THE LEASE OF ALL EVILS: HOW A MIDDLE-GROUND APPROACH CAN RESOLVE THE BANKRUPTCY CODE CONFLICT BETWEEN SECTION 363(f) SALES AND SECTION 365(h) LESSEE PROTECTIONS

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ABSTRACT

The Fifth Circuit's recent decision in *In re Royal St. Bistro, LLC* has awakened an unsettled issue in the Bankruptcy Code that has divided the bankruptcy community for over two decades. The question examined by the Fifth Circuit was whether a non-debtor lessee with a right to continued possession through section 365(h) of the Bankruptcy Code loses this right if the debtor-lessor can sell its property "free and clear" under section 363(f). While early decisions held that section 365(h) always protects lessees against debtors' free and clear sales, some subsequent decisions created a circuit split by ruling that section 365(h) is inapplicable to section 363(f) sales.

This Note discusses the relevant statutes, case law, and scholarship addressing the circuit split. Ultimately, this Note proposes that the cases ruling on this issue can be further categorized into a third middle-ground category. Specifically, this Note concludes that section 365(h) presumptively applies when a leasehold interest is present in a bankruptcy case, but a section 363(f) sale can nevertheless strip the leasehold. In such a case, the lessee can request adequate protection of its interest, which may come in the form of continued possession. This Note argues that a proposed middle-ground approach is supported by rules of statutory

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I would like to extend my sincerest gratitude to Professor Susan Block-Lieb for her invaluable expertise, guidance, and feedback. I would also like to thank the editors and staff of the *Journal of Corporate & Financial Law* for their assistance throughout the editing process. I would lastly like to thank my family and friends for their support throughout law school.

construction, balances the rights of both parties, alleviates constitutional concerns, and aligns with the spirit of the Bankruptcy Code.

INTRODUCTION

In *Precision Industries, Inc. v. Qualitech Steel, SBQ, LLC* (hereinafter "Qualitech"), a case of first impression at the circuit level, the Seventh Circuit deviated from a decade of bankruptcy court rulings protecting leasehold interests from free and clear sales.[1] The court was faced with a high-stakes decision about whether a steel mill operator could sell its property free and clear of a supplier's leasehold interest on their warehouse, especially considering that the parties had entered the agreement less than a month before the steel mill filed for bankruptcy and that the supplier had spent resources improving and stocking the warehouse in that time.[2] In an unprecedented ruling, the Seventh Circuit obviated the lessee's possessory interest through the debtor's[3] request for a § 363(f) sale and rejected the notion that the lessee protections in § 365(h) of the Code prevented such an outcome.[4] This Note examines this interplay between § 363(f) and § 365(h) of the Bankruptcy Code to explore the circuit split as to whether a debtor-lessor can sell property

1. *See generally* Precision Indus., Inc. v. Qualitech Steel SBQ, LLC (*Qualitech*), 327 F.3d 537 (7th Cir. 2003).

2. *See Qualitech*, 327 F.3d at 540–41.

3. In this Note, the term "debtor" shall refer to the corporate entity that filed for relief under the Bankruptcy Code.

4. *See Qualitech*, 327 F.3d at 547–48. In this Note, the terms "Bankruptcy Code" or "Code" refers to the Bankruptcy Reform Act of 1978, as amended, which is the current bankruptcy law in the United States and is codified at 11 U.S.C. § 101 et. seq. Furthermore, all section references in this Note are to the Bankruptcy Code.

"free and clear" of a leasehold interest under § 363(f) of the Code, notwithstanding the protections offered to non-debtor lessees under § 365(h).[5]

Courts and commentators have diverged when answering this question over the years.[6] In addressing a debtor's attempt to sell property with a leasehold interest, a majority of courts have ruled that § 365(h) trumps § 363(f) such that the lessee is entitled to continued possession of the leased premises and the debtor may not obviate this possessory right with a § 363(f) sale.[7] On the other hand, a minority of courts have found that § 365(h) is inapplicable to § 363(f) sales and the debtor can use § 363(f) to sell property without providing the lessee with § 365(h) protections.[8] This Note proposes a more desirable middle-ground approach maintaining that § 365(h) presumptively applies when a leasehold is present in a bankruptcy case, but that a § 363(f) sale can nonetheless strip a tenancy if one of § 363(f)'s five conditions is satisfied.[9]

This Note proceeds in three parts. Part I will provide an overview of the Code provisions and case law relevant to the circuit split. Part II will elaborate on the arguments for each side of the split by detailing the various courts' reasonings and notable scholarship. Part III categorizes a few cases as middle-ground and advocates for this middle-ground approach considering canons of statutory interpretation, practical administration of the Code, and sound policy arguments—among other considerations.

I. BACKGROUND

Part I identifies the overarching themes of the Code, the Code provisions relevant to the circuit split, and the notable case law comprising the circuit split.

5. *See* 11 U.S.C. §§ 363(f), (h).

6. *See* Bruce Grohsgal, *Colder than a Landlord's Heart? Reconciling a Debtor's Authority to Sell Property Free and Clear of a Lease Under Bankruptcy Code Section 363(f) with the Tenant's Right to Remain in Possession on a Lease Rejection Under Section 365(h)*, 100 MARQ. L. REV. 295, 299 (2016) (explaining the split).

7. *See, e.g.*, *In re* Taylor, 198 B.R. 142, 167–68 (Bankr. D.S.C. 1996).

8. *See, e.g.*, Qualitech, 327 F.3d 537, 548 (7th Cir. 2003).

9. *See id.* at 701–12.

A. BANKRUPTCY: A BALANCING ACT

The Bankruptcy Code is a multifaceted body of law that strikes a delicate balance between the competing interests of providing relief to insolvent debtors and ensuring fair treatment and maximum recovery for creditors.[10] When a debtor becomes insolvent, fundamentally there are insufficient resources to repay all creditors creating a "common-pool" problem.[11] To prevent creditor frenzy, the Code creates a procedure for the orderly distribution of the debtor's assets through a collective proceeding, wherein the bankruptcy courts must "sort[] the rights of 'owners' (creditors and others with rights against a debtor's assets) and . . . protect against the destructive effects of an individual remedies system where there are not enough assets to go around."[12]

There are two typical results in bankruptcy: liquidation and reorganization.[13] Liquidation involves selling the company's assets to maximize creditor recovery and eventually dissolving the company.[14] Conversely, reorganization allows for the debtor to continue operating the business while providing the debtor with time to engage in a period of debt restructuring, recapitalization, and operative changes.[15] In either result, the Bankruptcy Code facilitates a process where "debtors can reorder their affairs, make peace with their creditors, and [in the context of reorganization,] enjoy 'a new opportunity in life with a clear field for

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10. *See* Bartenwerfer v. Buckley, 598 U.S. 69, 72 (2023); *cf.* Clark v. Rameker, 573 U.S. 122, 129 (2014) (internal citations omitted).

11. *See* Todd J. Zywicki, *Bankruptcy*, ECONLIB, https://www.econlib.org/library/Enc/Bankruptcy.html [https://perma.cc/MZ7L-WG94]. The common-pool problem is generally exemplified by the tragedy of the commons, which refers to a situation in which individuals with access to a common public resource will act in their own interest and ultimately deplete the resource, leading to worse outcomes for all. *See* Alexandra Spiliakos, *Tragedy of the Commons: What It Is and 5 Examples*, HARV. BUS. SCH. ONLINE BUS. INSIGHTS BLOG (Feb. 6, 2019), https://online.hbs.edu/blog/post/tragedy-of-the-commons-impact-on-sustainability-issues [https://perma.cc/527C-4E6J].

12. Thomas H. Jackson, THE LOGIC AND LIMITS OF BANKRUPTCY LAW 20 (Harv. Univ. Press 1986); *see also* Zywicki, *supra* note 13.

13. *See Chapter 7 vs. Chapter 11: What's the Difference?*, BLOOMBERG L. (Feb. 25, 2022), https://pro.bloomberglaw.com/brief/chapter-7-vs-chapter-11-bankruptcy/ [https://perma.cc/Y9SW-CAMG]; David Lee, *Bankruptcy Primer for Sellers of Goods to Debtors* (2010).

14. *See* 6 COLLIER ON BANKRUPTCY ¶¶ 700.01, 700.04 (16th ed. 2023). Liquidation is provided for in Chapter 7 of the Code. *See* 11 U.S.C. §§ 701–84.

15. *See* 6 COLLIER ON BANKRUPTCY ¶ 1100.01. Reorganization is provided for in Chapter 11 of the Code. *See* 11 U.S.C. §§ 1101–95.

future effort, unhampered by the pressure and discouragement of preexisting debt.'"[16]

B. SECTION 365: ASSUMPTION OR REJECTION OF EXECUTORY CONTRACTS

1. *General Overview*

Section 365 provides relief to the debtor by authorizing the debtor[17] to "assume or reject any executory contract or unexpired lease."[18] This provision is a major tool for reshaping the bankruptcy estate because it authorizes the debtor to retain or reject contracts "in order to relieve the estate of burdensome obligations while at the same time providing 'a means whereby a debtor can force others to continue to do business with it when the bankruptcy filing might otherwise make them reluctant to do so.'"[19] When the debtor rejects a contract, § 365(g) states that such a rejection constitutes a pre-petition breach under the lease and that the lessee may assert a claim and recover pro-rata in the unsecured class.[20]

Generally, the debtor has a time limit to either assume or reject contracts: a Chapter 7 debtor has 60 days unless an extension is granted[21]

16. Grogan v. Garner, 498 U.S. 279, 277 (1991) (citing Loc. Loan Co. v. Hunt, 292 U.S. 234, 244 (1934)).

17. Though the statute specifically grants this power to the U.S. Trustee, the power is extended to the debtor-in-possession through § 1107(a), which provides that a debtor-in-possession generally has the same rights of a trustee in bankruptcy subject to a few exceptions. 11 U.S.C. § 1107(a); *see also* 7 COLLIER ON BANKRUPTCY ¶ 1107.03 (16th ed. 2023).

18. 11 U.S.C. § 365(a).

19. Total E&P USA, Inc. v. Marubeni Oil & Gas (USA), Inc., 393 F. Supp. 3d 515, 534–35 (S.D. Tex. 2018), *rev'd*, 824 F. App'x 197 (5th Cir. 2020) (citing *In re* Penn Traffic Co., 524 F.3d 373, 383 (2d Cir. 2008)).

20. *See* 11 U.S.C. § 365(g)(1); 3 COLLIER ON BANKRUPTCY ¶ 365.10 (16th ed. 2023) (explaining that this provision is generally meant to deprive the non-debtor party the right to seek specific performance, but still allow the non-debtor party the right to damages as if the debtor had breached the contract outside of bankruptcy). Pro rata recovery means that when there are not enough assets to pay all debts, then each unsecured creditor will receive their recovery bearing the same ratio to the amount of their claim that the aggregate of assets bears to the aggregate of debts. *Pro Rata*, BLACK'S LAW DICTIONARY (11th ed. 2019).

21. *See id.* § 365(d)(1); Cameron v. Pfaff Plumbing & Heating, Inc., 966 F.2d 414, 415 (8th Cir. 1992); *In re* Indep. Am. Real Estate, Inc., 146 B.R. 546, 552 (Bankr. N.D. Tex. 1992); *In re* 6177 Realty Assocs., 142 B.R. 1017, 1019 (Bankr. S.D. Fla. 1992).

whereas a Chapter 11 debtor may do so any time before plan confirmation unless the court orders otherwise.[22] While the Bankruptcy Code provides that the debtor may obtain court permission to assume or reject a contract, that language is permissive, creating a third possibility known as a "ride through."[23] In a Chapter 11 case, a debtor who does not assume or reject a contract in the plan of reorganization can allow the executory contract to "ride through" its bankruptcy case unaffected as the contract is deemed to have been assumed.[24] In contrast, given that a Chapter 7 debtor may only assume a contract through a motion and court order, the failure to reject the contract before the deadline in a Chapter 7 case results in a "ride through" constituting an automatic rejection.[25]

Notwithstanding the debtor's ability to reject and effectively terminate disadvantageous leases, the Code provides a protection to non-debtor lessees in § 365(h).[26] Section 365(h) provides that if a debtor-lessor wants to reject an unexpired real property lease of a non-debtor lessee, the lessee is provided with two options:

> (i) if the rejection by the [debtor or] trustee amounts to such a breach as would entitle the lessee to treat such lease as terminated by virtue of its terms, applicable nonbankruptcy law, or any agreement made by the lessee, then the lessee under such lease *may treat such lease as terminated* by the rejection; or
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> (ii) if the term of such lease has commenced, the lessee *may retain its rights under such lease* (including rights such as those relating to the amount and timing of payment of rent

22. *See* 11 U.S.C. § 365(d)(2); *see also* Theater Holding Co. v. Mauro, 681 F.2d 102, 104 (2d Cir. 1982); *In re* Holly's Inc., 140 B.R. 643, 682 (Bankr. W.D. Mich. 1992).

23. *See* 3 COLLIER ON BANKRUPTCY ¶ 365.03 (16th ed. 2023).

24. *See id.*; *see, e.g.*, NLRB v. Bildisco & Bildisco, 465 U.S. 513, 546 n.12 (1984) (if neither accepted nor rejected, "it will 'ride through' the bankruptcy proceeding and be binding on the debtor even after a discharge is granted"); ASARCO, LLC v. Mont. Res., Inc., 858 F.3d 949, 959 (5th Cir. 2017); *In re* Boston Post Rd. Ltd. P'ship, 21 F.3d 477, 484 (2d Cir. 1994); *In re* Pub. Serv. of N.H., 884 F.2d 11, 14–15 (1st Cir. 1989); *In re* Eutsler, 585 B.R. 231, 238 (B.A.P. 9th Cir. 2017).

25. *See* 11 U.S.C. § 365(d)(1); *see also In re* Off. Prod. of Am., Inc., 136 B.R. 675, 686 (Bankr. W.D. Tex. 1992) (citing *In re* Del Grosso, 115 B.R. 136, 139 (Bankr. N.S. Ill. 1990) (holding that if a Chapter 7 trustee does assume a contract within 60 days after the order of relief, then the contract is "deemed rejected"); *In re* Burger Boys, Inc., 94 F.3d 755, 763 (2d Cir. 1996); *see* FED. R. BANKR. P. 6006(a) (a proceeding to assume or reject a contract or lease is a contested matter).

