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The Time to Assume or Reject Nonresidential Leases in Bankruptcy

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The timing by which a debtor must assume or reject a nonresidential lease of real property is a critical element of the Bankruptcy Code. A landlord wants to know the long-term plans for its space, while a debtor needs to formulate its reorganization before it makes a permanent decision regarding the leased space. The tension between these competing interests is controlled by Section 365 of the Bankruptcy Code.

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCA) revised 11 U.S.C.S. § 365(d)(4) to provide a more concrete deadline by which a debtor had to assume or reject nonresidential leases. Prior to BAPCA's enactment, § 365(d)(4) essentially allowed continuous extensions on the deadline to assume or reject a lease. BAPCA revised § 365(d)(4) by providing that leases had to be assumed or rejected by "(i) the date that is 120 days after the date of the order for relief; or (ii) the date of the entry of an order confirming a plan." 11 U.S.C.S. § 365.

Extensions may be granted "for 90 days on the motion of the trustee or lessor for cause. If the court grants an extension under clause (i), the court may grant a subsequent extension only upon prior written consent of the lessor in each instance." 11 U.S.C.S. § 365. "A judge has no authority to grant [extensions of time in excess of 90 days] unless the lessor has agreed in writing to the extension." *In re Dickinson Theatres, Inc.*, No. 12-22602, 2012 WL 6043660, at *3 (Bankr. D. Kan. Dec. 4, 2012).

The purpose of the amendment to BAPCPA was to provide a firm deadline for assumption or rejection of a lease. The amendment accomplishes the Code's goal of providing "a firm, bright line deadline by which" a landlord would recover its property. H.R. Rep. 109-31(1), 109th Cong., 1st Sess. 2005, p. 152-153, 2005 U.S.C.C.A.N. 86-87, *reprinted in* Vol. E-2 Collier on Bankruptcy (Lexis Nexis 16th Ed.), App. Pt. 10(b), p. 10-354. This change was critical for landlords seeking finality.

BAPCA's new deadline removed the possibility of unbounded extensions and provided landlords with clarity on the deadline by which a debtor had to make a decision. That clarity was

unimpeded until recently when the United States Bankruptcy Court for the District of New Jersey, in *In re Rite Aid Corp*., held that a debtor could meet the assumption deadline by giving notice of an intent to assume a lease without filing a formal motion. The *Rite Aid* decision has led to questions regarding the future of assumption proceedings, particularly, what will be deemed adequate to satisfy the requirements for assumption by the deadline, and how the timeline to assume or reject a lease may be affected.

In the years following the enactment of BAPCA, courts strictly upheld the 120-day deadline and consistently stated that a motion was required in order to assume a lease. Arguments that a lease was assumed by way of conduct or notice to the lessor without a formal motion were rejected. Straying away from this precedent, the court in *In re Rite Aid* determined that § 365(d)(4) does not require a party to file a motion to assume in order to comply with the statutory requirements. Here, the court determined that any notice that made the intention to assume clear and unequivocal would be satisfactory under § 365(d)(4).

Decisions prior to *Rite Aid* were fairly consistent in defining the requirements to assume (or assume and assign) a lease. *See In re Jim Slemons Haw., Inc.*, No. 09-01802, 2010 Bankr. LEXIS 4116 (Bankr. D. Haw. Feb. 22, 2010). A landlord leased nonresidential real property to Jim Slemons Hawaii, Inc., the debtor in the case. On August 10, 2009, the debtor filed for Chapter 11 bankruptcy protection. The landlord filed a motion to compel payment of post-petition rent just a few weeks later. The court granted the motion to compel payment of rent, which the court granted. On October 19, 2009, the debtor filed a motion seeking determination of the amount of rent to pay. In January, after the 120 day deadline under § 365(d) had expired, the debtor gave notice of a hearing on the motion regarding rent. The landlord then filed a motion to confirm that the lease had been rejected because the debtor had not taken any action prior to the expiration of the 120 days to assume the lease.

