AMERICAN BANKRUPTCY INSTITUTE
JOURNAL
The Essential Resource for Today's Busy Insolvency Professional

On the Edge

By Richard E. Mikels and Adrienne K. Walker

Revel: To Stay or Not to Stay? Third Circuit Reveals the Answer

Richard E. Mikels
Mintz, Levin, Cohn, Ferris, Glovsky and Popeo, PC; Boston

Adrienne K. Walker
Mintz, Levin, Cohn, Ferris, Glovsky and Popeo, PC; Boston

Rick Mikels is chair and Adrienne Walker is a member of Mintz, Levin, Cohn, Ferris, Glovsky and Popeo, PC's Bankruptcy, Restructuring and Commercial Law Practice in Boston.

On Sept. 30, 2015, the Third Circuit Court of Appeals in *In re Revel AC Inc.*[1] issued a decision of significance to federal jurisprudence and bankruptcy practice. Hon. Thomas L. Ambro delivered the court's opinion, reversing the bankruptcy court's decision to deny a tenant a stay of a sale order pending appeal. Absent a stay of the sale order, the sale would close free and clear of the tenant's possessory rights in its leasehold interest. The court determined that the tenant had sufficiently satisfied a sliding-scale approach to balancing the traditional four stay factors. The decision is especially relevant considering the current trend of using chapter 11 to accomplish sales of substantially all of the assets of an enterprise.

The *Revel* decision arose in the context of a serial chapter 11 filing by casino operator Revel AC Inc. and its affiliates (collectively, "Revel"). The latest proceeding involved Revel's strategy to sell its property free and clear of interests under § 363, including, among the interests, the possessory rights of tenant IDEA Boardwalk LLC.[2]

The underlying issue in the bankruptcy court was whether the possessory interest of a tenant may be extinguished by a § 363 sale. Under § 365(h), a tenant of a rejected real estate lease has the option to (1) treat the lease as terminated and file its claim as a general unsecured claim against the estate, or (2) retain its possessory rights for the balance of the lease term and any extensions.[3] However, § 363(f) permits an asset sale free and clear of interests if certain conditions are met. There is a split in authority as to whether a sale pursuant to § 363(f) may eliminate a tenant's possessory rights under § 365(h).[4] While this issue was key to the case in bankruptcy court, the circuit court felt that it did not have to reach the issue on appeal because another issue was conclusive on the stay decision.

In *Revel*, the primary issue related to § 363(f)(4), which allows a sale free and clear of an interest if that interest (in this case, the existence of a true lease to which § 365(h) could apply) is in *bona fide* dispute. Section 363(f) permits a sale free and clear of any interests in such property if one of the five tests are met, including that the interest is in *bona fide* dispute. Accordingly, if there was no *bona fide* dispute as to nature of the tenant's possessory right, there could be no sale free and clear of IDEA's interests.

How can a tenant like IDEA protect its possessory rights if the bankruptcy court allows a sale free and clear of its interests? The answer is often that they cannot because, in an effort to provide certainty for a bankruptcy sale process, § 363(m) provides that the validity of a good-faith purchaser's sale will not be affected on appeal, unless the sale is stayed pending appeal. Thus, even if a tenant has legitimate grounds to retain its possessory rights, it loses those rights if it is not able to obtain a stay pending appeal. In the *Revel* case, IDEA would lose the right to ever argue that its possessory rights should not be cut off by a § 363 sale, unless it obtained a stay pending appeal.

Knowing that its right to possess would be eliminated (and it would have lost the value of its $16 million investment for tenant improvements) upon the sale closing, IDEA requested a stay pending appeal, which the bankruptcy court denied. The bankruptcy court held that Revel met its burden of

1 *In re Revel AC Inc.*, 802 F.3d 558 (3d Cir. 2015).
2 Before the bankruptcy case, IDEA entered into a 10-year lease with Revel, with a 15-year renewal option. In addition, the lease required IDEA to expend $16 million on improvements to the space.
3 11 U.S.C. § 365(h).
4 *Compare In re Haskell LP*, 321 B.R. 1 (Bankr. D. Mass. 2005) (discussing circuit split and denying § 363 sale in part because tenant "[could not] be compelled to accept money for its rejected leased under § 363(f)(5) in view of the provisions of § 365(h)"), *with Precision Indus. Inc. v. Qualitech Steel SBQ LLC*, 327 F.3d 537 (7th Cir. 2003) (§ 365(h) does not disable § 363(f)'s authority to sell property free and clear, but is only triggered by lease rejection).