26. 11 U.S.C. § 365(h).

> and other amounts payable by the lessee and any right of use, possession, quiet enjoyment, subletting, assignment, or hypothecation) *that are in or appurtenant to the real property for the balance of the term of such lease* and for any renewal or extension of such rights to the extent that such rights are enforceable under applicable nonbankruptcy law.[27]

Consequently, if the circumstances fall under § 365(h)(i), the lessee may choose to treat the lease as terminated and assert an unsecured claim for damages against the debtor's estate.[28] Otherwise, the lessee may retain its "appurtenant" rights, including the right to possession, under the lease and offset its damages against the rent.[29] Understanding that a lease is dual in nature, encompassing both contract and property rights, begs the question: when § 365(h)(ii) is invoked, which rights of the lessee survive a rejection?[30]

2. *Effect of Rejection*

A lease is a conveyance of both property and contract rights.[31] The property interests are the lessee's right to possession for a period of time and the lessor's right of reversion to possess the property at the end of the term.[32] The contractual interests are the corresponding rights and obligations set forth in the lease documents, such as the lessor providing heat and water and the lessee paying rent.[33]

Whether a debtor's rejection of a lease terminates or changes these substantive rights of the parties to the lease has been subject to controversy.[34] In response to the confusion as to what rights are appurtenant under § 365(h), Congress amended the statute to its current form, which recognizes that the right to reject the lease does not affect the lessee's property and contractual rights, such as continued possession at

27. 11 U.S.C. § 365(h)(1)(A)(i)-(ii) (emphasis added).
28. *Id.* § (h)(1)(A)(i); *id.* § (g).
29. *Id.* § (h)(1)(A)(ii).
30. *See* Dishi & Sons v. Bay Condos LLC, 510 B.R. 696, 705 (S.D.N.Y. 2014).
31. *See id.* at 705 (citing Broadway Corp. v. Alexander's, Inc., 46 N.Y.2d 506, 509 (1979)).
32. *See, e.g.*, *id.*
33. *Cf. id.*
34. *See id.* at 705–06.

the contracted for rental rate.[35] Thereafter, most courts have held that rejection does not extinguish the contract; it merely constitutes a breach and the terms of the contract still control the relationship of the parties.[36]

C. Section 363(f)–Sales Free and Clear

Section 363 of the Bankruptcy Code governs the use, sale, and lease of property of the bankruptcy estate.[37] Section 363(f) allows the debtor to "sell property under subsection (b) or (c) . . . free and clear of any interest in such property"[38] provided that at least one of the five conditions set forth in subsections (f)(1) through (f)(5) is satisfied.[39] This provision promotes the general policy of maximizing the value of the debtor's estate by allowing assets to be sold unencumbered.[40]

Although the word "interest" is not defined anywhere in the Bankruptcy Code,[41] courts have interpreted "interest" in § 363(f) broadly

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35. *See id.*; Section–by–Section Analysis to the Bankruptcy Reform Act of 1994, 140 Cong. Rec. H10752–01 (Oct. 4, 1994) (clarifying that §365 mandates that a lessee cannot have "their rights stripped away" and in fact, may maintain their appurtenant rights, including the "amount and timing of payment of rent or other amounts payable by the lessee, the right to use, possess, quiet enjoyment, sublet, and assign"); *see also* Robert M. Zinman, *Precision in Statutory Drafting: The Qualitech Quagmire and the Sad History of Section 365(h) of the Bankruptcy Code*, 38 J. MARSHALL L. REV. 97, 115–18 (2004) (describing legislative history of 1994 amendment as response to judicial divergence over what rights constituted lessee's "estate").

36. *See, e.g.*, *In re* Austin Dev. Co., 19 F.3d 1077, 1082 (5th Cir. 1994) (holding that a rejection breaches rather than terminates the contract), *cert. denied*, 115 S. Ct. 201 (1994); *In re* Yasin, 179 B.R. 43, 49–50 (Bankr. S.D.N.Y. 1995) (finding that rejection constitutes a breach of the contract or lease, it does not terminate it). *Compare In re* Chestnut Ridge Plaza Assocs., LP, 156 B.R. 477, 482–83 (Bankr. W.D. Pa. 1993) (holding that § 365(g) and § 365 (h), read together, do not mandate automatic termination where debtor-lessor rejects a lease) *with In re* Carlton Rest., Inc., 151 B.R. 353, 356 (Bankr. E.D. Pa. 1993) (finding that rejection always terminates lease and lessor's obligations thereunder and the lessee is entitled to only those rights provided under § 365(h)).

37. *See* 11 U.S.C. § 363; *see also* 3 COLLIER ON BANKRUPTCY ¶ 363.01 (16th ed. 2023).

38. While § 363(c) allows the debtor to use, sell, or lease its property in the ordinary course without a hearing, § 363(b) requires the debtor to obtain court permission to use, sell, or lease its property outside of the ordinary course. 11 U.S.C. § 363(b)–(c).

39. 11 U.S.C. § 363(f).

40. *See* United Mine Workers of Am. Combined Benefit Fund v. Walter Energy, Inc., 551 B.R. 631, 641 (N.D. Alaska 2016).

41. *See, e.g.*, *Qualitech*, 327 F.3d 537, 545 (7th Cir. 2003).

to include leasehold interests.[42] For the court to approve a sale free and clear of any interest—including leasehold interests—under Section 363(f), the movant must satisfy one of the following five conditions:

> (1) applicable nonbankruptcy law permits sale of such property free and clear of such interest;
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> (2) such entity [(the holder of the interest)] 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 proceeding, to accept a money satisfaction of such interest.[43]

The first exception, § 363(f)(1), allows a free and clear sale when such a sale is permitted under nonbankruptcy law.[44] There are limited circumstances under which nonbankruptcy law would permit such a sale,[45] but some courts have found that foreclosure law can be interpreted as "applicable nonbankruptcy law."[46] Section 363(f)(2) allows a free and

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42. *See, e.g.*, *id.* at 545–46; *In re* Chrysler LLC, 576 F.3d 108, 126 (2d Cir. 2009) (holding that the term "any interest in property" in the context of section 363(f) "encompasses those claims that 'arise from the property being sold'") (quoting *In re* Trans World Airlines, Inc., 322 F.3d 283, 290 (3d Cir. 2003)), *cert. dismissed*, 557 U.S. 961 (2009), *appeal dismissed*, 592 F.3d 370 (2d Cir. 2010); *see also* Russello v. United States, 464 U.S. 16, 21 (1983) (finding that the term interest is a broad term selected by Congress in order to avoid rigid technical definitions created by legal interpretations and that the word "comprehends all forms of real and personal property, including profits and proceeds"); *see also* 3 COLLIER ON BANKRUPTCY ¶ 363.06 (16th ed. 2023) (discussing different interpretations of "interest"). However, courts disagree as to the proper scope of the word "interest," especially in the context of "successor liability." *See* Anthony Asebedo, *The Sale of Real Property Free and Clear of a Lease: Making Sense of Sections 363(f) and 365(h) of the Bankruptcy Code*, 24 ABI L. REV. 279, 313–17 (2016).

43. 11 U.S.C. §§ 363(f)(1)–(5); *see also* 3 COLLIER ON BANKRUPTCY ¶ 363.06 (16th ed. 2023).

44. *See* 11 U.S.C. § 363(f)(1).

45. *See id.* For example, the Ninth Circuit found that foreclosure law constitutes nonbankruptcy law. *See In re* Spanish Peaks Holdings II, 872 F.3d 892, 900 (9th Cir. 2017).

46. *Compare* Dishi & Sons v. Bay Condos LLC, 510 B.R. 696, 710 (S.D.N.Y. 2014) (finding that nonbankruptcy law under § 363(f)(1) does not include foreclosure law) *with*

clear sale when the affected entity consents to the sale.[47] Section 363(f)(3) permits a sale free and clear of liens if the contemplated sale price is greater than the aggregate value of all liens on the property.[48] Though courts disagree on whether "value" is the actual economic value or the face amount,[49] this subsection essentially allows sales when the property has security interests that, when combined, exceed the value of the property.[50]

Section 363(f)(4) permits the sale free and clear of a lien or interest when they are in "bona fide dispute."[51] To meet this burden, the debtor must demonstrate that there is an objective basis for either a factual or legal dispute as to the validity of the interest.[52] This subsection is invoked to establish that a party's "interest is too controversial to warrant protection" and the actual existence of the interest itself is in question.[53] Lastly, § 363(f)(5) allows a sale free and clear of an interest where the holder of the interest could be compelled to accept a sum of money in satisfaction of that interest.[54] This subsection is the most "enigmatic"[55] and is not commonly found applicable in situations to lessees.[56]

In re Spanish Peaks Holdings II, 872 F.3d at 900 (finding no reason to exclude the law governing foreclosure sales from the language of § 363(f)(1)). While a debate regarding whether foreclosure law fits within § 363(f)(1) is beyond the scope of this Note, a more thorough discussion of this tension can be found *infra* at pp. 835–37 and accompanying notes.

47. 11 U.S.C. § 363(f)(2).

48. *Id.* § (f)(3).

49. 3 COLLIER ON BANKRUPTCY ¶ 363.06 (16th ed. 2023).

50. *See* 11 U.S.C. § 363(f)(3); 3 COLLIER ON BANKRUPTCY ¶ 363.06 (16th ed. 2023).

51. 11 U.S.C. § 363(f)(4).

52. *See* 3 COLLIER ON BANKRUPTCY ¶ 363.06 (16th ed. 2023); *see also* Zinman, *supra* note 39, at 133.

53. John Collen, *What Do the Subsections of Section 363(f) Really Mean? A Primer on Selling Free and Clear of Interests*, 6 J. BANKR. L. & PRAC. 563, 574 (1997).

54. 11 U.S.C. § 363(f)(5).

55. Zinman, *supra* note 39, at 134; *see also* 3 COLLIER ON BANKRUPTCY ¶ 363.06 (16th ed. 2023) (explaining differing interpretations of § 363(f)(5)).

56. *See, e.g.*, *In re* Smith, No. BR 13-61627-TMR7, 2014 WL 738784, *2 (Bankr. D. Or. Feb. 26, 2014) (noting a broad view of § 363(f)(5) and listing various hypothetical proceedings that purportedly satisfy that subparagraph). *But see In re* Haskell LP, 321 B.R. 1, 9 (Bankr. D. Mass. 2005) (adopting a narrow view of § 363(f)(5) and finding that it does not encompass eminent domain proceedings because the debtor or trustee must be the party capable of compelling the interest holder to accept money satisfaction); *In re* Patriot Place, Ltd., 486 B.R. 773, 815–16 (Bankr. W.D. Tex. 2013) (rejecting the argument "that a theoretical eminent domain proceeding could compel the tenant to accept a money satisfaction for its leasehold interest"); *see also In re* MMH Auto. Grp.,

D. SECTION 363(E)–ADEQUATE PROTECTION

Section 363(e) provides that at any point, upon the "request of an entity that has an interest in property used, sold, or leased," the court "*shall prohibit or condition* such use, sale, or lease as is necessary to provide adequate protection of such interest."[57] In practice, with a proposed § 363 sale, the holder of an adversely affected interest may request—from the court—adequate protection of its interest.[58] Section 361 defines "adequate protection" and provides that such protection may come in one of three forms: (1) periodic cash payments to protect against any decrease in value of the interest, (2) a lien or replacement lien, and (3) such other relief "as will result in the realization by such entity of the indubitable equivalent of such entity's interest in such property."[59]

The concept of adequate protection originated from the Fifth Amendment prohibition against the taking of private property without due process, but it has been interpreted as flexible, and courts have found that the circumstances of each case will determine the necessity and type of relief to be granted.[60] Adequate protection requested in the context of a proposed free and clear sale will commonly come in the form of an attachment to the proceeds of the sale,[61] but the consideration need not be cash.[62] However, if the court is unable to grant a satisfactory form of

LLC (*MMH*), 385 B.R. 347, 370–73 (Bankr. S.D. Fla. 2008), *as amended* (Mar. 18, 2008) (holding that § 363(f)(5) could be used to compel a lessee to accept monetary satisfaction of its interest where the lease contract itself expressly provided that the lease could be "bought out" under certain conditions).

57. 11 U.S.C. § 363(e) (emphasis added).

58. *Id.* § 363(e).

59. *Id.* § 361.

60. *See* Shanor, *A New Deal For Secured Creditors in Bankruptcy*, 28 EMORY L. J. 587, 620 (1979) (citing Wright v. Union Cent. Life Ins. Co., 311 U.S. 273 (1940)); Louisville Joint Stock Land Bank v. Radford, 295 U.S. 555 (1935); 3 COLLIER ON BANKRUPTCY ¶ 363.05 (16th ed. 2023); *see also In re* O'Connor, 808 F.2d 1393, 1396–97 (10th Cir. 1987) (finding adequate protection to be "a concept which is to be decided flexibly on the proverbial 'case-by-case' basis"); *In re* Realty Sw. Assocs., 140 B.R. 360 (Bankr. S.D.N.Y. 1992) ("'Adequate protection' is a question of fact because it has as its linchpin the concept of value, and therefore is determined on a case-by-case basis.") (internal citations omitted).

61. *See In re* Haskell LP, 321 B.R. 1, 6 (Bankr. D. Mass. 2005) (citing H.R. Rep. No. 595, 95th Cong. 1st Sess. 345–346 (1977), U.S. Code Cong. & Admin. News 1978, pp. 5963, 6301–03, Congressional Record Statements).

62. *See* 3 COLLIER ON BANKRUPTCY (16th ed. 2023).

adequate protection, it may not authorize the sale free and clear of the impacted interest—even if the entity requesting the sale satisfies all of § 363(f)'s conditions.[63]

E. Case Law Addressing the Circuit Split

The above-mentioned provisions seemingly conflict when applied in tandem—while § 363(f) authorizes the debtor to sell property free and clear of "any interest,"[64] § 365(h) provides that if a debtor-lessor rejects a lease, the lessee may retain its appurtenant rights for the remainder of the lease term, such as the right to continued possession.[65] The Bankruptcy Code does not indicate whether one section controls the other.[66] Courts have ruled in both directions,[67] and the most influential cases that address the issue at the root of the circuit split will be discussed below.

