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SELLING FREE AND CLEAR OF “INTERESTS”

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INTRODUCTION TO SALES FREE AND CLEAR

By: John P. Fitzgerald, III¹

I. Introduction

The Bankruptcy Code authorizes a trustee or debtor in possession to sell property of the bankruptcy estate free and clear of any “interest” in the property if the trustee or debtor can demonstrate that at least one of five conditions is met.

But what happens when a senior lienholder consents to the sale, the sale proceeds are insufficient to allow a distribution to anyone other than the senior lienholder and the junior lienholders do not consent? Can the trustee or debtor sell the property free and clear of the junior lienholder’s interests?

And what happens when a lessee does not consent to the sale and wants to retain possession of the property? Can the trustee or debtor sell the property free and clear of the lessee’s leasehold interests?

There are three sections to these materials. This section introduces sales free and clear under Section 363(b) and (f) of the Bankruptcy Code. The second section addresses sales free and clear of a non-consenting junior lienholder’s interest. The third section addresses sales free and clear of a lessee’s leasehold interest.

II. Statutory Framework

A. Section 363(b) and (f) – sale of estate assets outside the ordinary course

Section 363(b) authorizes the trustee (or debtor in possession under Section 1107(a)), after notice and a hearing, to sell estate property outside the ordinary course of business.

Section 363(f) authorizes a sale free and clear of “any interest in such property of an entity other than the estate” if the trustee can demonstrate that one of five exclusive conditions exists:

1. applicable nonbankruptcy law would permit a sale of such property free of the interest;
2. the other entity consents;
3. the interest is a lien and the sale price is greater than the aggregate value of all liens on such property;

¹ The panel appreciates the contributions of Eric K. Bradford, Trial Attorney in the Office of the United States Trustee in Boston, to this section of the written materials.

4. the interest is in bona fide dispute; or
5. the entity could be compelled in a legal or equitable proceeding to accept a money satisfaction of such interest.

11 U.S.C. § 363(f). *See also* 3 COLLIER ON BANKRUPTCY ¶ 363.06 Alan N. Resnick & Henry J. Sommer, eds., 16th ed. rev. 2018) (collecting cases).

B. Section 365(a) – rejection of leases and executory contracts

Section 365(a) authorizes the trustee, in the exercise of his business judgment and subject to court approval, to assume (favorable) or reject (unfavorable) unexpired leases or executory contracts of the debtor. 11 U.S.C. § 365(a).² *In re Great Atlantic & Pacific Tea Co., Inc.*, 54 B.R. 43, 48 (Bankr. S.D.N.Y. 2016) (approving the debtor’s rejection of a sublease).

But where the debtor is the lessor under a pre-petition lease, its power to reject is limited. That is because, upon rejection, Section 365(h) provides the lessee with a choice. The lessee can treat the rejection as a breach and assert a claim for damages or retain “its rights under such lease ... that are in or appurtenant to the real property ...” including to remain in possession for the specified term(s) and rent. 11 U.S.C. § 365(h). *See also* 3 COLLIER at 3.65.11 (discussing application of Section 365(h)). If the lessee elects the latter, it may offset its damages against the rent. 11 U.S.C. § 365(h)(1)(B).³

A lessee of real property is entitled to adequate protection for its interests under a lease rejected by a lessor debtor. 11 U.S.C. § 363(e). Adequate protection may be provided by “requiring the trustee to make a cash payment ... or ... granting such other relief [other than a priority administrative expense under section 503(b)(1)]

² Section 365 does not provide for the automatic rejection of a nonresidential real property lease where the debtor is the lessor. *Compare* 11 U.S.C. § 365(d)(1) (providing that, in a chapter 7 case, an unexpired lease of residential real property or personal property is deemed rejected within 60 days of the petition date, unless extended for cause) *with* (d)(2) (providing that in a chapter 9, 11, 12 or 13 case, an unexpired lease of residential real property or personal property may be assumed or rejected at any time prior to confirmation of a plan, unless the court, on motion of a counterparty, orders the debtor to do so within a specified period) *and with* (d)(4)(A) (providing that “an unexpired lease of nonresidential real property under which the debtor is lessee shall be deemed rejected ... if the trustee does not assume or reject ... by the earlier of ... the date that is 120 days after the date of the order for relief ... or ... the date of the entry of an order confirming the plan ...”).

