

Mooting a Circuit Split

Articles March 5, 2019

A case of interest to those who sell or purchase property in bankruptcy was handed down a few days ago. In *Trinity 83 Development LLC v. ColFin Midwest Funding LLC*, 2019 WL 987902 (7th Cir. March 1, 2019), the Court of Appeals for the Seventh Circuit overturned prior precedent by ruling that 11 U.S.C. § 363(m) does not moot appeals from sale orders. A panel of the Court had previously decided *In re Sax*, 796 F.2d 994 (7th Cir. 1986), which stood for the proposition that any dispute that fell within the scope of § 363(m) was moot. More recently in *In re River West Plaza-Chicago, LLC*, 664 F.3d 668 (7th Cir. 2011), § 363(m) was determined to prevent efforts to set aside the sale and, relying on *Sax*, to prohibit the court from putting the sale proceeds back into the estate. Because *Trinity 83 Development LLC* was also a panel decision, its author, Judge Easterbrook, circulated the opinion to all active circuit judges but none asked for *en banc* review.

Trinity 83 Development LLC involved a situation where, prepetition, a mortgagee erroneously satisfied a mortgage and when the mistake came to light, was corrected. The Court of Appeals described the facts as follows: In 2006 Trinity 83 Development borrowed about \$2 million from a bank, giving in return a note and a mortgage on certain real property. In 2011 the bank sold the note and mortgage to ColFin Midwest Funding. ColFin relied on Midland Loan Services to collect the payments. In 2013 Midland recorded a document (captioned “satisfaction”) stating that the loan had been paid and the mortgage released. But the loan was still outstanding, and Trinity continued paying. In 2015 ColFin realized Midland’s mistake and recorded a document cancelling the satisfaction. Soon afterward Trinity stopped paying, and ColFin filed a foreclosure action in state court.

Trinity 83 Dev., LLC v. ColFin Midwest Funding, LLC, No. 18-2117, 2019 WL 987902, at *1 (7th Cir. Mar. 1, 2019)

Trinity filed bankruptcy, which stopped the foreclosure. After Trinity filed its bankruptcy, it sued ColFin, arguing that the release extinguished the debt and security interest. The Bankruptcy Judge, later affirmed by the District Court, disagreed, and ruled that the release was a unilateral error that could be rectified unilaterally—and, as no one else had recorded a security interest between those two events, ColFin retained its original rights. ColFin appealed but before the appeal was heard, the property was sold under the bankruptcy court’s auspices. ColFin contended that § 363(m) mooted the appeal.

The Seventh Circuit decided, *inter alia*, that the appeal was not constitutionally moot. Section 363(m), deals with sales orders that have not been stayed and, as there is a live controversy regarding who should get the sales process, does not concern mootness at all. Moreover, § 363(m) “does not say one word about the disposition of the proceeds of a sale or lease. The text is straight-forward: ‘The reversal or modification on appeal of an authorization ... of a sale or lease of property does not affect the validity of a sale or lease ... to an entity that purchased or leased such property in good faith’. What should be done with the proceeds is a subject within the control of the bankruptcy court.” *Trinity 83 Dev., LLC*, supra, 2019 WL 987902, at *2. Thus, the appellate court decided, a bankruptcy court is not prevented from deciding what to do with sales proceeds when its sale order has not been stayed. This ruling brings the Seventh Circuit into line with other courts that have addressed this issue including, as noted by Judge Easterbrook, *In re Hope 7 Monroe Street L.P.*, 743 F.3d 867, 872–73 (D.C. Cir. 2014); *In re ICL Holding Co.*, 802 F.3d 547, 554 (3d Cir. 2015); and *In re Brown*, 851 F.3d 619, 623 (6th Cir. 2017).

For additional information contact Honorable (Ret.) Judith K.Fitzgerald