1. Bankruptcy Court Cases Pre-Qualitech

In 1996—in the case of *In re Taylor*—a debtor-lessor owned five nursing homes that it leased to five related entities named "Magnolia Entities."[68] The debtor filed a motion to sell the five properties free and clear of the Magnolia Entities' leases, and the Magnolia Entities objected to this sale.[69] The court ruled that § 365(h) is the "necessary avenue" with the presence of a leasehold interest such that § 365(h) trumps § 363(f) and allows the lessee to choose between continued possession or bringing a cause of action for breach.[70]

About a month later, another court encountered the same issue.[71] In *In re Churchill Properties III Ltd. Partnership* (hereinafter "In re Churchill"), the Bankruptcy Court of the Northern District of Illinois had approved the debtor's sale of its property free and clear of a leasehold

63. *See id.* ¶ 363.06 (citing *In re* Dewey Ranch Hockey, LLC, 414 B.R. 577 (Bankr. D. Ariz. 2009)).

64. 11 U.S.C. § 363(f).

65. *Id.* § 365(h).

66. *See* Grohsgal, *supra* note 8, at 299.

67. *Compare In re* Taylor, 198 B.R. 142 (Bankr. D.S.C. 1996) (disallowing a § 363(f) sale to dispossess a lessee) *with Qualitech*, 327 F.3d 537 (7th Cir. 2003) (allowing a § 363(f) sale to dispossess a lessee).

68. *In re Taylor*, 198 B.R. at 144.

69. *Id.* at 151–52.

70. *Id.* at 167.

71. *See In re* Churchill Props. III, 197 B.R. 283, 283 (Bankr. N.D. Ill. 1996).

interest.[72] Given that the debtor rejected the lease post-sale and the lessee did not receive proper notice, the court was tasked with retroactively applying the law to a bona fide purchaser and found that § 365(h) protections apply to § 363(f) sales.[73] *In re Taylor* and *In re Churchill* formed the basis for the prevailing, majority view that § 365 lessee protections consistently and indisputably trumped a lessor's free and clear sale, and therefore, a debtor was not able to sell a piece of property free and clear of a non-debtor leasehold interest.[74]

2. *Qualitech*

When the *Qualitech* court ruled in favor of the debtor and held that § 365(h) protections are inapplicable to § 363(f) sales, it understandably surprised the bankruptcy community.[75] In the case, Qualitech Steel Corporation and Qualitech Steel Holdings Corporation (collectively, " Qualitech Corp.") and Precision Industries, Inc. and Circo Leasing Co. (collectively, "Precision") entered a supply agreement and land lease wherein Precision would construct a warehouse, operate it for ten years, and provide on-site supply services to Qualitech Corp.[76] In this arrangement, Precision paid a nominal rent of $1 per year, and Qualitech Corp. had the right to purchase the warehouse and its improvements for $1 at the expiration of the term.[77]

In reliance on these agreements, Precision built and stocked a warehouse on the property.[78] A mere twenty-five days after execution of the lease, Qualitech Corp. filed for bankruptcy and sold all its property free and clear to purchaser Qualitech Steel SBQ, LLC ("New Qualitech").[79] Although the sale order reserved the purchaser's right to

72. *Id.* at 284.

73. *Id.* at 286, 288.

74. *See* Michael St. Patrick Baxter, *Section 363 Sales Free and Clear of Interests: Why the Seventh Circuit Erred in Precision Industries v. Qualitech Steel*, 59 BUS. L. 475, 476 (2004). (internal citations omitted); *see also* Joshua Stein, *Can a Landlord's Bankruptcy Destroy a Lease? A Third Look at the Qualitech Case*, 37 NO. 5 PRAC. REAL EST. L. 49, 50 (2021).

75. *See Qualitech*, 327 F.3d 537, 547–48 (7th Cir. 2003).

76. *Qualitech,* 327 F.3d at 540.

77. *Id.*

78. *Id.*

79. *Id.* at 540–41. Notably, Precision neither objected to the sale nor filed a request for adequate protection. *Id.* at 541.

assume and assign executory contracts and the parties extended the assumption deadline several times, Precision's lease and supply contracts were "*de facto* rejected" and Precision vacated and padlocked the warehouse.[80]

Shortly thereafter, New Qualitech changed the locks on the warehouse without the knowledge or consent of Precision.[81] As a result, this dispute was initiated and later appealed to the Seventh Circuit to find whether the § 363(f) sale extinguished Precision's possessory interest.[82] The Seventh Circuit ruled in favor of New Qualitech and found that § 365(h) does not supersede § 363(f).[83]

3. *Post-Qualitech Case Law*

After *Qualitech* surprised the bankruptcy community, the subsequent cases ruled in all directions as demonstrated by the cases below.[84]

a. In re Haskell LP and In re Samaritan Alliance LLC

Notwithstanding *Qualitech*, several courts still ruled in line with the majority stance in later cases.[85] In *In re Haskell LP*, the debtor-lessor sought to sell its property free and clear of a leasehold interest because the first mortgage was enormously undersecured, meaning the par value of the mortgage exceeded the sale value of the house.[86] Ultimately, the court agreed with the views espoused by the *In re Taylor* and *In re Churchill* courts and granted the lessees to continued possession upon the sale of property of the estate.[87] Similarly, in a succinct opinion, the *In re Samaritan Alliance LLC* court agreed with the *In re Haskell LP* ruling and

80. *Id.* (internal citations omitted).

81. *Id.*

82. *Id.* at 541–42.

83. *Id.* at 547.

84. *Compare In re* Haskell, LP, 321 B.R. 1, 9 (Bankr. D. Mass. 2005) *with In re* Spanish Peaks Holdings II, 872 F.3d 892, 898–99 (9th Cir. 2017).

85. *See generally In re* Haskell, LP, 321 B.R. at 8–10; *see In re* Samaritan All., LLC, No. 07-50735, 2007 WL 4162918, at *4–5 (Bankr. E.D. Ky. Nov. 21, 2007).

86. *In re Haskell, LP*, 321 B.R. at 2, 5. The fair market value of the land was approximately $6,500,000, while the first mortgage on the property was about $13,000,000. *Id.* at 5.

87. *Id.* at 8–10.

held that the lessee's possessory interests are preserved by § 365(h) in the context of a § 363(f) sale.[88]

b. In re MMH Automotive Group, LLC

In 2008, a Florida bankruptcy court ruled that a § 363(f) sale may dispose of a lessee's § 365(h) protection.[89] Nevertheless, the court granted adequate protection, but instead of granting continued possession, it granted a payout of the value of the leasehold interest through a buyout clause in the lease.[90] In *In re MMH Automotive Group, LLC*, (hereinafter "MMH"), MMH Automotive Group, LLC filed for Chapter 7 bankruptcy.[91] To settle an adversary proceeding, the debtor's property was sold via an auction to South Motor Company of Dade County ("South Motor") free and clear of all liens and encumbrances.[92] Unbeknownst to the buyer, Carter-Pritchett-Hodges, Inc. ("CPH" or lessee) had an unrecorded lease granting rights to a billboard on the property for a period of 99 years.[93] Unfortunately, because the lease was unrecorded, the parties did not provide notice of the sale to the lessee and the buyer only became aware the lessee's interest upon entering the premises and discovering a CPH employee painting the billboard pole.[94] The court had to determine what consequences the procedural flaw would have on the sale order.[95]

In addressing the circuit split regarding the relationship of § 365(h) and § 363(f), the court noted that "any sale pursuant to section 363(f) necessarily takes into account any rights of a non-debtor party to an unexpired lease pursuant to section 365(h), when those rights are applicable."[96] The court ultimately found that § 363(f)(5) could be utilized to compel the lessee to accept money in satisfaction of its interest.[97] The

88. *In re Samaritan All., LLC*, 2007 WL 4162918, at *4.
89. *See MMH*, 385 B.R. 347, 371–72 (Bankr. S.D. Fla. 2008).
90. *See id.* at 372.
91. *Id.* at 352.
92. *Id.*
93. *Id.* at 351–53. Importantly, the lease involved an upfront payment of $15,000. *Id.* at 353.
94. *Id.* at 352, 354.
95. *Id.* at 358–59.
96. *Id.* at 363, 365–66 (noting that the priority of a lessee's possessory rights "should not be impacted . . . by virtue of rejection or assumption prior to an attempt to sell the underlying [property]").
97. *Id.* at 372.

lease agreement contained a provision wherein if the lessor wishes to sell its property and the leasehold prohibits this result, the lessor shall have the right to buyout the leasehold interest for $60,000.[98] As such, the court found that § 363(f)(5) could invoke this right in the lease, and that given the notice issue, the court could grant adequate protection in the form of this buyout.[99]

c. Dishi & Sons v. Bay Condos LLC

In *Dishi & Sons v. Bay Condos LLC* (hereinafter, "Dishi & Sons"), Bay Condos LLC (the debtor) leased a commercial unit to New York Pubs, Inc. d/b/a The Ginger Man ("TGM").[100] After filing a plan with a proposed auction for sale indicating that the sale would be free and clear of liens, claims, and commercial leases, Dishi & Sons ("Dishi") won the bid.[101] Before the sale order was entered, TGM submitted a letter to the court claiming it had just received notice of the sale and asserted its right to remain in possession for the duration of the lease.[102] Specifically, TGM asserted its right to continued possession via § 365(h) or alternatively, as adequate protection under § 363(e).[103] The bankruptcy court ruled in favor of TGM, and Dishi appealed.[104]

The District Court "reach[ed] the same result, but declin[ed] to endorse the majority interpretation."[105] The court held that though § 365(h) applies to § 363(f) sales, it does not provide the lessee with absolute rights which take primacy over the debtor's right to engage in a free and clear sale.[106] In ruling as it did, the court criticized the minority interpretation for skirting the conflict, failing to provide a solution, and considering only the "easy" case where § 365(h) is never triggered without a formal rejection.[107]

Subsequently, the court assessed whether any of the conditions to § 363(f) were satisfied, but noted that the § 363(f) conditions are a high

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98. *Id.* at 371
99. *Id.* at 372.
100. Dishi & Sons v. Bay Condos LLC, 510 B.R. 696, 699 (S.D.N.Y. 2014).
101. *Id.* at 699–700.
102. *Id.* at 700. Notably, the debtor owed a creditor $13,500,000 in mortgage on the property, and the winning bid was for $6,075,000. *Id.* at 699–700.
103. *Id.*
104. *Id.*
105. *Id.* at 698.
106. *Id.*
107. *Id.* at 704.

barrier and will rarely permit a sale.[108] Specifically, in its analysis of § 363(f)(1), the court noted that there were "substantial and material differences" between foreclosure proceedings and free and clear sales which indicates that foreclosure law does not constitute "nonbankruptcy law" under § 363(f)(1).[109] Lasty, considering that the lessees timely requested adequate protection under § 363(e), the court held continued possession was necessary to protect the lessee's interest.[110] The court supported its argument by stating that § 363(e) is focused on "protecting the entity whose interest is threatened."[111] Given the debtor's capital structure[112] and the difficulty in valuing a leasehold interest, the court found that continued possession was the only way to adequately protect the interest.[113]

d. In re Revel AC, Inc.

In 2015, the Third Circuit confronted the issue in *In re Revel AC, Inc.* and held that § 365(h) protections apply to § 363(f) sales.[114] In the case, the debtor owned a casino and the lessee operated two nightclubs and a beach club venue at that casino.[115] The terms of the lease allowed the lessee to operate rent-free unless the lessee's operation was profitable, as set forth in the recoupment provision.[116] In bankruptcy, the debtor rejected the unexpired lease and sold the property at an auction, after which the bankruptcy court entered a sale order specifically ordering that the sale be free and clear of all interests but clarified that the lessee may retain its rights under the lease per § 365(h).[117]

The buyer appealed the order, but the Third Circuit held that under the § 363 sale order, and by virtue of the lessee's § 365(h) election, the

108. *See id.* at 699, 708–11.

109. *Id.* at 709–10 (citing *In re* Jaussi, 488 B.R. 456, 458 (Bankr. D. Colo. 2013)). While a debate regarding whether foreclosure law fits within § 363(f)(1) is beyond the scope of this Note, a more thorough discussion of this tension can be found *infra* at pp. 835–37 and accompanying notes.

110. *Id.* at 711–12.

111. *Id.* at 711.

112. Given that the lease contained a subordination clause, the court noted that TGM was unlikely to receive any proceeds for its interest. *Id.* at 709, 711–12.

113. *Id.* at 711–12.

114. *In re* Revel AC, Inc., 909 F.3d 597, 599 (3d Cir. 2018).

115. *Id.*

116. *Id.* at 601.