³ Section 365(h) “strikes a balance between the respective rights of the debtor-lessor and its tenant: the lessee retains the right to possess the property for the remainder of the term it bargained for, while the rejection frees the debtor-lessor of other burdensome obligations that it assumed under the lease (as, for example, the duty to provide services to the lessee) ...” *Precision Indus. Inc. v. Qualitech Steel SBQ, LLC*, 327 F.3d 537, 546 (7th Cir. 2003).

as will result in the realization ... of the indubitable equivalent of [the lessee's] interest in such property ...” 11 U.S.C. § 361.

III. Five Conditions for Sales Free and Clear Under Section 363(b) and (f)

The Fourth Circuit broadly interprets what constitutes an “interest” in property of the estate that the trustee can sell. *UMWA 1992 Benefit Plan v. Leckie Smokeless Coal Co. (In re Leckie Smokeless Coal Co)*, 99 F.3d 573, 581-83 (4th Cir. 1996), *cert. denied*, 520 U.S. 1118 (1997) (permitting the sale of coal operators’ assets free and clear of successor liability claims imposed by federal law and rejecting the appellants’ arguments that Section 363(f) applied strictly to *in rem* interests).

To obtain approval for a sale free and clear of interests, the trustee bears the burden of demonstrating that at least one of the following subsection (f) conditions is met. *In re Taylor*, 198 B.R. 142, 158 (Bankr. D.S.C. 1996).

A. Applicable nonbankruptcy law would permit a sale of such property free of the interest

“Applicable nonbankruptcy law” is generally state property law. *See In re Daufuskie Island Properties, LLC*, 431 B.R. 626, 622 (Bankr. D.S.C. 2010) (granting chapter 11 trustee’s motion to sell real property free and clear of seller’s claimed reversionary interest under South Carolina law). *Compare Taylor*, 198 B.R. 142 (denying trustee’s proposed sale of over-encumbered assets under (f)(1), notwithstanding a carve out for the estate, because no South Carolina law permitted it).

Courts have questioned whether the “applicable nonbankruptcy law” permitting the sale must be exercised solely by the trustee. *See Dishi & Sons v. Bay Condos LLC*, 510 B.R. 696, 710 (Bankr. S.D.N.Y. 2014) (denying proposed sale under subsection (f)(1) and holding that “paragraph (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 ...”) (citations and internal punctuation omitted).

B. The other entity consents

Sales free and clear under subsection (f)(2) require the consent of entities whose interests will be affected. There is a split in authority as to whether consent can be implied, where the entity has not objected. *See In re Silver*, 338 B.R. 277, 280 (Bankr. E.D. Va. 2004) (denying trustee’s proposed sale, because the court could not infer that subordinate lienholders who would receive nothing had consented).⁴

⁴ “This court has usually allowed sales of estate property where a lien or interest holder fails to respond to a motion to sell provided that the sale proceeds will be sufficient to pay liens of non-

- C. The interest is a lien and the sale price is greater than the aggregate value of all liens on such property

Collier acknowledges that there is a split in interpreting the phrase “the aggregate value of all liens.” One line of cases limits it to the economic value of the liens as determined under Section 506(a) of the Bankruptcy Code. The other line of cases holds that the sale price must “exceed the face amount of all liens ...” 3 COLLIER at 363.06[4]. Compare *In re Collins*, 180 B.R. 447 (Bankr. E.D. Va. 1995) (permitting sale of property for less than the amount of liens encumbering it) with *In re Silver*, 338 B.R. at 182 (holding the opposite).⁵

- D. The interest is in bona fide dispute

Under subsection (f)(4), in order to determine whether there is a bona fide dispute, the trustee must demonstrate that “there is an objective basis for either a factual or legal dispute as to the validity of the asserted interest. This standard does not require that the Court resolve the underlying dispute or determine the probable outcome of the dispute, but merely whether one exists ...” *In re Taylor*, 198 B.R. at 162 (holding that the lessee’s failure to pay rent was not a bona fide dispute and denying sale).