The United States Bankruptcy Court for the District of Hawaii cited to Fed. R. Bankr. P. 6006(a) and stated that there must be a formal motion filed to assume a lease, along with reasonable notice and an opportunity to respond given to "the party against whom the relief is sought." The debtor argued that its motion seeking determination of post-petition rent amount

satisfied those requirements. The court disagreed, stating that the motion seeking confirmation of the amount of rent due did not satisfy the requirements. The motion related solely to post-petition rent and never mentioned assumption. The debtor argued further that the lease was the centerpiece of its reorganization efforts, which should have put everyone on notice of its intention to assume the lease.

The Bankruptcy Court stated that it was insufficient for a debtor to solely state intentions to assume a lease and cited to *Sea Harvest Corp. v. Riviera Land Co.*, 868 F.2d 1077 (9th Cir. 1989), which stated that a formal motion requesting the relief and showing the grounds for assumption is required to assume a lease. The debtor failed to comply with § 365(d)(4). As a result, the landlord's motion to confirm the termination of the lease was granted.

A 2018 case from Arizona confirmed that a debtor cannot assume a lease by conduct. *See J & M Food Servs., LLC v. Camel Inv. L.L.C. (In re J & M Food Servs., LLC)*, No. AZ-17-1291-LKuB, 2018 Bankr. LEXIS 766 (B.A.P. 9th Cir. Mar. 14, 2018). In that case, the debtor leased property from a third party landlord. Several years before the debtor's bankruptcy case, the debtor agreed to the landlord's request to relocate. Rather than relocating the debtor, the landlord placed a different entity in the premises to which the debtor was supposed to move, and the debtor remained in the original premises. Following litigation between partners of the debtor and the new entity in which allegations of collusion were made, the landlord defaulted the debtor under the original lease. Shortly thereafter, the debtor commenced a Chapter 11 bankruptcy case.

The 120 day deadline to assume or reject the lease expired on June 18, 2017 with no intervening motion by the debtor seeking to assume the lease. On June 23, 2017, the landlord filed a motion seeking relief on the grounds that the debtor did not timely file to assume the lease by the deadline. One week later, the debtor filed a motion to assume the lease, claiming that it was not filed beforehand due to turmoil within counsel's law firm. The debtor asked the court to apply its equitable powers to permit the assumption of the lease after the statutory deadline.

In its request for equitable relied, the debtor argued that the landlord was on notice of the debtor's intent to assume the lease based on prior discussions, statements made at prior hearings, and the debtor's payment of pre and post-petition rent. The United States Bankruptcy Court for

the District of Arizona held that the lease was rejected and the debtor had not made any oral or written motion to assume the lease. The debtor appealed the decision.

On appeal, the Ninth Circuit Bankruptcy Appellate Panel cited to Fed. R. Bankr. P. 6006(a), which states that "[a] proceeding to assume, reject, or assign an executory contract or unexpired lease, other than part of a plan, is governed by Rule 9014." Rule 9014 states that "relief shall be requested by motion, and reasonable notice and opportunity for hearing shall be afforded the party against whom relief is sought." The debtor argued that its actions, including a planned reorganization to continue operating on the premises, constituted an implicit assumption. The Bankruptcy Appellate Panel, agreeing with the bankruptcy court, held that a lease may not be assumed by conduct and affirmed the ruling of bankruptcy court.

In contrast to the previous cases, a decision in the first Rite Aid bankruptcy case allowed the debtor to assume a lease by conduct rather than an express motion. *See In re Rite Aid Corp.*, No. 23-18993 (MBK), 2024 Bankr. LEXIS 2711 (Bankr. D.N.J. Nov. 6, 2024). Rite Aid Corporation and Fair Oaks, LLC ("Fair Oaks") were parties to a commercial lease. Rite Aid intended to extend and renew the lease for a five (5) year period commencing November 2, 2023. However, Rite Aid commenced a Chapter 11 bankruptcy proceeding on October 15, 2023. In December 2023, the time for Rite Aid to assume or reject the lease was extended to May 13, 2024. On February 26, 2024, Debtor issued a Notice of Assumption of Certain Unexpired Leases, which included the Fair Oaks lease. Fair Oaks objected to the assumption of its lease with Rite Aid. Rite Aid then included the Fair Oaks lease on a draft schedule of assumed leases attached to its Second Amended Chapter 11 Plan. Rite Aid also included the Fair Oaks lease on a schedule of assumed leases attached to its Third Amended Plan.