117. *Id.* at 599.

lessee was entitled to continued possession at the current rental rate contemplated by the agreement.[118] While the court did not engage in a substantive analysis of the issue concerning the split, it nevertheless held that § 363(f) sales were subject to the protections afforded by § 365(h) if the lessee so asserted their rights.[119]

e. In re Spanish Peaks Holdings II

Over ten years after *Qualitech*, the Ninth Circuit encountered the same issue in *In re Spanish Peaks Holdings II* and adopted the *Qualitech* holding.[120] The case involved a ski resort in Montana and two of its lessees: a restaurant and telecommunications company.[121] Notably, the founder of the debtor owned the restaurant ("Pinnacle") and was the sole member of the telecommunications company.[122] This founder also signed the restaurant lease as lessor and lessee.[123] Both leases were for nominal rent.[124] Despite making improvements to the leased space, Pinnacle stopped conducting its business on the premises in April 2011, a few years before the bankruptcy court issued the sale order.[125] After the court entered an order approving the sale with language indicating it was free and clear of leasehold interests, both lessees objected because the leasehold interests were not itemized in the list of encumbrances surviving the sale.[126] The bankruptcy court overruled the objection, finding that the sale obviated the leasehold interests and the lessees effectively waived this right because neither lessee requested adequate protection of their leasehold interest.[127]

The Ninth Circuit reached this minority view result by adopting the Seventh Circuit's "sound textual analysis" and ruled that § 365(h) does not apply to § 363(f) sales.[128] Specifically, the court found that § 363(f)(1) had been satisfied because, under Montana foreclosure law, a foreclosure

118. *Id.* at 603–04.
119. *Id.*
120. *See In re* Spanish Peaks Holdings II, 872 F.3d 892, 898 (9th Cir. 2017).
121. *Id.* at 894–95.
122. *Id.* at 894.
123. *Id.*
124. *See id.* at 894–95. The Pinnacle restaurant's monthly rent was $1,000 while the telecommunications company paid an annual rent of $1,285. *Id.*
125. *Id.* at 896.
126. *Id.* at 895.
127. *Id.* at 896.
128. *Id.* at 899.

sale to satisfy a mortgage terminates a subordinate lease on that property.[129]

f. In re Royal St. Bistro, LLC

In 2022, the Fifth Circuit contributed to the circuit split in the case of *In re Royal St. Bistro, LLC* by allowing a sale free and clear of a leasehold interest.[130] In the case, the debtor owned several parcels of land in New Orleans and entered into a series of leases with the debtor's insiders at below-market rates.[131] Importantly, these leases were junior to the rights of the mortgagee, who would have had the ability to foreclose on the property outside of bankruptcy.[132] The lessee was also in default under the lease because they had not paid rent in months.[133]

After the debtor filed for bankruptcy and the Chapter 11 trustee filed a motion to sell the property, the lessee timely objected seeking both adequate protection and to require the trustee to assume or reject their lease, triggering the § 365(h) protections.[134] Once the bankruptcy court denied these objections, the lessees appealed to the District Court and again to the Fifth Circuit.[135] Though the Fifth Circuit denied the writ of mandamus, the court published a four-page opinion to voice its approval for a majority of the lower court's reasoning and warn against broad acceptance of the minority viewpoint.[136]

The court essentially agreed that property could be sold via § 363(f) to obviate a leasehold notwithstanding § 365(h), but that the lower courts "both made the mistake of relying on [*Qualitech*] for the excessively broad proposition that sales free and clear under Section 363 override, and

129. *Id.* at 900.

130. *See In re* Royal St. Bistro, LLC, 26 F.4th 326, 326 (5th Cir. 2022).

131. *Id.* at 327.

132. *Id.* at 327–28.

133. *Id.* at 328. Presumably, the debtor had not moved for eviction because the lessees were insiders of the debtor. *See id.* at 327.

134. *See In re* Royal Alice Props., LLC, 637 B.R. 465, 470–71 (Bankr. E.D. La. 2021), *appeal dismissed sub nom., In re* Royal St. Bistro, LLC, No. CV 21-2285, 2022 WL 6308294 (E.D. La. Sept. 23, 2022), *appeal dismissed sub nom.,* Matter of Royal Alice Props., LLC, No. 22-30629, 2022 WL 19363790 (5th Cir. Nov. 22, 2022).

135. *In re Royal St. Bistro, LLC*, 26 F.4th at 326–27.

136. *See id.* at 326–29.

essentially render nugatory, the critical lessee protections against a debtor-lessor under Section 365(h)."[137]

II. MAJORITY VS. MINORITY: SHOULD § 363(f) SALES OBVIATE A LEASEHOLD INTEREST NOTWITHSTANDING § 365(h) PROTECTIONS?

This circuit split has sparked much debate between bankruptcy scholars and legal commentators.[138] Part II will identify the majority and minority views, provide an overview of the arguments courts employed for each side, and summarize the arguments of notable scholars.

A. GENERAL OVERVIEW OF MAJORITY AND MINORITY VIEWS

The majority opinion is characterized by a general preference for a strong protective stance for lessees, positing that § 365(h) offers robust rights, including uninterrupted possession, even when a property is sold under § 363(f).[139] Under this view, § 365(h) governs the treatment of leases in a bankruptcy case, meaning that any § 363(f) sale must first determine the treatment of the leasehold interest through § 365(h).[140] Essentially, this view finds that § 363(f) sales do not extinguish a leasehold interest.[141]

On the other hand, the minority view finds that § 365(h) and § 363(f) can be reconciled because § 365(h) is inapplicable to § 363(f) sales, and a leasehold can be extinguished by a § 363(f) sale.[142] This view can be

137. *Id.* at 328.

138. *See* Baxer, *supra* note 79, at 477 (describing the *Qualitech* decision as "substantially flawed"); *see also* Zinman, *supra* note 39, at 101 (noting that though *Qualitech* may have been rightly decided based on statutory construction, disrupting leasehold interests is contrary and was likely not the result contemplated by Congress).

139. *See, e.g.*, *In re* Taylor, 198 B.R. 142, 164–66 (Bankr. D.S.C. 1996).

140. *See, e.g.*, *id.*

141. *Id.*

142. *See, e.g., In re* Spanish Peaks Holdings II, 872 F.3d 892, 898 (9th Cir. 2017); *In re* R.J. Dooley Realty, No. 09-36777, 2010 WL 2076959, at *7 (Bankr. S.D.N.Y. May 21, 2010); *In re* Downtown Athletic Club of N.Y.C., No. M-47 (JSM), 2000 WL 744126, at *4 (S.D.N.Y. June 9, 2000); *In re* Hill, 307 B.R. 821, 823, 825–26 (Bankr. W.D. Pa. 2004); *In re* Ng, No. 06-30904 TC, 2007 WL 4365564, at *1 (Bankr. N.D. Cal Dec. 13, 2007); Hewlett v. U.S. Bankr. Ct., No. C 07-05532 CRB, 2007 WL 3232239, at *1 (Bankr. N.D. Cal. Oct. 31, 2007).

seen as providing greater flexibility for debtors in restructuring and liquidating assets.[143]

B. JUDICIAL REASONING BEHIND MAJORITY AND MINORITY VIEWS

1. Cannons of Statutory Interpretation

Both the majority and minority views employed tools of statutory construction in their reasonings.[144] The majority view employs the canon of statutory interpretation—*generalia specialibus non derogant*—known as the specific controls the general.[145] The courts maintain that because § 365(h) addresses the rights of non-debtor lessees "with great particularity," it should prevail over the less specific sale provisions of § 363(f).[146] These courts also note that ruling otherwise would render § 365(h) "nugatory," effectively eviscerating that provision.[147]

Meanwhile, the minority view argues for the use of the cannon of statutory interpretation that the words in statutes should be read according to their ordinary meaning and the court must "construe the two statutory provisions . . . in such a way as to avoid conflicts between them, if such a construction is possible and reasonable."[148] In doing so, the Seventh

143. *Cf. Qualitech*, 327 F.3d 537, 548 (7th Cir. 2003) (by allowing sales such as the court allowed in this case, debtors can rid of lessee interests through § 363(f) and sell property unencumbered).

144. *Compare In re* Taylor, 198 B.R. 142 (Bankr. D.S.C. 1996) *with Qualitech*, 327 F.3d. at 544–48.

145. *In re Taylor*, 198 B.R. at 165; *see also* Morales v. Trans World Airlines, Inc., 504 U.S. 374, 384 (1992) (citation omitted) (finding that it is a common canon of statutory interpretation that the specific provisions govern the general provision).

146. *See, e.g.*, *In re Taylor*, 198 B.R. at 165 (emphasis omitted); *see In re* Churchill Props. III, 197 B.R. 283, 288 (Bankr. N.D. Ill. 1996).

147. *See, e.g.*, *In re Churchill Props. III*, 197 B.R. at 288; *In re* Haskell, LP, 321 B.R. 1, at 9 (Bankr. D. Mass. 2005); *In re* Royal St. Bistro, LLC, 26 F.4th 326, 327–28 (5th Cir. 2022) (claiming that the lower courts "both made the mistake of relying on [*Qualitech*] for the excessively broad proposition that sales free and clear under Section 363 override, and essentially render nugatory, the critical lessee protections against a debtor-lessor under Section 365(h)").

148. *See Qualitech*, 327 F.3d at 544. The Ninth Circuit adopted the Seventh Circuit's "sound textual analysis" and simply added observations to appease concerns that "an attempt to harmonize the two statutes 'arguably results in the effective repeal of § 365(h).'" *In re* Spanish Peaks Holdings II, 872 F.3d 892, 899 (9th Cir. 2017) (citing Dishi & Sons v. Bay Condos LLC, 510 B.R. 696, 711–12 (S.D.N.Y. 2014)).

Circuit found that that § 363(f) and § 365(h) can be read to avoid conflict; the plain language of § 365(h)(1)(A) suggests that it "is limited in scope" because it "focuses on a specific type of event," namely the rejection of an executory contract by the trustee or debtor.[149]

Further, the Seventh Circuit found that neither statute supersedes the other as evidenced by the lack of cross-references.[150] In making this argument, the court argues that the "effect of the sale might be understood as the equivalent of a repudiation of Precision's lease" and "nothing in the express terms of section 365(h) suggests that it applies to any and all events that threaten the lessee's possessory rights."[151] As such, the minority view maintains that § 365(h) applies only to situations involving "rejections" and § 363(f) applies to sales in general.[152]

The minority view is also supported by the canon that statutes should not be read to produce absurd results.[153] Interpreting § 365(h) to mean that a sale can never dispossess a lessee elevates lessees "of rejected leases . . . to a protected status they might not enjoy in the absence of rejection, and do[es] so at the expense of other creditors at the estate."[154] This outcome produces an absurd result because lessees are essentially guaranteed their rights in a bankruptcy, whereas creditors would not only need to recover pro rata, but be subject to a lower property sale price by the presence of the leasehold.[155] Yet, "any sale pursuant to section 363(f) necessarily takes into account any rights of a non-debtor party to an unexpired lease pursuant to section 365(h), when those rights are applicable."[156]

Interestingly, the Dishi & Sons court "reach[ed] the same result, but declin[ed] to endorse the majority interpretation."[157] The court held that although § 365(h) applies to § 363(f) sales, it does not provide the lessee with absolute rights which take primacy over the debtor's right to engage

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149. *See Qualitech*, 327 F.3d at 544.

150. *See id.* at 547 ("The omission suggests that Congress did not intend for [§ 365(h)] to limit [§ 363(f)].").

151. *See id.*

152. *See id.*

153. *See MMH*, 385 B.R. 347, 364–65 (Bankr. S.D. Fla. 2008).

154. *Id.*

155. *Cf. id.*; 3 COLLIER ON BANKRUPTCY ¶ 363.06 (16th 2023) ("Presumably the additional price that a purchaser would be willing to pay to obtain assets free of successor liability can ultimately flow to the benefit of claimants in the bankruptcy.").

156. *Id.* at 365 (noting that the priority of a lessee's possessory rights "should not be impacted . . . by virtue of rejection or assumption prior to an attempt to sell the underlying [property]").

157. Dishi & Sons v. Bay Condos LLC, 510 B.R. 696, 698 (S.D.N.Y. 2014).

in a free and clear sale.[158] The court engaged in a statutory analysis of § 365 and concluded that it was unnecessary "to rely upon an artificial distinction between 'rejection' and 'repudiation'" and other formalities because the lessee's appurtenant rights under the lease must be respected.[159] The court elaborated that when the debtor assumes, rejects, or does nothing with respect to the lease, this does not alter the appurtenant rights of the lessee.[160] Although the court recognized the lessee's rights in this way, the court also found that "nothing in § 365(h)—which simply preserves the lessee's appurtenant rights in the event of rejection—precludes the [debtor] from terminating such rights if so empowered under another provision of the Code."[161]

2. *Legislative History*

The majority view maintains that the legislative history surrounding § 365 reveals that Congress demonstrated a clear intent to strengthen lessee rights.[162] These courts argue that dispossessing a lessee of their bargained-for leasehold rights would be in direct contravention of this purpose.[163]

The minority courts argue that because § 365(h) applies only to situations purely involving "rejections," as discussed in the previous Section, and § 363(f) applies to sales in general, the legislative history surrounding § 365(h) is pertinent to situations involving the rejection of

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158. *See id.*

159. *Id.* at 707.

160. *Id.* at 706; *see also In re* Scharp, 463 B.R. 123, 129 (Bankr. C.D. Ill. 2011) (noting that rejection and "abandonment" by the trustee—that is, "the trustee's failure to reject [or assume] the Lease" — "both have the effect of removing a lease from property of the estate").

161. *Id.* at 707. The court cited to Professor Andrew's analysis of executory contracts. *See* Michael T. Andrew, *Executory Contracts in Bankruptcy: Understanding "Rejection"*, 59 U. COLO. L. REV. 845, 904–05 (1988); *see also MMH*, 385 B.R. 347, 365 (Bankr. S.D. Fla. 2008) (noting that the priority of a lessee's possessory rights "should not be impacted . . . by virtue of rejection or assumption prior to an attempt to sell the underlying [property]").

162. *See, e.g.*, *In re Taylor*, 198 B.R. at 165–67; *see also In re* Churchill Props. III, 197 B.R. 283, 288 (Bankr. N.D. Ill. 1996). Professor Zinman engages in a more thorough discussion about the legislative history of § 365(h). *See* Zinman, *supra* note 39, at 106–18.

163. *See In re* Haskell LP, 321 B.R. 1, 7 (Bankr. D. Mass. 2005).

contracts, not § 363(f) sales.[164] In fact, the Ninth Circuit noted that the minority view outcome balances the protection of lessees in bankruptcy and the maximization of creditor recovery "in the way Congress intended."[165] If Congress intended for lessee's § 365(h) rights to trump a debtor's right to sell property free and clear, then Congress would have expressly provided for that protection.[166]

3. *Purpose of the Bankruptcy Code and Practical Considerations*

Though § 363(e) allows the court to grant adequate protection to a party whose interest is affected by a § 363(f) sale,[167] the majority view courts have found that this protection is insufficient.[168] For example, in *In re Haskell LP*, the court noted that if it were to grant adequate protection under § 363(e) by replacing the lessee's leasehold with a lien, then the lessee, as a second mortgagee, would be unlikely to recover any proceeds.[169] The court found this result to be unacceptable and noted that "under the circumstances of this case adequate protection can only be achieved through continued possession of the leased premises."[170] Similarly, the *Dishi & Sons* court held that continued possession was necessary to protect the lessee's interest.[171] The court supported its argument by stating that § 363(e) is focused on "protecting the entity whose interest is threatened."[172] Given the debtor's capital structure[173] would likely prevent any recovery for the lessee and the difficulty in valuing a leasehold interest, the court noted that continued possession was the only way to adequately protect the interest.[174] The Court also noted that the § 363(f) conditions themselves are a high barrier and will rarely permit a sale, serving as a form of protection.[175]

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164. *See Qualitech*, 327 F.3d 537, 546–47 (7th Cir. 2003).
165. *In re* Spanish Peaks Holdings II, 872 F.3d 892, 901 (9th Cir. 2017).
166. *See MMH*, 385 B.R. at 366.
167. *See* 11 U.S.C. § 363(e).
168. *Cf. In re Haskell LP*, 321 B.R. at 9–10.
169. *Id.*
170. *Id.* at 10.
171. *See* Dishi & Sons v. Bay Condos LLC, 510 B.R. 696, 711–12 (S.D.N.Y. 2014).
172. *Id.* at 711.
173. As noted above, the debtor owed the mortgagee $13,500,000 and the property sold for $6,075,000. *Id.* at 699–70. Given that the lease contained a subordination clause, the court noted that TGM was unlikely to receive any proceeds for its interest. *Id.* at 709, 711.
174. *See id.* at 711–12.
175. *See id.* at 708–11.

