately protected”*; and by loaning to a borrower at any time, any lender takes on the risk that the borrower will file for Bankruptcy Code protection and thereby in effect modify the terms of the loan and the use of the collateral for months or years beyond what the parties originally contemplated.

⁸ Generally secured claims must be satisfied in full or to the extent of the collateral “before” the unsecured creditors receive a distribution, but in this sense, the term “before” is not used in its chronological sense but instead in the sense of a condition to the unsecured creditors receiving payment.

These release prices should provide the Debtor with sufficient incentive to dispose of the real property in order to continue its development efforts and to ensure that it has no excuse whatever for failing to make a monthly adequate protection payment. They also amply protect the Bank’s interest, and, in light of the estimate that it will take about seven years to sell out Woodland Hills, leave the estate to derive the large equity it anticipates from that project after

the Bank has been paid in full.

The Court acknowledges the uncertainty inherent in setting prices based on appraisals and other estimates of present and future market value, even when done at the request of the parties. For that reason, this order is entered without prejudice to either party seeking modifications to this order or, for that matter, to the order arising from the Bank's motion for stay relief, and specifically the \$15,000 per month adequate protection payment if there is a substantial reduction in the debt owed to the Bank.¹²

Compass appealed the Release Order.

II. Appellate Jurisdiction

The jurisdiction of this Court requires a timely filed notice of appeal from a final order of the bankruptcy court, or with leave of court, from a bankruptcy court's interlocutory order, and the consent of all parties to our jurisdiction.¹³ We have jurisdiction over Compass's appeal. Compass timely filed its Notice of Appeal from the Release Order, and the parties have consented to this Court's jurisdiction because they have not elected to have the appeal heard by the United States District Court for the District of New Mexico.¹⁴ For the reasons stated below, the Release Order is a final order over which we have jurisdiction.¹⁵ Alternatively, even if the Release Order is not a final order, we will treat Compass's Notice of Appeal as a petition for writ of mandamus pursuant to 28 U.S.C. § 1651(a) and grant the petition.

A final order traditionally is one that "ends the litigation on the merits and leaves nothing for the court to do but execute the judgment."¹⁶ The Release Order was entered by the bankruptcy court without prejudice, thus allowing the

¹² Release Order, *in* Appellant's Appendix at 122-24 (emphasis added).

¹³ 28 U.S.C. § 158(a) & (c); Fed. R. Bankr. P. 8001(e) & 8002(a).

¹⁴ 28 U.S.C. § 158(c); Fed. R. Bankr. P. 8001(e) & 8002(a).

¹⁵ 28 U.S.C. § 158(a)(1).

¹⁶ Van Cauwenberghe v. Biard, 486 U.S. 517, 521 (1988) (quoting Catlin v. United States, 324 U.S. 229, 233 (1945)).

parties to seek reconsideration of the release prices or adequate protection set therein. While this provision makes the finality of the Release Order questionable under the traditional test set forth above, we conclude that it is “final” under the collateral order doctrine because the Release Order conclusively determines how Compass’s claim will be treated in the debtor’s case, resolves an issue completely separate from the amount of the release prices (*i.e.*, the debtor’s right to sell property free and clear of Compass’s lien interests), and is effectively unreviewable on appeal from a final judgment.¹⁷ As discussed below, Compass’s rights to meaningfully participate in the debtor’s Chapter 11 case will be “irretrievably lost in the absence of an immediate appeal.”¹⁸ Thus, the Release Order is a final order over which we have jurisdiction.

Even if the Release Order is not a final order, we will treat Compass’s Notice of Appeal as a petition for writ of mandamus and grant the petition. Here, such a drastic remedy is necessary because, as discussed below, the bankruptcy court lacked authority to enter the Release Order.¹⁹ Several grounds favoring the mandamus relief are present in this case: if the Release Order is not a final order, Compass has no other adequate means to secure relief inasmuch as the grounds for granting leave to appeal an interlocutory order under 28 U.S.C. § 158(a)(3) are not present in this case; Compass will be damaged if it cannot proceed; and, as discussed below, the bankruptcy court lacked authority to enter the Release

¹⁷ Coopers & Lybrand v. Livesay, 437 U.S. 463, 468 (1978); *see* Digital Equipment Corp. v. Desktop Direct, Inc., 511 U.S. 863 (1994); Cohen v. Beneficial Indus. Loan Corp., 337 U.S. 541 (1949).

¹⁸ Magic Circle Energy 1981-A Drilling Program v. Lindsey (In re Magic Circle Energy Corp.), 889 F.2d 950, 954 (10th Cir. 1989).

¹⁹ *See, e.g.*, Dalton v. United States (In re Dalton), 733 F.2d 710, 716 (10th Cir. 1984) (petition granted when inferior court acted wholly without jurisdiction or clearly abused discretion or usurped its power); *see also* Mallard v. United States Dist. Court, 490 U.S. 296, 308 (1989) (writ of mandamus is used to aid an appellate court “to confine an inferior court to a lawful exercise of its prescribed jurisdiction”).