Rite Aid never filed a formal motion to either extend the assumption deadline or to assume the lease. Fair Oaks filed a motion to compel rejection of unexpired real estate leases on the basis that Rite Aid had never filed a motion to assume the lease prior to the statutory deadline. The United States Bankruptcy Court for the District of New Jersey held that filing a motion was not the only way to effectuate assumption under § 365(d)(4). The court determined, based on the statutory language and case law, that assumption is effectuated when intention to assume is timely communicated.

In its order, the court stated that the word "motion" explicitly appears in other subsections of § 365, but does not appear in § 365(d)(4), and reasoned that if Congress had intended to require a motion to effectuate assumption, it could have done so. The court found that the statutory language was unambiguous, so the filing of a motion is not a prerequisite to assumption. Rather, Rite Aid had clearly and unequivocally expressed an intent to assume the lease prior to the deadline. As a result, the lease was not deemed rejected. Fair Oaks appealed the decision, and the appeal is pending.

The *Rite Aid* decision presents a sharp contrast from prior bankruptcy decisions which held that a formal motion, not mere notice, was required for satisfaction of § 365(d)(4). This decision could give debtors a loophole to extend their deadline to assume by filing a notice of assumption, but reserving the right to amend that notice, and possibly reject the lease if they decide they are unwilling to pay the cure amount. This would take away the certainty on which landlords have come to rely in the last twenty (20) years since BAPCPA. As of now, the *Rite Aid* decision is still pending appeal, and no other courts have addressed the issue. Time will tell whether *Rite Aid* is an aberration or a sign of a shift away from the strict statutory deadlines.

SALES FREE AND CLEAR OF LEASES 20 YEARS AFTER *QUALITECH*: MANY UNCERTAINTIES REMAIN

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In *Precision Indus. v. Qualitech Steel SBQ, LLC*, 327 F.3d 537 (7th Cir. 2003), the United States Court of Appeals for the Seventh Circuit addressed whether "a sale order issued under section 363(f), which purports to authorize the transfer of a debtor's property 'free and clear of all liens, claims, encumbrances, and interests,' operates to extinguish a lessee's possessory interest in the property, or whether the terms of section 365(h) operate to preserve that interest." *Precision Indus. v. Qualitech Steel SBQ, LLC*, 327 F.3d 537, 543 (7th Cir. 2003). This article (i) reviews the reasoning and result of the *Qualitech* decision, (ii) summarizes some of the more important decisions that followed the *Qualitech* case, and (iii) attempts to harmonize the treatment of §§363(f) and 365(h) in the subsequent decisions. As will be seen, the courts addressing the purported conflict between the two statutes have yet to develop a consistent approach to the issues raised by *Qualitech*.

I. *Precision Industries v. Qualitech Steel SBQ, LLC*

The relevant facts of the *Qualitech* case were simple: approximately one month before its Chapter 11 filing, the debtors Qualitech Steel Corporation and Qualitech Steel Holdings Corporation (together, the "Debtor") and Precision Industries executed a lease agreement under which Precision would use and occupy the relevant property for a term of 10 years. The execution of the lease was followed by the Debtor's filing of its petition for relief in the Bankruptcy Court for the Southern District of Indiana. The Debtor's assets, including the leased property, were sold pursuant to an order entered by the bankruptcy court to an entity formed by

[1] The author gratefully acknowledges the work and contributions of Edson'n Pierre, a summer intern at Hinckley, Allen & Snyder, LLP, whose research formed a significant foundation for this article.

the Debtor's senior lenders (the "Buyer"), "free and clear of all liens, claims, encumbrances, and *interests*, except for specifically enumerated liens, pursuant to section 363(f), among other provisions of the Code." 327 F.3d at 541.[2] The interests of Precision under its lease were not excluded from the scope of the sale order. *Id.*