The minority view courts maintain that § 363(e) explicitly "provides for a mechanism to protect the rights" of lessees who are adversely affected by the sale of real property.[176] The mandatory language of adequate protection in § 363(e) also creates a "powerful check on potential abuses of free-and-clear sales."[177] As the Seventh Circuit noted, protection does not necessarily result in continued possession but rather demands that the lessee be compensated for the value of its interest—which usually comes in the form of proceeds from the sale.[178] The Ninth Circuit also concluded that adequate protection could take the form of continued possession, but the court seemed to suggest that it could come in other forms as well.[179]

C. SCHOLARS' PERSPECTIVES AND ARGUMENTS FOR MINORITY AND MAJORITY VIEWS

In light of the opposing arguments for both views, scholars have written various noteworthy articles adding additional and novel arguments, which are summarized below per view.[180]

1. Scholar's Majority View Arguments

Similar to the court rulings, the post-*Qualitech* commentators wrote scathing remarks about *Qualitech* and bemoaned the disastrous consequences of the ruling.[181] Commentators elaborated on the reasonings discussed above and one even adopted novel arguments to further support their claims that § 363(f) sales should be subject to §

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176. *See Qualitech*, 327 F.3d 537, 547 (7th Cir. 2003).

177. *In re* Spanish Peaks Holdings II, 872 F.3d 892, 900 (9th Cir. 2017).

178. *Qualitech*, 327 F.3d at 548.

179. *See In re* Spanish Peaks Holdings II, 872 F.3d at 899–900. The Ninth Circuit did not elaborate on differing forms of adequate protection as the issue was not before it because the appellants had failed to request adequate protection in time. *Id.*

180. *See* Baxter, *supra* note 79; Zinman, *supra* note 39; Grohsgal, *supra* note 8; *see generally* Bradford N. Barnhardt, *Closing the Loophole in Commercial Landlord Bankruptcies: Why the Ninth Circuit Made the Right Decision in Matter of Spanish Peaks Holdings II, LLC*, 35 EMORY BANKR. DEV. J. 191, (2019).

181. *See, e.g.*, Baxter, *supra* note 79, at 477 (describing the *Qualitech* decision as "substantially flawed"); *see also* Zinman, *supra* note 39, at 127 (noting that though *Qualitech* may have been rightly decided based on statutory construction, disrupting leasehold interests was likely not the result contemplated by Congress).

365(h) lessee protections.[182] Two commentators have been particularly influential to the majority view: Professor Michael St. Patrick Baxter and Professor Robert M. Zinman.[183]

Professor Baxter argues that *Qualitech* was wrongly decided and that § 365(h) limits § 363(f) for both statutory, interpretive, and practical reasons.[184] Baxter first argues that there is no evidence of statutory primacy and, in fact, that the cross-reference contained within § 363(l) demonstrates that § 363 as a whole is subject to § 365(h).[185] Though generally providing that certain laws and contractual clauses are unaffected by a sale under § 363, § 363(l) is known for the proposition that *ipso facto* clauses[186] do not bar the sale of property.[187] Professor Baxter states that § 363(l) is a general provision governing all sales in the ordinary course under § 363(c) and outside of the ordinary course under § 363(b).[188] Because § 363(f) is a subset of the aforementioned types of sales, § 363(f) sales are "[s]ubject to the provisions of [§] 365" through § 363(l).[189]

Similar to the majority case law, Professor Baxter also maintains that the legislative history behind § 365(h), "reveals that Congress has consistently sought to strengthen lessee rights when they were threatened by narrow court interpretations."[190] Next, he argues that § 365(h) has been triggered by a rejection of the lease in a § 363(f) sale, which must occur at some point whether triggered by the debtor or the buyer of the property.[191] Lastly, he reasons that adequate protection via § 363(e) is an insufficient protection for the lessee.[192] While he notes that "it will be rare for the debtor to have the right to sell free and clear of a lease,"[193] he explains that converting a lessee's rights to cash would be "tantamount"

182. *See generally* Baxter, *supra* note 79.
183. *See generally id.*; Zinman, *supra* note 39.
184. *See* Baxter, *supra* note 79, at 476–82.
185. *See id.* at 482–84.
186. An ipso facto clause is a "contract clause that specifies the consequences of a party's bankruptcy," the enforcement of which is prohibited by the Bankruptcy Code. *Ipso Facto Clause*, BLACK'S LAW DICTIONARY (11th ed. 2019).
187. *See* 11 U.S.C. 363(l); 3 COLLIER ON BANKRUPTCY ¶ 363.10 (16th ed. 2023).
188. *See* Baxter, *supra* note 79, at 482–83.
189. *Id.* at 483 (citing 11 U.S.C. 363(l)).
190. *Id.* at 484.
191. *See id.* at 485–86.
192. *See id.* at 491.
193. *Id.* at 491.

to a cramdown[194] and questions how a court would be able to place a value on a leasehold interest given the scant precedent.[195]

In his practical argument, Professor Baxter predicts that the *Qualitech* decision will have a profound impact on lessees and real estate financings.[196] He notes that a debtor's "stealth rejections" to avoid the protections of § 365(h) could be damaging to both lessees and real estate financiers who rely on the ability of the lessee to retain possession of the property in bankruptcy.[197] A lessee may not have a reasonable basis to know that the debtor's § 363(f) motion was intended to eviscerate its lease and thereby fail to object.[198] Then, upon request for adequate protection, the lessee's possessory rights are effectively crammed down.[199] Even when adequate protection comes in the form of a payment from the proceeds of sale, the lessee may not receive any funds if the sale proceeds are insufficient to cover the liens on the property.[200] Professor Baxter's opinion is clear: *Qualitech*'s decision is a "judicial repeal" of § 365(h).[201]

Professor Zinman takes a slightly different stance.[202] He contends that *Qualitech* may well have been decided correctly based purely on the statutory language of the relevant provisions, but that "the *Qualitech* result was certainly not contemplated when the Bankruptcy Code was drafted."[203] Zinman urges for a resolution through amended legislation mandating that § 363(f) sales be made subject to the protections of § 365(h).[204]

First, Professor Zinman conducts a thorough analysis of the background to the drafting and every subsequent change to § 365(h).[205]

194. A cramdown is a nonconsensual imposition of a plan of reorganization via § 1129(b). 7 COLLIER ON BANKRUPTCY ¶ 1129.03 (16th ed. 2023). In making this reference, Professor Baxter argues that converting a lessee's possessory rights into cash compensation in the form of adequate protection would be a nonconsensual treatment of their interest, and, given that the cramdown requirements of § 1129(b) do not cover lessees, this treatment is impermissible. *See* Baxter, *supra* note 79, at 491–92.

195. *See* Baxter, *supra* note 79, at 491–95.

196. *See id.* at 495–96.

197. *See id.*

198. *See id.* at 497.

199. *See id.* at 498.

200. *See id.*

201. *See id.* at 497.

202. *See generally* Zinman, *supra* note 39.

203. *Id.* at 127.

204. *Id.* at 100–01.

205. *Id.* at 106–19.

In doing so, he discovers that, "Congress, again and again, from the drafting of the Code to the amendments that followed over the years, expressed in concrete statutory provisions its intention to protect the tenant's estate and [its] rights . . . when the lease is disaffirmed in the landlord's bankruptcy."[206] As such, Professor Zinman concludes that Congress unquestionably did not intend for bankrupt lessors to "easily avoid these protections by employing § 363 in lieu of § 365."[207] Although deploring *Qualitech*'s consequences, Professor Zinman notes that the Seventh Circuit likely interpreted the statutory interplay between § 363(f) and § 365(h) correctly.[208] Both scholars bemoaned *Qualitech* and predicted dire consequences if the ruling's impact was not dealt with by legislative correction.[209]

2. *Scholars' Minority View Arguments*

Though the bankruptcy community received the minority decisions with much criticism,[210] several commentators noted that the minority approach is supported by logical use of canons of statutory interpretation, the overarching purpose and principles of the Bankruptcy Code, and the notion that the rights of the parties under state law and within bankruptcy court should be the same.[211] As noted in the previous section, though Professor Zinman deplored the outcome in *Qualitech*, he found that § 363(f) and § 365(h) do not conflict from a statutory analysis standpoint.[212] Furthermore, Professor Bruce Grohsgal and Bradford N. Barnhardt also wrote articles, each supporting the *Qualitech* holding for differing reasons.[213]

Professor Zinman argues that the "specific controls the general" canon of statutory interpretation only applies when two provisions deal with the same situation but produce different results and finds that in *Qualitech*, the two provisions deal with "two distinct sets of

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206. *Id.* at 118.

207. *Id.*

208. *Id.* at 124–27.

209. *See* Zinman, *supra* note 39, at 99–100 (noting that *Qualitech* "has the potential [] to completely disrupt leasehold investments"); Baxter, *supra* note 79, at 475 (maintaining that *Qualitech* "will have profound implications not only on bankruptcy sales but on real estate leasing and real estate lease financing").

210. *See, e.g.*, Baxter, *supra* note 79.

211. *See generally* Grohsgal, *supra* note 8; Barnhardt, *supra* note 185.

212. *See generally* Zinman, *supra* note 39; *see also* discussion *supra* Part II.B.iv.1.

213. *See generally* Grohsgal, *supra* note 8; Barnhardt, *supra* note 185.

circumstances."[214] He also maintains that the clear lack of cross references between § 363(f) and § 365(h) could represent Congress's purposeful omission—especially since § 363(l) does have such a cross-reference.[215] In making this argument, he refutes Professor Baxter's argument that § 363(l) subjects the whole of § 363 to § 365.[216] Where Professor Baxter's argument claims that this cross-reference can be carried through the whole statute and that the *ipso facto* prohibition was an afterthought,[217] Professor Zinman claims to the contrary—that "[s]ection 363(l) was intended *only* to deal with clauses that might prevent use, sale, or lease based on the insolvency . . . [of] the debtor."[218] Professor Zinman further notes that if Congress had intended to subject the whole of § 363 to § 365, "it would have been so simple to make that clear in other ways."[219] As such, while Professor Zinman believes that allowing § 363(f) sales to rid lessees of their § 365(h) protections was not contemplated in the drafting of the Code, the result is technically correct when engaging in text-based statutory interpretation.[220]

Professor Grohsgal argues that the answer to reconciling the two statutory provisions lies in "affording the tenant the same protection and priority against the property sold and the sale proceeds that the tenant has under state law."[221] Specifically, he maintains that when the debtor wishes to conduct a free and clear sale, the holders in interest in the property, such as the lessee and the mortgagee, should be treated in accordance "with the priorities of their respective bargained-for, prepetition state law property interests against the property."[222] Consequently, he argues that *Qualitech* was correctly decided, and that § 363(f) and § 365(h) do not conflict at all.[223]

Professor Grohsgal begins his analysis by referencing the Supreme Court's holding in the landmark cases of *Butner v. United States* and *Nobleman v. American Savings Bank* for the proposition that property

214. *See* Zinman, *supra* note 39, at 127 (internal citations omitted).
215. *See id.* at 125.
216. *See id.*
217. *See* Baxter, *supra* note 79, at 485.
218. Zinman, *supra* note 39, at 126.
219. *Id.* at 127.
220. *See id.*
221. Grohsgal, *supra* note 8, at 295.
222. *Id.*
223. *Id.* at 307.

interests are formed and defined by state law.[224] Given that the state law where the property is located governs the mortgagee's right to payments during bankruptcy, Professor Grohsgal maintains that the bankruptcy court should take necessary steps to ensure that the mortgagee is afforded the same protections afforded by state law as they would be had no bankruptcy occurred.[225] Simply put, he argues that the treatment of property rights (i.e., the relationship between the mortgagee and any other interest holder) are governed by state law and bankruptcy outcomes should adhere to those rules.[226]

To support his argument, Professor Grohsgal notes that Congress has generally left the determination of property rights in bankruptcy to state law and that such a treatment is sensible because the subordinate interest would not be granted entitlement to a differing value as a result of the bankruptcy.[227] He indicates that the practice of attaching lien and interest holders' interests to the cash generated from the free and clear sale has endured—predating the 1978 Bankruptcy Code and the 1898 Bankruptcy Act—and is reflected in Article 9 of the Uniform Commercial Code.[228]

Additionally, he contends that applying state law property rights in bankruptcy furthers the fundamental purpose of a predictable and orderly debt-collection device.[229] Otherwise, providing parties with greater rights in bankruptcy creates incentives for interest holders to exploit the bankruptcy process in order to gain an advantage for themselves.[230] As Professor Grohsgal puts it, "[s]training to read the lease rejection provision in section 365(h) to protect an out-of-the-money subordinate lease on a free and clear sale under section 363(f) is nothing less than alchemy: it transforms a subordinate lease under state law into a first, superpriority encumbrance against the property under bankruptcy law."[231]

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224. *Id.* at 319 (citing Butner, 440 U.S. 48, 55 (1979) (1898 Act case); Nobleman, 508 U.S. 324, 329 (1993) (1978 Code case)).

225. *Id.* at 319 (citing Butner, 440 U.S. at 49).