establishing that there was a *bona fide* dispute with IDEA as to the characterization of the lease (whether it was a true lease to which § 365(h) would apply). However, the court conceded that while time was of the essence, "[Revel] didn't give me any of the leases ... or any, really, evidence in support of its position of the *bona fide* dispute."[5] Despite limited evidence, the bankruptcy court approved the sale free and clear of IDEA's possessory interest and denied IDEA's request for a stay pending appeal. The district court also denied the stay pending appeal, reasoning in part that IDEA did not make a substantial showing of likely success on the merits of § 363(h).[6]

On further appeal, the Third Circuit provided a tutorial on the application of the traditional four factors at issue for obtaining a stay pending appeal. Since a party's rights may be dramatically affected if no stay is granted, the standard for obtaining a stay pending appeal is critical. While the decision represents the law in the Third Circuit, it will likely have an influence in other circuits, even though the dissenting opinion strongly disagrees with the approach taken by the majority. Rather than requiring that all four factors favor the movant, as would be required by the dissent, the Third Circuit recognized a "sliding-scale approach to balancing the stay factors."[7] The court explained that the traditional standards for granting a stay pending appeal are:

> whether the stay applicant has made a strong showing that [it] is likely to succeed on the merits; (2) whether the applicant will be irreparably injured absent a stay; (3) whether issuance of the stay will substantially injure the other parties interested in the proceedings; and (4) where the public interest lies.[8]

The court held that the most critical factor is likelihood of success, with irreparable harm to the applicant next important.[9] For the first factor, the court recognized that the law varies widely; some courts require "more likely to succeed than fail," while others require a "substantial possibility, although less than a likelihood, of success."[10] The court then rejected the district court's analysis that no stay was warranted because IDEA did not show a "substantial" or "strong" chance of success.[11] The court explained that the first factor requires "a sufficient degree of success for a strong showing exists if there is 'a reasonable chance, or probability, of winning.'"[12]

With respect to the second factor (irreparable injury), the court held that the applicant must "demonstrate that irreparable injury is *likely* [not merely possible] in the absence of [a stay]."[13] In this context, the Third Circuit recognized that "likely" means "more apt to occur than not."[14]

If these two factors are met, a court should consider whether there may be irreparable harm to the stay opponent, which is a factually dependent test. In considering the fourth factor (public interest), a court should evaluate the consequences of the stay beyond the immediate parties.

The efficiency of sales is a very important policy of the Bankruptcy Code.... *Revel* provides a better opportunity for aggrieved parties to realize the benefits of the stay exception to the finality otherwise imposed by § 363(m).

While the court recognized that the first two factors are most critical, it endorsed a "sliding-scale" approach to all four interconnected factors. The court summed up its reasoning with the following flow chart:[15]

- Did the applicant make a sufficient showing that (a) it can win on the merits (significantly better than negligible but not greater than 50 [percent]) *and* (b) [it] will suffer irreparable harm absent a stay?
- If it has, the court must "balance the relative harms considering all four factors using a 'sliding scale' approach.
- If the applicant does not make the requisite showings on either of the [first] two factors, the ... inquiry into the balance of harms [and the public interest] is unnecessary, and the stay should be denied without further analysis."
- If the movant makes a strong showing on the merits, a stay is permissible even if the balance of harms and public interest weigh against finding a stay pending appeal.

The court recognized that when the test is applied, the strength of the first factor (likelihood of success on the merits) differs depending on the balance of the other factors. Thus, the more strongly the other three factors weigh toward denying the stay, the stronger the showing the likelihood of success must be. Conversely, if the other three factors strongly favor the applicant, the bar would be lower for the first factor to justify the issuance of the stay.[16]

The court began its application of the test in *Revel* by starting with the second, third and fourth factors. On the issue of irreparable harm (the second factor), the court acknowledged that if adequate relief could be granted at the end of a successful appeal, this factor would not have been met. However, in *Revel*, if a stay had not been granted, IDEA would have lost its possessory interest under § 363(m) and its investment of $16 million in tenant improvements. The court found that any future damage awards against Revel would not be adequate because the potential economic loss would threaten the very existence of IDEA's business.

On the issue of the balancing of the harm (the third factor), the court held that Revel had not produced sufficient evidence of harm. The harm to Revel (the loss of the sale) was deemed speculative compared to the harm to IDEA (the certainty of the loss of its business).