Significantly, Precision did not object to the sale. They were subsequently locked out of the property, and brought a diversity suit against the Buyer in the Southern District of Indiana, which was referred to the bankruptcy court to determine whether Precision's possessory interest was terminated by the sale order. The bankruptcy court ruled in favor of the Buyer, holding that "based on the terms of both section 363(f) and the Sale Order itself … New Qualitech [the Buyer] had obtained title to Qualitech's property free and clear of any possessory rights that Precision otherwise might have enjoyed under its lease … Precision's possessory interest was among those interests extinguished by the Sale Order." 327 F.3d at 541. Precision appealed that decision to the district court, which reversed the bankruptcy court, and held that "the terms of section 365(h) prevail over those of section 363(f) as applied to the rights of lessees." 327 F.3d at 542 (quoting 2001 U.S. Distr. LEXIS 8328, WL 699881, at 11). [3]

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[2] Bankruptcy Code Section 363(f) allows a debtor or trustee to sell property free and clear of any interests therein, but only if one of the following requirements are met:

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

11 U.S.C. §363(f)(1) – (5).

[3] Bankruptcy Code Section 365(h)(1)(A)(ii) permits a tenant under a lease rejected by its landlord to remain in possession, providing that "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 and other amounts payable by the lessee and any right of use, possession, quiet enjoyment, subletting 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." In addition, Code Section 365(h)1)(B)

The Buyer then appealed the matter to the Seventh Circuit. The Seventh Circuit held that the provisions in Section 363(f) were not trumped by Section 365(h), as the two sections refer to different situations, and therefore do not conflict. According to the Seventh Circuit, 365(h) applies when a debtor rejects a lease but retains possession of the property (for example, under a plan of reorganization). In contrast, when a debtor or trustee seeks to sell property subject to a lease, Section 363(f) governs the debtor's ability to sell free and clear, requiring that one of the five requirements for a sale free and clear in the statute be met. Equally important, Section 363 provides its own protections for the tenant – namely, the requirement that the tenant be afforded adequate protection for the interest being extinguished. *Id*. at 545.

In a way, *Qualitech* was the easy case – the tenant failed to object to the sale or to request adequate protection. The failure to object allowed the Debtor to satisfy §363(f)(2) – the lack of an objection was deemed to constitute the tenant's consent to the sale. And since the tenant failed to request adequate protection, none needed to be provided by the Debtor, thus avoiding the question whether adequate protection could only be provided by continued possession.

II. Principal Decisions After *Qualitech*

There have been several decisions applying and interpreting *Qualitech* in the past 20-plus years since its issuance. Those decisions have sought to resolve some of the open issues left by the decision. A brief summary of some of the major decisions follows.

1. *In re Haskell L.P.*, 321 B.R. 1 (Bankr. D. Mass. 2005) (Feeney, J.). In this early case following *Qualitech*, the debtor filed a motion to sell an assisted living facility located in Roxbury; a portion of the property was subject to a lease with New England Baptist Hospital

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permits the lessee to offset against the rent any damages caused by the landlord's nonperformance of its contractual lease obligations.

("NEBH"). The debtor's sale motion sought to dispose of the property free and clear of the NEBH lease. The debtor also filed a liquidating plan, under which the NEBH lease would be rejected.

The debtor supported its request by relying on Code Section 363(f)(5), arguing that, since an eminent domain proceeding could extinguish the lease, the test in that provision (requiring that the tenant could be compelled to accept a money satisfaction of its interest) was satisfied. The bankruptcy court disagreed, stating that "the only logical interpretation of the language of §363(f)(5) is that the statute requires that the trustee or the debtor be the party able to compel monetary satisfaction for the interest which is the subject of the sale." 321 B.R. at 9. The court held further that the debtor could not show that it could compel the tenant to accept a money satisfaction, for two reasons: first, the tenant's claim could not be quantified, and second, since the debtor sought to reject the NEBH lease in its plan, Code Section 365(h) allowed the tenant to remain in the premises, and not accept a money satisfaction. *Id*.