- E. The entity could be compelled in a legal or equitable proceeding to accept a money satisfaction of such interest

Here, too, there is a split, with some courts holding that a trustee cannot sell property under subsection (f)(5) if the interests to which the property is subject cannot be satisfied fully in a compelled legal or equitable proceeding. See *Richardson v. Pitt County (In re Stroud Wholesale, Inc.)*, 47 B.R. 999 (E.D.N.C. 1985), *aff’d*, 983 F.2d 1057 (4th Cir. 1993) (reversing order authorizing chapter 7 trustee to sell real estate free and clear of tax liens).⁶ Accord, *In re Silver*, 338 B.R.

responsive parties. However, I am reluctant to accept silence as consent where, as here, the proceeds are not sufficient ...” *Id.*

⁵ “The estate will not benefit from the sale of this real property because the property cannot possibly bring a large enough sale price to satisfy all the liens to which it is subject. The only parties who will benefit from trustee’s proposed sale are those with the most senior liens. Even if there is a carve-out from the sale price reserved for lien creditors whose claims become unsecured, those creditors will receive next to nothing ...” *Id.*

⁶ “[T]he only reasonable interpretation of (f)5 is that ‘money satisfaction’ means full satisfaction of creditors’ interests in sales in liquidation of the estate [chapter 7 cases]. This court’s decision that (f)5 requires full monetary satisfaction of creditors’ liens in liquidation cases does not mean that (f)5 would require full monetary satisfaction of creditors’ liens in rehabilitation cases. Trustees must be given flexibility in the difficult task of rehabilitating debtors while providing adequate protection for creditors’ interests ...” *Id.* at 1003.

277. *Compare In re Healthco Int'l. Inc.*, 174 B.R. 174 (Bankr. D. Mass. 1994) (authorizing sale for less).

SALES FREE AND CLEAR UNDER SECTION 363(f)(3) AND (5)

By: Patricia B. Jefferson

I. Introduction

A common scenario arising in connection with Chapter 11 bankruptcy sales is whether assets of the bankruptcy estate may be sold free and clear of interests, when:

- A. There is a creditor with a senior lien on the assets;
- B. The senior lienholder consents to the sale;
- C. The sale proceeds will not be sufficient to pay anyone other than the senior lienholder; and
- D. There are junior lienholders who do not consent to the sale.

Presuming that applicable non-bankruptcy law does not permit the sale free and clear of the junior lienholder interests, and the interests are not in bona fide dispute, the only remaining grounds for selling the assets free and clear would be Section 363(f)(3) and (5).

II. Section 363(f)(3)

- A. Section 363(f)(3) provides:

The trustee may sell property under subsection (b) or (c) of this section free and clear of any interest in such property of an entity other than the estate, only if 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.

- B. Courts disagree over whether the “value of the lien” for purposes of Section 363(f)(3) is the face amount of the claim or the economic value of the lien, as determined by the fair market value of the property.
 - 1. Some courts have found that the sale price must be greater than the aggregate face value of the liens on the property. *See Clear Channel Outdoor, Inc. v. Knupfer (In re PW, LLC)*, 391 B.R. 25 (B.A.P. 9th Cir. 2008); *In re WDH Howell, LLC*, 298 B.R. 527 (D.N.J. 2003); *In re Stroud Wholesale, Inc.*, 47 B.R. 999 (E.D.N.C. 1985) (“sales free and clear of liens and interests may be justified by (f)(3) only if the sale price will exceed the aggregate value of all liens on the property. This interpretation is consistent with the well-established rule that the bankruptcy court should not order the sale of property free and clear of interests and liens unless the court is satisfied that the sale proceeds will fully compensate the secured lienholders and produce some equity for the estate”).