Order.²⁰

III. Discussion

Compass claims that the bankruptcy court erred in entering the Release Order. We agree, and hereby vacate the Release Order because the bankruptcy court lacked authority to enter it. Our decision is based on two points: the Release Order approves the sale of property of the estate free and clear of Compass's undisputed lien interests therein without satisfying 11 U.S.C. § 363(f),²¹ and it establishes the debtor's treatment of Compass's claim without affording it the protections of the Chapter 11 plan confirmation process. Each point is discussed below.

The Release Order authorizes the debtor to sell the Woodland Hills lots described in its Second Motion to Compel (Known Lots) and other Woodland Hills lots, the exact ones being unknown (Unknown Lots), free and clear of Compass's undisputed lien interests therein. In bankruptcy, all sales free and clear of a lien interest must comply with § 363(f), which states:

(f) The trustee may sell property under subsection (b) [non-ordinary course of business sales] or (c) [ordinary course of business sales] of this section free and clear of any interest in such property of an entity other than the estate, *only if*—

- (1) applicable nonbankruptcy law permits sale of such property . . . ;
- (2) such entity consents;
- (3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property;
- (4) such interest is in bona fide dispute; or
- (5) such entity could be compelled, in a legal or equitable

²⁰ See, e.g., Pacificare v. Burrage, 59 F.3d 151, 153 (10th Cir. 1995).

²¹ All future statutory references are to title 11 of the United States Code.

proceeding, to accept a money satisfaction of such interest.²²

Outside of the confirmation of a Chapter 11 plan of reorganization, this section, which is applicable to debtors in possession as well as to trustees,²³ is the sole authority for the sale of property of the estate free and clear of liens, whether such a sale is in the ordinary course of the debtor's business or not.²⁴ The record, however, shows that § 363(f) was not pled, argued or considered in conjunction with the bankruptcy court's entry of the Release Order. Examination of the relief granted makes apparent that the Release Order was entered in violation of § 363(f).

Section 363(f) expressly states that a free and clear sale may only occur if a showing thereunder is made in connection with a particular property. The Release Order, however, authorizes the debtor's future sale of the Unknown Lots free and clear of Compass's interests. Such relief is not permitted under § 363(f).

Even if the Release Order could be limited to authorizing the sale of the Known Lots free and clear of Compass's interests therein, such authorization should not have been granted under § 363(f). Section 363(f) expressly requires that the debtor show that at least one of its subsections has been met prior to a sale free and clear interests. The only subsections that could conceivably apply to the Known Lots are § 363(f)(1) and (f)(5). However, review of both subsections shows that neither is applicable.

Section 363(f)(1) states that property of the estate may be sold free and clear of any interest only if applicable law allows such a sale. We are unaware of

²² 11 U.S.C. § 363(f) (emphasis added).

²³ Id. § 1107(a).

²⁴ The debtor assumes that its sale of Woodland Hills lots is in the ordinary course of its business. We question this assumption given the fact that Woodland Hills is undisputably the debtor's primary asset. This issue was not addressed by the parties, and we need not address it here because in setting release prices, the bankruptcy court did not comply with § 363(f).

any nonbankruptcy law allowing the sale of real property securing a lien to be sold free and clear of that lien in exchange for the lien holder's payment of less than all of the net sale proceeds. Thus, the debtor's proposed sale of the Known Lots could not have been approved under § 363(f)(1).

Section 363(f)(5) states that property of the estate may be sold free and clear of any interest only if the interest holder could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of its interest. Discussing real property sales under § 363(f)(5), Collier on Bankruptcy states:

[B]ecause a lien on real estate continues into the hands of a buyer, it appears that a trustee should not be able to sell real estate free of a lien unless the trustee can assert a basis for finding a money satisfaction or one of the other grounds of section 363(f) [i.e., §363(f)(1)-(4)] is satisfied.

Cram down under chapter 11 has been suggested as a means by which an entity could be compelled to accept a money satisfaction. If the holder of a lien could be compelled in a cram down to accept less than full satisfaction, some courts have held that the holder may be compelled to accept such satisfaction under § 365(f)(5). . . . This approach makes sense, assuring the lien or interest holder the distribution that it could reasonably expect upon the resolution of the bankruptcy case.²⁵

There is nothing in the Release Order or the record establishing that this application of § 363(f)(5) was utilized by the bankruptcy court. We therefore will not speculate as to whether it can be applied to a § 363(f)(5) sale, and whether it was done in this case. Outside of applying such a procedure, § 363(f)(5) does not apply to the sale of the Known Lots free and clear of Compass's interests.

In addition to violating § 363(f), the Release Order should be vacated because it establishes the debtor's treatment of Compass's claim without affording Compass the protections of the plan confirmation process to which it is entitled under Chapter 11. As a secured creditor whose claim appears to be impaired, Compass has the right to vote on a plan, which in the debtor-real estate

²⁵ 3 Collier on Bankruptcy ¶ 363.06[6][a] (15th ed. rev. 1998) (footnotes omitted).

developer's case--would deal exclusively with the debtor's use of Compass's collateral.²⁶ The debtor's proposed plan could only be approved as to Compass's dissenting vote if it was fair and equitable under § 1129(b)(1)-(2)(A). The context in which the Release Order was made essentially precludes any meaningful application of the cram down provisions of § 1129(b).

IV. Conclusion

For the reasons stated herein, the bankruptcy court's Release Order is VACATED.

²⁶ 11 U.S.C. § 1129(a)(7)-(8).