Finally, the bankruptcy court noted that the debtor had not offered adequate protection for the NEBH's interest, an additional shortcoming in its effort to sell free and clear of the lease. The court also observed that the amount of the first mortgage on the property greatly exceeded the property's value, thus making it unlikely that the tenant could be adequately protected by an interest in the sale proceeds. Under such circumstances, the court found that adequate protection could only be provided by continued possession. *Id*. at 10.

2. *Dishi & Sons v. Bay Condos LLC*, 510 B.R. 696 (S.D.N.Y. 2014). The debtor filed a plan which provided for the sale of a commercial condominium free and clear of a lease under which the tenant operated a bar on the premises. The plan also proposed to reject the lease. The property was subject to a first mortgage, the amount of which substantially exceeded

the proposed sale price. The tenant objected to the sale free and clear, and the bankruptcy court upheld the tenant's continued right to remain in possession, citing Section 365(h); the bankruptcy court also ruled that, as adequate protection of the tenant's interest, it could remain in possession of the premises. 510 B.R. at 700.

On appeal, the district court began its decision by analyzing the interests held by a lessor under a lease, as a means to harmonize the provisions of Sections 363(f) and 365(h). It found two such interests: the lessor's reversion (the real estate interest giving the lessor the right to possession at the end of the lease term), and its contractual rights under a lease. 510 B.R. at 706. Rejection by a landlord alters the contractual rights of the tenant, but not its fundamental right to possession (the tenant's real estate interest paralleling the landlord's reversion). *Id*. Sale, on the other hand, is a means for the lessor to dispose of its interest in the fee, which can be free and clear of liens and interests only if one of the requirements of §363(f) is met. *Id*.

Based on this analysis, the district court concluded that Sections 363(f) and 365(h) are consistent. Section 365(h) protects the lessee's appurtenant rights (rent, term, etc.) if the trustee or debtor rejects the lease, but has nothing to do with the disposition of the lessor's real estate interest. That interest, and its disposition, is governed by §§363(b) and (f), and the requirement of adequate protection under Section 363(e). Put another way, the limitations of Sections 363(f) and (e) are the protections afforded to a tenant in connection with the sale of the property.

The district court then addressed the basis offered by the debtor for a sale free and clear: the mortgagee's foreclosure power, which it contended satisfied both §363(f)(1) and §363(f)(5). Like the bankruptcy court in *Haskell*, the district court in *Dishi* rejected both arguments. 510 B.R. at 708-711. The court ruled that, in the application of either section of the statute, it must be the trustee or debtor that could sell free and clear under applicable nonbankruptcy law, or

compel a monetary satisfaction of the tenant's interest. *Id*. at 710, 711. The court also held that adequate protection could be provided to the tenant solely by continued possession. *Id*. at 711.

3. *IDEA Boardwalk, LLC v. Revel AC, Inc. (In re Revel AC, Inc.)*, 525 B.R. 12 (D.N.J. 2015). In this case, the debtor sought to sell its failed casino free and clear of various leasehold interests under §363(f)(4), arguing that the leasehold interest of each of the tenants was the subject of a bona fide dispute. After reviewing the evidence presented, the bankruptcy court determined that a dispute could exist concerning whether each of the leases was a true lease, and that the property could therefore be sold free and clear of those interests. 52 B.R. at 22. The tenants appealed the bankruptcy court decision, and sought a stay of the relevant portions of the sale order in connection with that appeal. In declining to grant the stay, the district court ruled that, on appeal, that the tenants were not likely to succeed with their arguments that (i) §365(h) "trumps" the right to sell free and clear under §363(f), and (ii) the status of the leases as true leases was not the subject of a legitimate dispute. The district court also did not accept the tenants' argument that the bankruptcy court failed to provide adequate protection in connection with the sale. Id. at 30-31. The court went on to question whether continued possession was the only means of providing adequate protection, stating that "offering a lessee a 'possessor interest' as adequate protection, effectively 'catapult[s] it ahead of its position behind secured, administrative, and priority unsecured creditors, in complete contravention of the priorities of the Bankruptcy Code.'" *Id*. at 30 (quoting *In re R.J. Dooley Realty, Inc.*, 2010 Bankr. LEXIS 1761, 2010 WL 2076959, at 7 (Bankr. S.D.N.Y. May 21, 2010)). The court stated further that "granting possession to these alleged tenants in the present circumstances of a catastrophically failed casino-hotel concept would be no more 'adequate' than what these Appellants have

received, namely, the right to assert claims for rejection damages or other relief as secured creditors." *Id*. at 31.