226. *Id.* For example, Professor Grohsgal's argument results in the following scenario: if the lessor's contract contained a clause subordinating its interest to that of the mortgagee, then when the debtor elects to sell its property via § 363(f), the lessee will obtain an adequate protection payment after the mortgagee is paid in full. *See id.* The converse would occur if the mortgagee was the party subordinated in relation to the lessee. *See id.*

227. *Id.* at 306–11.

228. *Id.* at 311.

229. *Id.* at 320 (citing Jackson, *supra* note 15, at 21).

230. *Id.*

231. *Id.* at 324.

Professor Grohsgal also examines the history behind § 363 and he concludes that pre-Code bankruptcy law regularly characterized § 363(f) sales as equivalent to state law foreclosure sales and that interests were treated in accordance with the parties' prepetition state law rights.[232] In addition, Professor Grohsgal applies the canons of statutory interpretation and found that the text of § 365(h) makes no mention of sales.[233] Similarly, the text of § 363(f) makes no reference to lease rejections or distinctions between a lessee's interest and a lien holder's interest.[234] He remarks that Congress knows how to draft exclusions and the lack thereof in both provisions is clear evidence that Congress intended no such exclusion or special treatment of leases in a § 363(f) sale.[235] He also re-emphasizes the fact that § 363(f) and § 365(h) are co-equal Code provisions that cover two explicitly distinct circumstances—a sale and rejection of contract respectively.[236] Lastly, Professor Grohsgal finds that there is no discernible purpose within the Code to protect non-debtor lessees.[237] In fact, such a treatment "transcends the general goals of equitable distribution based on the parties' bargained-for, state law prepetition rights and maximizing the value of the estate and distribution to creditors."[238]

In another article, Barnhardt theorizes that *Spanish Peaks Holdings II* was a "result-oriented" opinion and that, to resolve the split, courts should fashion adequate protection to the circumstances.[239] First, he observes that the judges in the Ninth Circuit were likely seeking to avoid providing the lessees with continued possession to prevent a windfall to the billionaire insider-lessees at the expense of the legitimate creditors.[240] Essentially, these founders entered leases for nominal rent knowing the property was encumbered by a large mortgage.[241] In fact, one of the

232. *See id.* at 336.
233. *See id.* at 350.
234. *See id.*
235. *See id.* at 337, 350.
236. *See id.* at 351, 353.
237. *Id.* at 365.
238. *Id.*
239. Barnhardt, *supra* note 185, at 210, 217.
240. *Id.* at 211.
241. *Id.* Barnhardt noted that the fair market annual rental value of the property that Pinnacle rented was $100,000 while Pinnacle was paying a mere $1,000 in rent. *Id.* He also posits that given the term of the rent, the buyer of the property would have forgone $92,000,000 in market rent, $92,000,000 is the aggregation of $100,000 of annual rent

founders was jailed over his alleged "missing funds" and inability to account for millions from the sale of another property.[242] As the lessees failed to request adequate protection, the court's determination was much simpler.[243]

However, had the lessees timely requested or the court taken the majority view granting continued possession, the buyout from a prospective buyer would have greatly reduced the amount the mortgagee could have recovered.[244] This outcome would have failed to honor the overarching purpose in bankruptcy of maximizing creditor recovery.[245] As such, Barnhardt contends that the Ninth Circuit avoided a "tremendous abuse of the bankruptcy system."[246]

Considering the possibilities of outcomes if the lessees requested adequate protection, Barnhardt notes that, "in cases where undeserving tenants with bad intentions diligently request adequate protection, judges will be trapped between the Scylla of continued possession and the Charybdis of compensation."[247] He suggests that the solution lies in granting lessees adequate protection upon request, but adjusting the value placed on the leasehold interest to the circumstances of the case.[248] He contends that this solution closes the loopholes created by the majority approach by preventing the unjust recovery of undeserving lessees.[249]

III. A MIDDLE-GROUND APPROACH EXISTS AND SHOULD BE FOLLOWED

This Note proposes that the issue and rulings thereupon are not easily categorized as two-sided. Part III will present a middle-ground view and argue that this median approach clarifies and resolves the ambiguities and

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for ninety-two years. *Id.* Barnhardt also notes that the founder of Pinnacle "fought so hard for continued possession for a boarded-up restaurant suggests that he was seeking a buyout from the purchaser in an amount exceeding his legal fees incurred in taking the dispute all the way to the Ninth Circuit." *Id.*

242. *Id.*; *see* Daniel Fisher, *Former Billionaire Tim Blixseth Jailed Over Missing Funds*, FORBES (Dec. 18, 2014, 10:13 PM), https://www.forbes.com/sites/danielfisher/2014/12/18/former-billionaire-tim-blixseth-jailed-over-missing-funds/?sh=2837348b76ao [https://perma.cc/PU77-BL9C].

243. Barnhardt, *supra* note 185, at 213.

244. *Id.*

245. *Id.*

246. *Id.* at 214.

247. *Id.*

248. *Id.* at 215.

249. *Id.* at 217.

conflicts that have arisen in the interpretation and application of § 363(f) and § 365(h).

A. *DISHI & SONS* AND *MMH* SHOULD BE CATEGORIZED AS TAKING A MIDDLE-GROUND APPROACH

In navigating the complex legal terrain shaped by § 363(f) and § 365(h) of the Code, a median approach emerges as a compelling alternative.[250] Although no other cases or articles recognize a third view, this Note proposes the existence of a middle-ground view. This view essentially (1) rejects the idea that a failure to formally reject allows debtors to skirt § 365(h) protections agreeing with the majority view, but also (2) maintains that a § 363(f) sale can dispossess a non-debtor lessee in line with the minority view.[251]

Given these views, it is sensible to separate *Dishi & Sons* and *MMH* from the majority and minority views and categorize these cases as middle-ground because these cases do not conform fully to either the majority or minority views.[252] *Dishi & Sons* and *MMH* find that § 365(h) protection applies in the presence of a leasehold interest as the appurtenant rights to possession are vested, but hold that nothing in § 365(h) prevents a debtor from using another right granted by the Code (i.e., selling the property via § 363(f)) to eviscerate these property rights.[253] While the *Dishi & Sons* court granted adequate protection of the leasehold interest in the form of continued possession,[254] the *MMH* court noted that without the procedural mistake that occurred, the lessee would have been entitled to adequate protection measured as the value of its interest paid from the sale proceeds.[255]

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250. *See generally* Dishi & Sons v. Bay Condos LLC, 510 B.R. 696, 698 (S.D.N.Y. 2014) (in declining to fully endorse the majority view while reaching the same result, this case demonstrates the reasoning behind the middle ground view supported by this Note); MMH, 385 B.R. 347, 362–64 (Bankr. S.D. Fla. 2008).

251. *See, e.g.*, *Dishi & Sons*, 510 B.R. at 704–12; *MMH*, 385 B.R. at 362–64.

252. *See generally Dishi & Sons*, 510 B.R. 696; *In re* Royal St. Bistro, LLC, 26 F.4th 326 (5th Cir. 2022); *MMH*, 385 B.R. 347.

253. *See Dishi & Sons*, 510 B.R. at 707; *MMH*, 385 B.R. at 366; *see also* Andrew, *supra* note 166, at 904–05.

254. *See Dishi & Sons*, 510 B.R. at 711–12.

255. *See MMH*, 385 B.R. at 372.

B. THE MIDDLE-GROUND VIEW SHOULD BE ADOPTED TO RESOLVE THE CIRCUIT SPLIT

The middle-ground approach maintains that § 365(h) protections are triggered in the presence of a leasehold interest.[256] The debtor-lessor should not be able to avoid the explicit obligations set forth therein through conveniently failing to seek a court order to either assume or reject the lease.[257] The middle-ground approach also contends that the § 365(h) protections can be terminated in the case of a § 363(f) sale.[258] In this situation, the lessee can be provided with adequate protection under § 363(e) upon request.[259] This approach is supported by sound statutory analysis, constitutional concerns and the underlying goals, purpose, and practical considerations of the administration of the Bankruptcy Code. This approach also has the benefit of integrating the strengths and mitigating the weaknesses of the existing interpretations of § 363(f) and § 365(h),[260] while respecting the debtor's need to maximize asset value through free and clear sales and acknowledging the legitimate expectations and rights of lessees.[261]

Furthermore, the resolution of this conflict is not only of theoretical interest but has become increasingly relevant in the aftermath of the COVID-19 pandemic, which has significantly altered the landscape of commercial leasing.[262] With companies continuing to scale back their in-office footprint,[263] there is likely to be further decreased demand for

256. *See* 11 U.S.C. § 365(h).

257. *See id.*

258. *See id.*

259. *See id.* § 363(e).

260. *Compare In re* Taylor, 198 B.R. 142 (Bankr. D.S.C. 1996) *with Qualitech*, 327 F.3d 537 (7th Cir. 2003).

261. *Cf.* 3 COLLIER ON BANKRUPTCY ¶ 363.06 (16th ed. 2023) ("Presumably the additional price that a purchaser would be willing to pay to obtain assets free of successor liability can ultimately flow to the benefit of claimants in the bankruptcy."); Baxter, *supra* note 79, at 496 (discussing the potential consequences of ending a leasehold interest to lessee).

262. *See* Milton Ezrati, *Covid's Long Shadow Still Spreads over Commercial Real Estate*, FORBES (Mar. 17, 2023), https://www.forbes.com/sites/miltonezrati/2023/03/17/covids-long-shadow-still-spreads-over-commercial-real-estate/?sh=541a3e5227ae [https://archive.is/pHIOu]; *The Impact on Real Estate*, MCKINSEY GLOB. INST. (July 13, 2023), https://www.mckinsey.com/mgi/our-research/empty-spaces-and-hybrid-places-chapter-2 [https://perma.cc/QEK8-KGTF].

263. After the pandemic forced much of the United States workforce to work remotely from home, the world discovered that much in-office work can be done from home

commercial office leasing—likely harming the commercial office leasing market and resulting in real-estate intensive bankruptcies.[264] This economic change in the real estate market underscores the urgency of addressing the legal ambiguities between § 363(f) and § 365(h).[265] The adoption of this middle-ground view would benefit the administration of bankruptcy law in this context, the balancing of rights and expectations of lessors and lessees, and the commercial leasing market as a whole. The arguments in favor of this middle ground approach will be discussed below.

1. The Tools of Statutory Interpretation Support the Middle-Ground View

In applying cannons of statutory interpretation, the minority view of allowing § 363(f) sales to dispossess a leasehold interest notwithstanding the protections afforded by § 365(h) is more persuasive.[266] Although the majority view's use of the canon that suggests that specific provisions should control over general provisions seems logical upon initial glance, this author maintains that this canon is inapplicable here.[267] As Professor Zinman contends, application of the specific controls the general canon

without the burdens of commuting, daycare expense, and business attire. *See* Jefferey Kirwin, *COVID-19 and the Rise in Commercial Real Estate Bankruptcies: The Path to Reach the Goals of Bankruptcy Code §365(D)(3)*, 15 J. BUS. ENTREPRENEURSHIP & L. 205, 209, 211 (2022) (noting that "office spaces are in a precarious position as businesses have found ways for employees to do more from home, and some technology companies are even considering permanent work from home strategies"). Three years after the pandemic, many law firms and other organizations are still allowing a hybrid work schedule. *See The Impact on Real Estate*, *supra* note 267.

264. *See* Peter Eavis et al., *WeWork Bankruptcy Would Deal Another Blow to Ailing N.Y. Office Market*, N.Y. TIMES (Nov. 4, 2023), https://www.nytimes.com/2023/11/04/business/wework-bankrupcty-office-real-estate.html [https://archive.is/xcT3D]; *see also* Kirwin, *supra* note 268, at 211. In fact, WeWork—a company that provides flexible office spaces—just filed for bankruptcy on November 6, 2023. *See* Jordyn Holman & J. Edward Moreno, *WeWork Files for Bankruptcy Amid Glut of Empty Offices*, N.Y. TIMES (Nov. 6, 2023), https://www.nytimes.com/2023/11/06/business/wework-bankruptcy.html [https://archive.is/vGNwJ].

265. *See* Kirwin, *supra* note 268, at 206. All cases described in this Note were decided before March 2020 except for *In re Royal St. Bistro, LLC*, which was decided in 2022. 26 F.4th 326 (5th Cir. 2022).

266. *See, e.g.*, Dishi & Sons v. Bay Condos LLC, 510 B.R. 696 (S.D.N.Y. 2014).

267. *See, e.g.*, *In re* Churchill Props. III, 197 B.R. 283, 288 (Bankr. N.D. Ill. 1996).

should be limited to statutory provisions which deal with the *same circumstances*.[268]

Here, § 363(f) controls when a debtor can sell its property free and clear of interests, whereas § 365 controls the debtor's ability to assume or reject contracts, and § 365(h) specifically allows non-debtor lessees to maintain their appurtenant rights in the event of a rejection.[269] Additionally, this argument can easily be reversed: because the subject matter of the issue before the court is the debtor's motion to sell property free-and-clear via § 363(f), which is the provision that explicitly governs such sales, § 363(f) is more specific than the general protections of § 365(h) in the case of the rejection of an unexpired lease.[270] The fact that the statutes apply to differing circumstances indicates that this canon does not assist in this analysis.[271]

Turning to the canon of statutory interpretation that counsels for the reading of statutes to avoid conflicts,[272] the two statutory provisions can be read harmoniously while still preserving and giving effect to the purpose of each.[273] Though many courts have found these statutes to conflict,[274] the minority stance contends that they can be read to avoid conflicts for similar reasons as expressed above: § 363(f) and § 365(h) apply to different circumstances.[275] While this Note posits in the section below that both statutory provisions apply to the circumstances that give rise to the circuit split, both statutes' effect can still be honored.

On one hand, § 365(h) protects the lessee's leasehold interest in the case of rejection or assumption of the lease effectively balancing the debtor's ability to reorganize and the lessee's bargained for rights.[276] On the other hand, § 363(f) empowers the debtor to sell its property and distribute the proceeds to creditors and entities granted adequate protection.[277] As the *Qualitech* court contends, these statutes can easily be read to give effect to each and avoid a conflict altogether.[278]

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268. *See* Zinman, *supra* note 39, at 127 (internal citation omitted).
269. *See* 11 U.S.C. §§ 363(f), 365(h).
270. *See id.*
271. *See Qualitech*, 327 F.3d 537, 547 (7th Cir. 2003).
272. *See id.* at 544; MMH, 385 B.R. 347, 364–65 (Bankr. S.D. Fla. 2008).
273. *See, e.g.*, *Qualitech*, 327 F.3d at 544.
274. *See, e.g.*, *In re* Churchill Props. III, 197 B.R. 283, 286 (Bankr. N.D. Ill. 1996).
275. *See Qualitech*, 327 F.3d at 544.
276. *See* 11 U.S.C. § 365(h).
277. *See id.* § 363(f).
278. *See Qualitech*, 327 F.3d at 544; MMH, 385 B.R. 347, 364–65 (Bankr. S.D. Fla. 2008).