2. Other courts have found that Section 363(f)(3) refers to the economic value of the liens, *i.e.*, the present value of the property. *See In re Bos. Generating, LLC et al.*, 440 B.R. 302 (S.D.N.Y. 2010) (“If Section 363(f)(3) and Section 363(f)(5) are read in the manner suggested by the Second Lien Lenders, it seems unlikely that a Court, under any circumstance, could approve a non-consensual Section 363 sale. As both a practical matter and a matter of statutory construction, that cannot be the case. It is hard to imagine that Congress intended to so limit a debtor’s power to dispose of encumbered assets, particularly where such disposition otherwise satisfies the requirements of Section 363(b)”; *In re Collins*, 180 B.R. 447 (Bankr. E.D. Va. 1995) (“the Supreme Court has ruled that value in § 506(a) means the same as “value” under other provisions of the Code, specifically §§ 361(1) and (2), which address adequate protection. In light of § 363(d) which makes adequate protection an integral element of any proposed sale under § 363(f), it is therefore logical to extend the definition of ‘value’ with regard to a secured creditor’s interest to ‘value in § 363(f)(3)...’”).
3. As explained by courts rejecting the “economic value” analysis, if the aggregate value of liens means the total amount of allowed secured claims, then Section 363(f)(3) could never be used to authorize a sale free and clear of overencumbered assets because the allowed secured claims would only ever equal the sale price, never be less than it.

III. Section 363(f)(5)

Most courts evaluating Section 363(f)(5) read it to contain at least three elements: (1) a proceeding exists or could be brought, in which (2) the nondebtor could be compelled to accept a money satisfaction of (3) its interest. Although there is some dispute regarding the interpretation of the third element, most courts read “interest” broadly to encompass liens. Additionally, the second element generally is not read to require monetary payment in full, because that would essentially render subsection (f)(5) meaningless. The real disagreement revolves around whether a state court foreclosure action is a legal or equitable proceeding in which the monetary satisfaction may be forced on a junior lienholder.

- A. Courts that have permitted sales free and clear under Section 363(f)(5) based upon a hypothetical state court foreclosure:
 1. One position is that, because a junior lienholder could be compelled to accept a money satisfaction of its lien under a foreclosure sale or a receivership, an undersecured creditor arguably could be stripped of its interest that exceeds the value of the property being sold under Section 363(f)(5). These courts require more than merely a showing that it is theoretically possible to compel a creditor to accept a monetary satisfaction.
 2. *See In re Boston Generating, LLC*, 440 B.R. 302, 333 (Bankr. S.D.N.Y. 2010) (noting that “the existence of judicial and nonjudicial foreclosure and enforcement actions under state law can satisfy section 363(f)(5)”).

3. *See In re Jolan, Inc.*, 403 B.R. 866 (Bankr. W.D. Wash. 2009) (bankruptcy court authorized sale of real estate free and clear of junior lienholders' interests in Chapter 7 case because state law providing for judicial and nonjudicial foreclosures would clear their interests).
 4. *See In re Trans World Airlines, Inc.*, 322 F.3d 283 (3d Cir. 2003) (employment discrimination claims and travel voucher claims of employees were subject to monetary valuation and satisfy the requirements for sales free and clear of such claims under Section 363(f)(5)).
 5. *See also Compass Bank v. Investment Co. of the Southwest, Inc. (In re Investment Co. of the Southwest, Inc.)*, 302 B.R. 112 (unpublished table decision) (10th Cir. B.A.P. Dec. 8, 2003) (recognizing chapter 11 cram down as a legal or equitable proceeding under Section 363(f)(5), citing Collier's bankruptcy treatise); *In re Healthco Intern., Inc.*, 174 B.R. 174 (Bankr. D. Mass. 1994) (hypothetical chapter 11 plan cramdown qualified as money satisfaction of taxing authority's interest within meaning of Section 363(f)(5)).
- B. The most expansive interpretation of Section 363(f)(5) is that adopted by the Third Circuit, which has upheld a sale free and clear of all claims of creditors as long as the claims of the creditors objecting to the sale are subject to monetary valuation, and thus the right to receive a distribution as a creditor in a bankruptcy case satisfies the sale free and clear condition under this subsection. *See Trans World Airlines, Inc.*, 322 F.2d at 290-91.
- C. Courts that reject sales free and clear under Section 363(f)(5) based upon a hypothetical state court foreclosure:
1. Other courts reject this view, however, and rule that Section 363(f)(5) does not authorize a sale over the objection of an undersecured lien holder due to the possibility of a strip off of its secured claim into secured and unsecured claims, or treatment of the secured claim in a Chapter 11 confirmed plan.
 2. *In re PW, LLC*, 391 B.R. 25 (B.A.P. 9th Cir. 2008) (sale free and clear of undersecured junior lien was not permissible under Section 363(f)(5) because of the absence of a separate proceeding).
 3. *In re Ricco, Inc.*, 2014 Bankr. LEXIS 1265, 2014 WL 1329292, *3 (Bankr. N.D. W. Va. Apr. 1, 2014) (“[T]he only logical interpretation of ... § 363(f)(5) is that the statute requires that the trustee or debtor be the party able to compel monetary satisfaction for the interest which is the subject of the sale.”).
 4. *In re Haskell*, 321 B.R. 1, 9 (Bankr. D. Mass 2005) (subsection (5) does not encompass eminent domain proceedings because the trustee must be the party capable of compelling the interest holder to accept a money satisfaction).