4. *Pinnacle Rest. at Big Sky, LLC v. CH SP Acquisitions, LLC (In re Spanish Peaks Holdings II, LLC)*, 872 F.3d 892 (9th Cir. 2017). The debtor, the operator of a resort and related businesses (a ski club, golf course and residential properties) in Big Sky, Montana, commenced a case under Chapter 7 in the Delaware bankruptcy court; the case was subsequently transferred to the bankruptcy court for the District of Montana. The trustee and the debtor's secured creditor (Spanish Peaks Acquisition Partners, LLC, the assignee of Citigroup Global Markets) agreed to seek a sale of all of the debtor's real and personal property free and clear of all of liens and interests, including two leases held by insiders of the debtor. The bankruptcy court approved the sale free and clear of the two leases; among its findings were that the two leases were the subject of bona fide disputes (for example, the fact that an insider controlled both parties to the lease negotiations, that operations had not occurred under one lease for several years, that the insiders' leases were vastly under market, and that one of the leases was not recorded). 872 F.3d at 896. The district court affirmed the bankruptcy court's ruling, relying on the fact that a foreclosure of the senior mortgage would extinguish both leases. *Id*.

The Ninth Circuit Court of Appeals upheld the bankruptcy court's sale order. In so doing, it addressed the argument that Sections 363(f) and 365(h) conflict, and that in such a conflict, §365(h) should prevail. The court held:

> [S]ection 363 governs the sale of estate property, while section 365 governs the formal rejection of a lease. Where there is a sale, but no rejection (or a rejection, but no sale), there is no conflict.

872 at 899. This 9th Circuit went on to rule that because the debtor did not seek to reject the leases prior to the sale, Section 365(h) was not triggered by the transaction. *Id*. Instead, the sale

could be authorized under Section 363(f)(1), because a foreclosure sale of the Citigroup mortgage would have extinguished the two insider leases. 872 at 900. The court noted that Section 363(f)(1) does not require an actual foreclosure sale, only that a sale would be "legally permissible." *Id*.

The court also stated that, in most cases, sales authorized under 363(f) would not leave a tenant without protection; tenants whose leases were extinguished by a sale free and clear would still have the right to seek adequate protection under §363(e). *Id*. at 898. In *Spanish Peaks*, the tenants failed to request adequate protection, and so the issue was not directly before the court.

5. *In re Royal Bistro, L.L.C.*, 26 F. 4th 326 (5th Circuit 2022). Denying a motion for a writ of mandamus, the Fifth Circuit Court of Appeals upheld a sale free and clear that extinguished two insider leases. The court pointed to the existence of a senior mortgage; the lender's foreclosure rights were held to satisfy Section 363(f)(1). 26 F.4th at 327. Because one of the leases was also in default, Section 363(f)(4) provided an additional basis for approving the sale free and clear of the interests of that tenant. *Id*. The 5th Circuit also questioned the bankruptcy court's reliance on *Qualitech* in reaching its decision, noting that it did not represent the majority view of the interplay between Sections 363(f) and 365(h). *Id*. at 328-329.

III. Cases Following *Qualitech*: The Unfulfilled Quest for Uniformity

The decisions that followed *Qualitech* have sought to resolve the issues raised by the decision. Unfortunately, the decisions have not always helped, as they do not agree on many of the answers to the underlying questions raised by the *Qualitech* decision. A summary of these issues, and how they are dealt with in the decisions, follows.