Next, courts "generally presume[] that Congress acts intentionally and purposely in [circumstances of] disparate inclusion or exclusion."[279] As Professor Grohsgal maintains, § 363(f) and § 365(h) are two separate, co-equal Code provisions that do not contain any cross-references.[280] This fact alone suggests that § 365(h) does not limit § 363(f). Meanwhile, Congress has explicitly subjected § 363(l) to § 365.[281] Professor Zinman refutes Professor Baxter's argument that the subjection of § 363(l) to § 365 effectively extends to the whole of § 363, arguing instead that § 363(l) was triggered only in situations where clauses would prevent a sale.[282] Had Congress intended this singular exclusion to extend to the whole of § 363, "it would have been so simple to make that clear in other ways."[283] The fact that Congress expressly included a clear, unambiguous cross-reference to § 365 within § 363(l) and failed to do so for § 363(f) demonstrates that it is unlikely that Congress intended to subject § 363(f) sales to the automatic continued possession of leasehold interests.[284]

In reviewing the legislative history behind the enactment of and amendments to § 365(h), the consistent goal of strengthening lessee rights is evident.[285] Yet, finding that § 365(h) can be eviscerated by a § 363(f) sale does not preclude § 365(h) from protecting non-debtor lessees in the case of rejections.[286] The legislative history of § 365(h) should not be utilized to make arguments related to the interpretation of § 363(f).[287] Further, § 365(h) must be considered in light of the delicate balance of the Bankruptcy Code, which weighs the debtor's ability to rehabilitate in a reorganization with the fair treatment of creditors.[288] Again, if Congress intended to limit the debtor's statutorily explicit power to sell property

279. Keene Corp. v. United States, 508 U.S. 200, 208 (1993) (internal citation omitted).

280. *See* Grohsgal, *supra* note 8, at 337, 350–53.

281. *See* 11 U.S.C. § 363(l) (the whole provision is "[s]ubject to the provisions of section 365").

282. *See* Zinman, *supra* note 39, at 126–27; *see also* Baxter, *supra* note 79, at 485.

283. *See* Zinman, *supra* note 39, at 126–27.

284. *See* 11 U.S.C. § 363(f)(l).

285. *See* Zinman *supra* note 39, at 106–19; *In re* Taylor, 198 B.R. 142, 165–67 (Bankr. D.S.C. 1996).

286. *See* 11 U.S.C. § 365(h).

287. *See id.* §§ 363(f), 365(h).

288. *See* Bartenwerfer v. Buckley, 598 U.S. 69, 72 (2023); *cf.* Clark v. Rameker, 573 U.S. 122, 129 (2014) (internal citations omitted).

free-and-clear of leasehold interests, it could have included the limitational language contained in § 363(l).[289]

Lastly, in response to the majority view argument that allowing sales to dispossess lessees renders § 365(h) "nugatory,"[290] this Note's solution proposes that § 365(h) is triggered in the presence of a leasehold the debtor does not intend to assume regardless of the failure to assume by motion.[291] Even if § 365(h) can be eviscerated by a sale, the court must grant adequate protection upon request.[292] Notably, despite his opposition to the predicted effects of the minority view, Professor Zinman states that "*Qualitech* was correctly decided."[293]

In conclusion, the middle-ground outcome that § 365(h) does limit a debtor's ability to sell property free and clear of a leasehold interest through § 363(f) is strongly supported by the tools of statutory interpretation.

2. Adequate Protection and the Higher Barrier Posed by § 363(f) Sufficiently Protect the Lessee

Under the middle-ground approach, lessees who are facing a § 363(f) sale have several protections in place to prevent the removal of, or to ensure the fair compensation for, their interest: the judge's discretion in granting adequate protection through § 363(e) and the high barrier of the five § 363(f) conditions.[294] This subsection will examine each protection in turn.

To reiterate, adequate protection is a safeguard baked into § 363 to protect parties whose interests are affected by a sale.[295] Adequate protection has been interpreted as a flexible concept and the circumstances of each case will determine the necessity and type of relief to be granted.[296] For example, the *In re Haskell LP* court noted that

289. *See* 11 U.S.C. § 363(f)(l).

290. *See In re* Churchill Props. III, 197 B.R. 283, 288 (Bankr. N.D. Ill. 1996).

291. *See* discussion *infra* Part III.B.iii.

292. *See* discussion *infra* Part III.B.ii; *see also* 11 U.S.C. § 363(e).

293. *See* Zinman, *supra* note 39, at 100.

294. *See* 11 U.S.C. §§ 363(e),(f).

295. *See id.* § 363(e).

296. *See* 3 COLLIER ON BANKRUPTCY ¶ 363.05 (16th ed. 2023); *see also In re* O'Connor, 808 F.2d 1393, 1396–97 (10th Cir. 1987) (finding adequate protection to be "a concept which is to be decided flexibly on the proverbial 'case-by-case' basis"); *see also In re* Realty Sw. Assocs., 140 B.R. 360 (Bankr. S.D.N.Y. 1992) (internal citations omitted).

adequate protection could come in the form of continued possession, compensation from the sale proceeds, or other relief as is appropriate.[297] Further, though the lessee failed to request adequate protection in *Matter of Spanish Peaks Holdings II, LLC*, the Ninth Circuit noted that the broad definition of adequate protection creates a "powerful check on potential abuses of free-and-clear sales."[298] Thus, adequate protection is the ideal solution to protect lessee interests and prevent abuse to the bankruptcy system because courts may use judicial discretion to award the form of protection that is warranted under the circumstances or prohibit the sale when adequate protection is insufficient.[299]

As far as non-possessory protection, Professor Zinman believes that valuing a lease is possible and happens frequently (especially in condemnation proceedings), but it may be complex and time-consuming.[300] Allowing adequate protection to be flexible and fashioned on a case-by-case basis allows a judge to consider other factors, such as the other creditors and the reorganization of the debtor, to produce the most equitable outcome.[301] The *In re Haskell LP* court countered this argument by noting that adequate protection cannot be provided when a sale is allowed via § 363(f)(1) and the mortgage is undersecured because there are no sale proceeds left to pay the lessee for adequate protection.[302] However, the court fashioned the relief it saw appropriate in this circumstance—realizing that the sale proceeds would not reach the lessee, the court determined that continued possession was the only manner of protecting the leasehold interest.[303]

Assuming lessees are vigilant in requesting that the court grant protection of their interests, adequate protection is a shield to protect

297. *In re* Haskell LP, 321 B.R. 1, 8, 10 (Bankr. D. Mass. 2005); *see also* Dishi & Sons v. Bay Condos LLC, 510 B.R. 696, 711–12 (S.D.N.Y. 2014) (finding that given the facts before it, continued possession was the only form of adequate protection of the lessee's interest).

298. *See In re* Spanish Peaks Holdings II, 872 F.3d 892, 899–900 (9th Cir. 2017).

299. *See* 3 COLLIER ON BANKRUPTCY ¶ 363.05 (16th ed. 2023).

300. *See* Zinman, *supra* note 39, at 146 (citing James Cooper, *Lease Interest Valuations*, APPRAISAL & VALUATION MANUAL AM. SOC'Y APPRAISERS 71 (1960); Edward T. Matheny, *Leasehold Interests*, 27 APPRAISAL J. AM. INST. REAL EST. APPRAISERS, 375 (1959)).

301. *Cf.* Barnhardt, *supra* note 185, at 215 (suggesting the use of adequate protection to provide judges with the discretion to minimize adequate protection in the case of under-deserving commercial tenants).

302. *See In re* Haskell LP, 321 B.R. 1, 10 (Bankr. D. Mass. 2005).

303. *See id.*

lessees against the complete evisceration of their leasehold interest, which can be fashioned by courts to suit the circumstances.[304] In this way, § 363(e) effectively replaces § 365(h) as a form of protection for the lessee within a § 363(f) sale.

As the *Dishi & Sons* court noted, lessees are further protected by the fact that satisfaction of one of the five disjunctive but mandatory conditions of § 363(f) will rarely permit a sale free and clear of a leasehold interest.[305] Generally, only subsections (1) and (4) have the potential to apply to leases in these cases.[306] In these circumstances, some courts have found § 363(f)(1) applies to cases wherein foreclosure law allows the senior mortgagee to foreclose upon the property under state law in a nonbankruptcy setting.[307] In support of this interpretation, Professor Grohsgal maintains that using § 363(f)(1) to permit a sale when the senior mortgagee would have the ability to foreclose on the property outside the bankruptcy is necessary to ensure that the mortgagee is afforded the same rights within federal bankruptcy court as they would have had if no bankruptcy had occurred.[308] However, the *Dishi & Sons* court held that foreclosure law could not constitute "nonbankruptcy law."[309] As support, the court noted the following: (1) by its terms, § 363(f) is arguably limited to actions that can be taken by the debtor or trustee, not the mortgagee, (2) the Code distinguishes between foreclosure law and bankruptcy law,

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304. *Cf.* Barnhardt, *supra* note 185, at 215 (suggesting the use of adequate protection to provide judges with the discretion to minimize adequate protection in the case of under-deserving commercial tenants).

305. *See* Dishi & Sons v. Bay Condos LLC, 510 B.R. 696, 699, 708–11 (S.D.N.Y. 2014); *see also* Baxter, *supra* note 79, at 419.

306. Section 363(f)(5)'s use has been rejected by courts, except for the *MMH* court which granted relief via this provision for a lease which contained a right to buyout. *MMH*, 385 B.R. 347, 371–72 (citing *In re Haskell, LP*, 321 B.R. at 8–10 (rejecting the use of § 363(f)(5) in attempting to eviscerate leasehold rights)). In addition, no case cited in this Note has granted relief through § 363(f)(2) or § 363(f)(3). *See, e.g.*, *Qualitech*, 327 F.3d 537, 546 (7th Cir. 2003).

307. *See In re* Royal St. Bistro, LLC, 26 F.4th 326, 328 (5th Cir. 2022); *In re* Spanish Peaks Holdings II, 872 F.3d 892, 900 (9th Cir. 2017) (noting that "it [is] significant that section 365 recognizes appurtenant rights conferred by a lease 'to the extent that such rights are enforceable under applicable nonbankruptcy law,'" . . . and the court "[saw] no reason to exclude the law governing foreclosure sales from the analogous language in section 363(f)(1)").

308. *See* Grohsgal, *supra* note 8, at 353–55.

309. *See Dishi & Sons*, 510 B.R. at 699, 708–10 (holding that given "the substantial and material differences," § 363(f)(1) refers not to foreclosure sales, but rather "only to situations where the owner of the asset may, under nonbankruptcy law, sell an asset free and clear of an interest in such asset").

and (3) the fact that the circumstances between a § 363(f) sale and foreclosure differ markedly in that one is a voluntary action undertaken by the debtor and the other is a forced proceeding undertaken by the mortgagee.[310] Regardless of the correct interpretation of the foregoing conflict,[311] this is an issue the lessee could have contracted for in the lease by requesting a subordination of the mortgage to the leasehold.[312] Given the uncertainty in the interpretation and the lessee's ability to contract around this result, the lessee is reasonably protected against a sale via § 363(f)(1).[313]

Likewise, lessees can also prevent the applicability of § 363(f)(4) which allows a debtor to dispossess a lessee when there is a bona fide dispute—an objective factual or legal dispute as to the validity of the lease.[314] Parties who have invoked this provision successfully have done so because the lessee was in default under lease, which is entirely within the lessee's control.[315]

As such, under the middle-ground approach, the lessee is protected by the difficulty the debtor will face in invoking these provisions and the ability of the lessee to contractually protect itself or control these

310. *See id.* The court also noted that if the mortgagee "believes that its interest will not be adequately protected in bankruptcy, it may seek leave from the stay to commence [] foreclosure proceedings." *Id.* at 710.

311. Although the complex issue as to whether foreclosure law qualifies as "nonbankruptcy law" under § 363(f)(1) is beyond the scope of this Note, this Note agrees with the *Dishi & Sons* court that foreclosure law should not apply in this setting. *See id.* at 708–10. In addition to the reasons set forth in *Dishi & Sons*, this Note further argues that: (1) bankruptcy is frequently used as a protection against foreclosure law through the automatic stay provided in § 362 which prevents and pauses such proceedings, (2) foreclosure law is a creature of state law and using § 363(f)(1) to create an artificial foreclosure procedure in bankruptcy court raises federalism concerns, and (3) foreclosure law only governs when the mortgagor (or debtor here) is in default under the loan and the mortgagee brings an action to foreclose. *See* 3 COLLIER ON BANKRUPTCY ¶ 362.03 (16th ed. 2023); OneWest Bank, FSB v. Farrar, Civ. No. 12-00108 ACK-KSC, 2014 WL 5023472, at *5 (D. Haw. Oct. 8, 2014) ("In general, there is no federal foreclosure law; rather, state law serves as the law of decision in foreclosure actions."); *see also* Frank S. Alexander, *Federal Intervention in Real Estate Finance: Preemption And Federal Common Law.*, 71 N.C. L. REV. 293, 300, 349 (1993).

312. *See* Zinman, *supra* note 39, at 122.

313. *See* 11 U.S.C. § 363(f)(1).

314. *See id.* § (f)(4).

315. *See In re* Royal St. Bistro, LLC, 26 F.4th 326, 328 (5th Cir. 2022) (noting that the lessee had not paid rent in months).

circumstances.[316] The lessee further may receive adequate protection of its interests through § 363(e).[317]

3. The Middle-Ground View Is Supported by the Interpretation of a Rejection in Addition to Constitutional and Practical Concerns

In support of the middle-ground view, this subsection will argue that a formal rejection is needed to trigger § 365(h) protections.[318] It will also examine constitutional concerns, emphasize Barnhardt's observation that the minority cases were likely results-oriented, and highlight other practical concerns in the minority view.