5. *Dishi & Sons v. Bay Condos, LLC*, 510 B.R. 696 (S.D.N.Y. 2014) (adopting the narrow view that subsection (5) should be read to reach only those legal or equitable proceedings that could be brought by the trustee as owner of the property).

IV. Questions

- A. Does it matter whether the foreclosure sale is judicial, *i.e.*, is a judicial proceeding required for something to be a “legal or equitable proceeding” – like judicial foreclosure — or if it is enough that the proceeding be sanctioned or authorized by law – like a nonjudicial foreclosure sales?
- B. Does preventing a trustee or debtor to effectuate within bankruptcy what a senior lienholder could accomplish under state foreclosure law frustrate a fundamental purpose of maximizing value for the estate while minimizing a senior lender’s growing claim?
- C. Should a court deny the sale of property free and clear of liens if the sale does not provide some equity for the benefit of the bankruptcy estate, and only pays a secured creditor, as stated by the Seventh Circuit Court of Appeals in *In Re Riverside Inv. Partnership*, 674 F.2d 634 (7th Cir. 1982)? What bankruptcy policies and goals are sales free and clear intended to satisfy?

SALES FREE AND CLEAR OF LEASEHOLD INTERESTS

By: Maria Ellena Chavez-Ruark

I. Introduction

Another common scenario arising in connection with Chapter 11 bankruptcy sales is when a debtor seeks to sell property free and clear of leasehold interests which have not yet been assumed or rejected. Arguably, a direct conflict between the debtor's right to sell "free and clear of any interest in such property of an entity" under Section 363(f) and the lessee's right to "retain its rights under such lease (including ... any right of use, possession, quiet enjoyment ...)" under Section 365(h) arises.

Whose rights are superior in this scenario – the debtor's or the lessee's? The answer is unclear.

II. Statutory Framework

A. Section 363(f) provides:

The trustee may sell property under subsection (b) or (c) of this section *free and clear of any interest in such property* of an entity other than the estate, only if –

(1) applicable nonbankruptcy law permits sale of such property 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) (emphasis added).

B. Section 365(h)(1)(A) provides:

If the trustee rejects an unexpired lease of real property under which the debtor is the lessor and –

(i) if the rejection by the 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

(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 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.*

11 U.S.C. § 365(h)(1)(A) (emphasis added).

C. Read in isolation, Section 363(f) and Section 365(h) are clear and unambiguous. However, when a debtor in possession seeks to sell property free and clear of a lessee's leasehold interests, these two sections are arguably in direct conflict.