1. Do 363(f) and 365(h) "conflict" with one another and, if so, does 365(h) override or supersede 363(f)?

Qualitech certainly answered this question, with a definitive "no." Instead, as noted above, the decision states that the two provisions deal with different situations - §363(f) with a sale, and §365(h) with lease rejection. In addition, the Seventh Circuit ruled that, in a sale free and clear, §363(f) could extinguish rights under a lease that had not yet been assumed or rejected, provided the requirements of Section 363(f) had been met and the tenant provided adequate protection under §363(e).

Three decisions – *Dishi & Sons*, *Revel AC* and *Spanish Peaks* – accept *Qualitech*'s view that §§363(f) and 365(h) do not conflict. In each of these cases (as well as *Haskell*), the courts generally undertake the following analysis in response to a sale free and clear of a lease:

- Has the tenant objected to the sale;
- If so, does the sale satisfy one of the remaining four prongs of §363(f);
- If so, has the tenant requested adequate protection?
- If so, what form should it take?

However, other decisions have cast doubt on the *Qualitech* approach to sales free and clear of leases. In *Haskell*, for example, the Bankruptcy Court for the District of Massachusetts, after rejecting the debtor's attempts to sell free and clear of a lease under §§363(f)(1) and (f)(5), stated that "[i]f the Court were to grant the Debtor's Sale Motion, the provisions of §365(h) would be eviscerated. In other words, the Debtor would be doing indirectly what it could not do directly, namely, dispossessing [the tenant]." *Haskell*, 321 B.R. at 9. Further, in *Royal Oaks*, the Fifth Circuit criticized the bankruptcy and district courts for their reliance on *Qualitech* for the proposition that Section 363 overrides "and essentially render[s] nugatory, the critical lessee

protections against a debtor-lessor under Section 365(h)." *Royal Oaks*, 26 F. 4th at 328.[4] See also *In re Samaritan Alliance, LLC*, 2007 Bankr. LEXIS 3896 (Bankr. E.D. Ky. Nov. 21, 2007) ("The court finds the reasoning in *Haskell* instructive, and agrees with its conclusion that section 365(h) is applicable in the context of a section 363(f) sale.")

In sum: there is not yet clarity – particularly in the District of Massachusetts – on whether the *Qualitech* approach to sales free and clear of leases, and the inapplicability of §365(h) in such sales, is the accepted approach. Thus, the question answered by *Qualitech* – that §363(f) and §365(h) do not conflict – has not yet been put to rest.

2. Can a lease be extinguished by an unsubordinated mortgage under Section 363(f)(1)?

This question is also a toss-up. Under *Spanish Peaks* and *Royal Bistro*, the answer is yes. Under *Dishi & Sons*, the answer is no. The *Dishi* decision stated: "paragraph [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.'" *Dishi & Sons*, 510 B.R. at 710 (quoting *In re Jaussi*, 488 B.R. 456, 458 (Bankr. D. Colo. 2013)).

Even in cases where applicable law approves of the use of the foreclosure power under §363(f)(1), care must be taken to ensure that the mortgage is actually senior to the lease. In this regard, it is important to review the subordination and non-disturbance provisions of a lease such provisions may also be set forth in a separate subordination, non-disturbance and attornment (SNDA) agreement.

3. Can the lease be extinguished under Section 363(f)(4)?

[4] The Fifth Circuit panel did approve the lower courts' following *Spanish Peaks* and their reliance on a prior mortgage in allowing the sale free and clear under §363(f)(1).

Where supported by the facts of a case, this is likely to be more successful than a challenge under §363(f)(1) or (f)(5). In *Spanish Peaks*, the leases involved were with insiders, and presented numerous additional issues, including lack of recordation, under market rent, and the absence of actual use and occupancy. In *Revel AC*, there was evidence that the leases could be construed as partnership or joint venture agreements, given the complexity of the debtor casino's relationships with the tenants involved in the case. See also *Royal Oaks*, 26 F.4th at 328 (both leases were held by insiders; the fact that one tenant had failed to pay rent for a protracted period, and was therefore in default, provided a basis for a sale free and clear under Section 363(f)(4)).