Assuming that the minority is correct and that a rejection only occurs with a formal motion to the court,[319] what happens to a lease when it is rejected post-sale?[320] Professor Baxter finds that, in these circumstances, "the subsequent rejection of the lease" by the buyer triggers section 365(h).[321] Granted, treating the issue in this manner makes for a much simpler analysis; this result "skirts the purported conflict and thus fails to offer a real solution."[322] Regardless, it is unnecessary to rely on the "artificial distinction" between rejection and repudiation[323] because the lessee's appurtenant rights are unaffected whether the debtor assumes, rejects, or does nothing with regard to the leasehold interest.[324]

Considering the effect of an assumption or rejection discussed above,[325] the debtor's inaction or election to assume or reject the lease has no impact on the reversionary "property" interest of the lessee as the debtor's rejection does not affect or enhance this right.[326] Section 365(h) simply represents an explicit statutory provision providing for this outcome.[327] Further, in a Chapter 11 case, when a debtor does not assume

316. *See* Dishi & Sons v. Bay Condos LLC, 510 B.R. 696, 699, 708–11 (S.D.N.Y. 2014).

317. *See* 11 U.S.C. § 363(e).

318. *See* 11 U.S.C. § 365(h).

319. *See In re* Spanish Peaks Holdings II, 872 F.3d 892, 896 (9th Cir. 2017); *see also* Qualitech, 327 F.3d 537, 547 (7th Cir. 2003).

320. *See* Baxter, *supra* note 79, at 486.

321. *Id.*

322. Dishi & Sons v. Bay Condos LLC, 510 B.R. 696, 699, 704 (S.D.N.Y. 2014).

323. *See Qualitech*, 327 F.3d at 547.

324. *See Dishi & Sons*, 510 B.R. at 706–07.

325. *See* Andrew, *supra* note 166, at 10; *See* Jay L. Westbrook, *A Functional Analysis of Executory Contracts*, 74 MINN. L. REV. 227, 255 (1989).

326. *See* Andrew, *supra* note 166, at 10.

327. *See id.*

or reject a contract, the contract "rides through" the bankruptcy case, unaffected and deemed to have been accepted.[328]

As such, the logical conclusion of the debtor's failure to make a § 365 election is a de-facto assumption, and the debtor is unable to avoid the § 365(h) protections by failing to make an election via court filing.[329] The notion that without a "formal" rejection, the debtor can use the back door free and clear sale to fully obviate a lease is mistaken.[330] The middle-ground approach thereby adopts the stance that the § 365(h) protections apply in the presence of a leasehold even when a debtor has no intention of assuming the lease.[331]

Furthermore, as Professor Westbrook points out, the property rights created by a leasehold interest are not absolute and may be avoided through the "avoiding powers," such as preferences and fraudulent conveyances.[332] The *Dishi & Sons* court notes that "[t]he purpose of § 365(h) is to clarify that rejection is not an avoidance power—not to give the lessee rights that may never be avoided by some other means."[333] The power of the debtor or trustee to request court permission to sell property free and clear of interests can thereby be seen as one such power. The ability to sell free and clear is a high barrier and may result in the need to provide adequate protection to affected interests.[334] Nevertheless, § 363(f) is a provision that empowers the debtor to sell estate property and clear such property from "interests."[335]

The middle-ground approach also resolves constitutional concerns. Where § 365(h) is deemed inapplicable to a § 363(f) sale and adequate protection is not requested, the evisceration of a leasehold interest can be seen as violating the Fifth Amendment.[336] As noted, adequate protection originated from the Fifth Amendment prohibition against the taking of

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328. *See* 3 COLLIER ON BANKRUPTCY ¶ 365.03 (16th ed. 2023); *see also Dishi & Sons*, 510 B.R. at 707 (noting that § 365(h) preserves the lessee's appurtenant rights in the event of rejection or non-assumption by the debtor).

329. *Cf.* 3 COLLIER ON BANKRUPTCY ¶ 365.03 (16th ed. 2023).

330. *Cf. id.*

331. *See* 11 U.S.C. § 365(h).

332. *See* Westbrook, *supra* note 331, at 270–75.

333. *See Dishi & Sons*, 510 B.R. at 708.

334. *See id.*

335. *See* 11 U.S.C. § 363(f).

336. *Cf.* Shanor, *supra* note 65, at 620 (citing Wright v. Union Cent. Life Ins. Co., 311 U.S. 273 (1940)); Louisville Joint Stock Land Bank v. Radford, 295 U.S. 555 (1935)).

private property without due process of law.[337] In order for the minority and middle-ground viewpoint to uphold constitutional principles, § 363(e) must be interpreted in a broad manner to provide protection to leasehold interests, not solely security interests.[338] Many courts have interpreted adequate protection in this manner[339] and fashioned relief as needed, allowing courts to uphold the purpose of the Code as a dynamic body of law based in fairness and equity.[340] If the court is unable to grant a form of adequate protection it deems satisfactory, or at least the minimum constitutionally required, then the court may not authorize the sale free and clear of the impacted interest, even if the entity requesting the sale satisfies all of § 363(f)'s conditions.[341] As such, through adequate protection, both the minority and middle-ground views avoid an unconstitutional taking of an interest, whether by providing compensation or continued possession.[342]

Lastly, as noted by Barnhardt, the minority opinions were "results-oriented" and aimed to prevent billionaire founders from "exploiting the bankruptcy process by recovering millions of dollars at the expense of creditors."[343] The court was able to do so in both cases because the lessees failed to request adequate protection.[344] Therefore, the artificial distinction between rejection and repudiation is unnecessary to reach a fair outcome.[345] Barnhardt recommends fashioning adequate protection to

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337. *See id.*; *see also* Andrew N. Karlen, *Adequate Protection Under the Bankruptcy Code, Its Role in Business Reorganization*, 2 PACE L. REV. 1, 1 (1982).

338. *See In re* Megan-Racine Assocs., Inc., 192 B.R. 321, 326–27 (Bankr. N.D.N.Y. 1995) (collecting cases and describing the varying interpretations for whom § 363(e) applies).

339. *See* 3 COLLIER ON BANKRUPTCY ¶ 363.05 (16th ed. 2023); *see also In re* O'Connor, 808 F.2d 1393, 1396–97 (10th Cir. 1987).

340. *See* Bartenwerfer v. Buckley, 598 U.S. 69, 72 (2023); *cf.* Clark v. Rameker, 573 U.S. 122, 129 (2014) (citations omitted).

341. *See* 3 COLLIER ON BANKRUPTCY ¶ 363.06 (16th ed. 2023).

342. *Cf. id.*

343. *See* Barnhardt, *supra* note 185, at 206.

344. *See In re* Spanish Peaks Holdings II, 872 F.3d 892, 899 (9th Cir. 2017); Qualitech, 327 F.3d 537, 548 (7th Cir. 2003).

345. As Barnhardt notes, these leases involved insider leases with nominal rent and long terms. *See* Barnhardt, *supra* note 185, at 206–07. Interestingly, the courts did not discuss recharacterization of the leases as unperfected security interests and termination of said leases on the grounds of fraudulent conveyances. *Cf. In re* Fitness Holdings Int'l, Inc., No. CV 14-1059 AG, 2014 WL 12628681, at *7 (C.D. Cal. Oct. 9, 2014), *aff'd*, 660 F. App'x 546 (9th Cir. 2016) (holding that the bankruptcy court has the authority to recharacterize debt for the purpose of determining whether a transfer was fraudulent under § 548).

suit the circumstances by providing unfairly treated lessees and dubious debtors with appropriate outcomes.[346] This outcome can also be achieved by the middle-ground view.

4. The Middle-Ground View is Supported by Policy Arguments and the Goals of the Bankruptcy Code

As stated in Part I, the Code attempts to strike a delicate balance between the competing interests of providing relief to the insolvent debtor and ensuring fair treatment and maximum recovery for creditors.[347] Given the Code's purpose, the tension between § 363(f) and § 365(h) should be resolved in a way that allows the debtor to reorganize or liquidate while balancing the interests of creditors and other parties in interest, such as non-debtor lessees.[348]

If the debtor needs to sell property to reorganize effectively, the debtor should be able to do so if enabled by the Code.[349] Further, providing lessees with the absolute right to maintain its leasehold interest through § 365(h) regardless of the debtor's ability to reorganize effectively or the creditor's legitimate interests in the property provides lessees with disproportionate rights.[350] As Professor Grohsgal stated, "[b]ankruptcy policy strongly favors equality of treatment of all creditors and strongly disfavors the creation of property rights upon the filing of a bankruptcy case . . . [and the creation of such rights] unfairly defeat[s] legitimate expectations of other creditors who may have relied on the absence of any such prior interests in extending credit."[351]

The majority's viewpoint that § 365(h) is absolute thereby fails to fairly balance the rights of parties in interest.[352] Given that the purpose of

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346. *See* Barnhardt, *supra* note 185, at 210, 217.

347. *See Bartenwerfer*, 598 U.S. at 72; *cf. Clark*, 573 U.S. at 129.

348. *See Bartenwerfer*, 598 U.S. at 72; *cf. Clark*, 573 U.S. at 129.

349. Notably, properties with leasehold interests sell at much lower prices. *See* Baxter, *supra* note 79, at 493; *cf.* 3 COLLIER ON BANKRUPTCY ¶ 363.06 (16th ed. 2023) ("Presumably the additional price that a purchaser would be willing to pay to obtain assets free of successor liability can ultimately flow to the benefit of claimants in the bankruptcy.").

350. *Cf. In re* R.J. Dooley Realty, Inc., No. 09-36777, 2010 WL 2076959, at *8 (Bankr. S.D.N.Y. May 21, 2010) (noting that "allowing a party to a terminated lease to take 'adequate protection' would advance its well-established bankruptcy law position as an unsecured creditor.")

351. *See* Grohsgal, *supra* note 8, at 366 (citing H.R. Rep. No. 95-595, at 456 (1977)).

352. *See, e.g.*, *In re* Taylor, 198 B.R. 142, 168 (Bankr. D.S.C. 1996).

§ 365(h) is to clarify that rejection through § 365 is not a power to avoid leasehold rights, the lessees' rights are not absolute and may be avoided in other contexts.[353] Conversely, the minority view that § 365(h) does not apply to § 363(f) sales because § 365(h) is only triggered by a formal rejection also fails to balance the rights of the parties.[354] The ability of the debtor to purposefully fail to assume or reject the contract should not result in the inapplicability of § 365(h).[355]

The middle-ground approach advanced by this Note fairly balances the interests of all parties involved. The lessee is protected by § 365(h) without needing to hope that the debtor formally rejects their contract via a motion to the court.[356] The debtor is also able to sell property free and clear if it satisfies one of the five conditions and uses this tool to effectively reorganize.[357] The lessee, in turn, must request adequate protection after which the court will decide whether a monetary payment or continued possession protects their interest.[358] The creditors will recover according to their bargained-for priority between themselves and the lessee.[359] In short, every party's interest is afforded fair treatment and protection under the middle-ground approach.

CONCLUSION

Assessing the middle-ground approach within the current legal context involves a critical examination of how this balanced perspective aligns with prevailing legal principles. The Note seeks to contribute to the ongoing discourse in bankruptcy law by proposing an approach resolving the issue while engaging in sound statutory interpretation and adhering to constitutional principles. In light of the spirit of the Bankruptcy Code, this Note's proposal aims to resolve the split in the circuits with a solution that balances the interests of the debtor-lessor and the non-debtor lessee. This solution is supported by sound statutory analysis, constitutional concerns, and practical considerations in the administration of the Code, and the underlying goals and purpose of the Bankruptcy Code. While both Professor Baxter and Professor Zinman were concerned about the impact

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353. *See* Dishi & Sons v. Bay Condos LLC, 510 B.R. 696, 708 (S.D.N.Y. 2014).
354. *See* Qualitech, 327 F.3d 537, 546–47 (7th Cir. 2003).
355. *Id.*
356. *See* 11 U.S.C. § 365(h).
357. *Cf. id.* § 363(f).
358. *See id.* § 363(e).
359. *See* Grohsgal, *supra* note 8, at 295.

of the minority decisions on the real estate financing market, this concern can be alleviated by careful contractual drafting and lessees' timely request for adequate protection.[360]

The timely resolution of this split is especially important considering the impact of COVID-19 on the commercial leasing market.[361] The prolonged contraction in the leasing market may cause office commercial real estate holding companies to experience difficulties meeting loan obligations and file for bankruptcy relief creating an uptick in lease intensive bankruptcies.[362] Without a resolution, these companies may engage in forum shopping and file in minority jurisdictions to avoid all leasehold obligations. Though, as noted above, in both the minority cases, the lessees failed to request adequate protection.[363] Although in the *Bistro* case, the court refused to grant adequate protection, likely because of the below-market rental rate and insider status of lessees.[364] This begs the question as to what the minority courts would have done had the lessees made timely requests.[365]

In navigating the complex legal terrain shaped by § 363(f) and § 365(h) of the Code, a middle-ground approach emerges as a compelling alternative and seeks to harmonize the conflicting interpretations, offering a balanced solution that respects the rights and needs of all parties involved in bankruptcy proceedings. This Note ultimately argues that this issue is optimally resolved in a way that allows the debtor's attempt at rehabilitation to be successful, while respecting the contractual rights of non-debtor lessees.

360. *See* Baxter, *supra* note 79, at 477; Zinman, *supra* note 39, at 127.

361. *See* Ezrati, *supra* note 267; *The Impact on Real Estate*, *supra* note 267.

362. *See* Peter Eavis et al., *supra* note 269; *see also* Kirwin, *supra* note 268, at 211.

363. *See In re* Spanish Peaks Holdings II, 872 F.3d 892, 899 (9th Cir. 2017); Qualitech, 327 F.3d 537, 548 (7th Cir. 2003).

364. *See In re* Royal St. Bistro, LLC, 26 F.4th 326, 327-28 (5th Cir. 2022); *see also* Barnhardt, *supra* note 185, at 213 (nothing that the Ninth Circuit avoided the lessee's abuse of the bankruptcy system).

365. *Cf.* Barnhardt, *supra* note 185, at 213.