5 *In re Revel AC Inc.*, 802 F.3d at 564 (citation omitted).
6 *In re Revel AC Inc.*, 525 B.R. 12, 24 (D.N.J. 2015).
7 *In re Revel AC Inc.*, 802 F.3d at 567-68.
8 *Id.* at 568 (citation omitted).
9 *Id.* (citing *Nken v. Holder*, 556 U.S. 418, 434 (2009)).
10 *Id.* at 568 (citing *Abdul Wali v. Coughlin*, 754 F.2d 1015, 1026 (2d Cir. 1985) (more likely to succeed than fail); *Dubose v. Pierce*, 761 F.2d 913, 920 (2d Cir. 1985) (substantial possibility, although less than a likelihood, of success)).
11 *Id.* at 575-76.
12 *Id.* at 568-69 (citing *Singer Mgmt. Consultants Inc. v. Milgram*, 650 F.3d 223, 229 (3d Cir. 2011)).
13 *Id.* at 569 (citing *Winter v. Natural Res. Def. Council Inc.*, 555 U.S. 7, 22 (2008) (emphasis in text)).
14 *Id.* (citing *Michigan v. U.S. Army Corps of Engineers*, 667 F.3d 765, 788 (7th Cir. 2011) (holding that for harm to be likely "there must be more than a mere possibility that harm will come to pass ... but the alleged harm need not be occurring or be certain before a court may grant relief") (citation omitted)).
15 *Id.* at 571.
16 *Id.* at 570.

The court then considered public interest (the fourth factor). On the one hand, even with little evidence, the court recognized that jobs were at stake and considered the benefits that a sale would help the general economic malaise of Atlantic City, N.J. On the other hand, the court considered that the public has a stake in protecting tenants' rights and in the correct application of the Bankruptcy Code. On balance, the court felt that this factor tipped in Revel's favor.

Most significantly, the court felt that on the issue of likelihood of success (the first factor), victory for IDEA was practically certain. Revel had argued that the lease was not a true lease and that IDEA would not be entitled to the protection of its possessory rights under § 363(h). However, according to the court, the mere assertion that a document may not be a true lease does not make it a *bona fide* dispute under § 363(f)(4). Further, the court was strongly influenced by language in the lease that specifically provided that the document was intended as a lease and that the percentage rent clause was intended as a measurement of adequate rent and not as an indication that the document reflected any other type of relationship. The court found that the assertions of a *bona fide* dispute by Revel were fanciful, if not disingenuous.[17] Thus, the court found that the test of likelihood of success on the merits was not only met, but that IDEA's success on the issue was all but certain.[18]

Conclusion

The *Revel* decision affects bankruptcy practice in many ways, even beyond its obvious implications on federal court practice generally:

- Issuing a stay involves a sliding-scale balancing test, instead of requiring all four factors to be met. This will enhance the likelihood that the applicant for stay of a sale order will receive a stay.
- The decision clarifies that the impact of § 363(m), and its potential to moot an appeal absent a stay, is an issue for courts to consider in evaluating the irreparable harm factor (second factor). This might be very beneficial to stay applicants since courts, such as the district court in *Revel*, did not think that this was an applicable consideration.
- Important bankruptcy policies, such as preserving tenants' rights and proper application of the Bankruptcy Code, are relevant factors to consider in determining the public interest (fourth factor).
- Lastly, language in a document specifying the parties' intent with respect to the nature of that document may be considered in characterizing that document.[19]

The *Revel* ruling will help protect the rights of parties legitimately aggrieved by bankruptcy sale orders. However, the case may also increase the leverage of sale objectors and thereby reduce the efficiency of the current utilization of § 363 sales. The efficiency of sales is a very important policy of the Bankruptcy Code, as evidenced by the existence of § 363(h). However, no one party should inappropriately bear the loss that such a sale might cause. Section 363(m) recognizes the right of an aggrieved party to seek a stay pending appeal when its rights would otherwise be cut off. *Revel* provides a better opportunity for aggrieved parties to realize the benefits of the stay exception to the finality otherwise imposed by § 363(m). It will be interesting to see how this decision affects practice surrounding § 363 sales and other aspects of bankruptcy practice. abi

Reprinted with permission from the ABI Journal, Vol. XXXV, No. 1, January 2016.

17 *Id.* at 574.

18 *Id.* at 574-75.

19 The authors question whether the characterization proposed by self-interested contracting parties should be anywhere near conclusive on a bankruptcy estate where the contract is form over substance. In other words, a small animal that quacks, waddles and swims does not become an elephant just because it serves the interest of two contracting parties to call it an elephant.