4. Can the lease be extinguished under Section 363(f)(5)?

Here, the courts that have addressed this issue have been in agreement. Both *Haskell* and *Dishi & Sons* rejected the "hypothetical" approach, which would allow the possibility of an eminent domain action or the foreclosure of a tax lien to satisfy the requirement that the tenant could be compelled to accept a money satisfaction of its interest. Per *Haskell*: [T]he only logical interpretation of the language of §363(f)(5) is that the statute requires that the trustee or the debtor be the party able to compel monetary satisfaction." 321 B.R. at 9.

5. Does the adequate protection requirement of Section 363(e) mandate continued possession by the tenant?

The post-*Qualitech* decisions do not consistently address this issue. Two of the cases – *Spanish Peaks* and *Royal Oaks* – ruled that the tenant is not entitled to adequate protection at all where the basis for the sale free and clear of the lease arises under §363(f)(1). Under such circumstances, the two courts ruled, the tenant's interest in the property is terminated by a foreclosure, giving it no interest to protect. In contrast, both *Haskell* and *Dishi & Sons* stated that adequate protection of a tenant's interest could only be provided by continued possession.

The *Haskell* court further stated that, where the proceeds of sale are less than claims secured by the property being sold, compensation for the tenant from the sale proceeds cannot constitute adequate protection, since there will not be any funds available for that payment.

Further, in *Revel AC*, 525 B.R. at 30, the district court expressed concern about giving the tenant continued possession, as it has the effect of advancing the tenant's claim to a priority to which it would not be otherwise entitled, to the detriment of the estate's other creditors.

Finally, the cases do make clear that, in order for a tenant to obtain adequate protection under §363(e), or to sustain an objection based on the lack thereof, the tenant must not only object to the sale, but it must demand adequate protection in connection with that objection. A number of the decisions – including *Qualitech* – rely on a tenant's failure to seek adequate protection timely as a basis to avoid ruling on the issue. See *Qualitech*, 327 at 548; *Spanish Oaks*, 872 F.3d at 900.

6. What result if the debtor seeks to sell free and clear of a lease and simultaneously moves to reject the same lease?

Seeking simultaneously to sell free and clear of, and to reject, a lease can complicate the debtor's ability to invoke §363(f). In *Samaritan Alliance*, the bankruptcy court acted on the rejection motion prior to ruling on the sale, and relied on Section 365(h) to preserve the tenant's possessory right – never getting to the §363(f) analysis. The court cited *Haskell* – which had in turn rejected the debtor's sale free and clear because it would undermine the essential purpose of Section 365(h). Notably, the sale at issue in *Haskell* was proposed under the same plan that included a provision rejecting the lease encumbering the debtor's property. Conversely, where the debtor has sought only a sale, courts have more readily focused on the §363(f) analysis as standing separate and apart from lease rejection protections under §365(h). See, e.g., *Spanish Peaks*, 872 F.2d at 901.

IV. Conclusion and Practice Pointers

As can be seen from the above review, the cases since *Qualitech* have differed on a variety of issues raised by the case – even on the question whether Sections 363(f) and 365(h) are in conflict. The use of Sections 363(f)(1) and (f)(5) to extinguish a lease is in question – with the outcome depending on whether the court making the ruling favors the "actual" as opposed to the "hypothetical" approach to those two provisions. Equally unclear is whether adequate protection under §363(e) is required, especially where the sale free and clear is approved under Section 363(f)(1). And, a debtor's concurrent sale and lease rejection further confuses the analysis.

All this being said, certain practice pointers do emerge from the cases. From the tenant's perspective, the following should be considered:

- File a timely objection to the sale;
- Request adequate protection in connection with the issue;
- Push hard on the argument that only a sale by the debtor or trustee can be used to satisfy §§363(f)(1) and (f)(5).

From the debtor's perspective:

- File the sale motion prior to moving to reject the lease rights sought to be extinguished, and wait to file the rejection motion until after the sale is approved;
- If possible, rely on tenant defaults or other state-law issues related to the existence or enforceability of the lease (§363(f)(4)) to support the sale free and clear.

In the meantime, practitioners will have to wait for further decisions on these issues, to determine whether a uniform set of "rules" governing sales free and clear of leases does, in fact, emerge.

Faculty

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