D. Rules of statutory construction

1. When considering a potential conflict between two statutes, one must begin with the statutory language itself. *Hughes Aircraft Co. v. Jacobson*, 525 U.S. 432, 438 (1999). The Supreme Court instructs one “presume that a legislature says in a statute what it means and means in a statute what it says there ... When the words of a status are unambiguous, then this first canon is also the last: ‘judicial inquiry is complete.’” *Connecticut Nat’l Bank v. Germain*, 503 U.S. 249, 253 (1992).
2. “[W]hen two statutes are capable of co-existence, it is the duty of the courts, absent a clearly expressed congressional intention to the contrary, to regard each as effective.” *Pittsburgh & Lake Erie R.R. Co. v. Railway Labor Executives’ Ass’n*, 491 U.S. 490, 510 (1989) (citations omitted).
3. “Statutory construction ... is a holistic endeavor,” and a court should elect a meaning that “produces a substantive effect that is comparable with the rest of the law.” *United Sav. Ass’n of Tex. v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 371 (1988).
4. A court should consult a statute’s legislative history only when necessary to resolve “statutory ambiguity.” *Barnhill v. Johnson*, 503 U.S. 393, 401 (1992).
5. When two statutes are in conflict, a court must apply the canon of construction that the specific prevails over the general. *Morales v. Trans World Airlines, Inc.*, 504 U.S. 374, 384 (1992).
6. “Congress has enacted a comprehensive scheme and has deliberately targeted specific problems with specific solutions.” *RadLAX Gateway*

Hotel, LLC v. Amalgamated Bank, 566 U.S. 639, 645 (2012) (quotation omitted).

III. The Debtor's Position

- A. The debtor may sell estate property free and clear of “any interest” in the property under Section 363(f) even when the property is subject to an unexpired lease of real property and the lessee wants to retain possession of the property.
1. Section 363(f) and Section 365(h) are not in conflict because they address two different events – sale and rejection – and Section 365(h) does not apply when the debtor is selling the property but not rejecting the lease. Section 365(h), by its express terms, applies only when there is an actual rejection of an unexpired lease of real property under Section 365. In other words, there is no such thing as a *de facto* rejection; a rejection only occurs when the debtor satisfies the requirements for rejection under Section 365 and Bankruptcy Rule 6006 and obtains court approval of the rejection. *See* 11 U.S.C. § 365(a) (“the trustee, *subject to the court’s approval*, may assume or reject any ... unexpired lease of the debtor”) (emphasis added).
 2. Because there is no conflict between the two statutes, there is no need to consider whether one provision is more specific and therefore supersedes the other, general provision. Similarly, there is no need to examine the legislative history.
 3. If Congress wanted to make a debtor’s ability to sell real property free and clear subject to a lessee’s rights, it knows how to do so and could have done so. *See, e.g.*, 11 U.S.C. § 363(l) (“Subject to the provisions of section 365, the trustee may use, sell, or lease property ... notwithstanding any provision in a contract, a lease or applicable law that is conditioned on the insolvency or financial condition of the debtor”). *See also* 11 U.S.C. § 363(d) (“The trustee may use, sell, or lease property under [Section 363] subsection (b) or (c) ... only to the extent not inconsistent with any relief granted under subsection (c), (d), (e), or (f) of Section 362”). There is no similar cross-reference in either Section 363(f) or Section 365(h)(1)(A).
 4. Instead, Congress built certain safeguards into Section 363 to protect parties in interest who may be adversely affected by a sale free and clear. Section 363(f) requires that at least one of five statutory requirements be satisfied before property can be sold free and clear of interests such as a leasehold interest. In addition, Section 363(e) requires a court, upon request of a party with an interest in property to be sold, to either prohibit or condition such sale “as is necessary to provide adequate protection of such interest.” Section 361 defines “adequate protection” to include a cash payment, an additional or replacement lien or “such other relief ... as will result in the realization by such entity of the indubitable equivalent of such entity’s interest in such property.” 11 U.S.C. § 361.

B. Cases in support of the debtor's position

1. *Pinnacle Rest. at Big Sky, LLC v. CH SP Acquisitions, LLC (In re Spanish Peaks Holdings II, LLC)*, 862 F.3d 892 (9th Cir. 2017) (holding that Section 365(h) does not protect a lessee when property is sold free and clear under Section 363(f) and lease has not been rejected under Section 365 because “sale of property free and clear of a lease may be an effective rejection of the lease in some everyday sense but it is not the same thing as the ‘rejection’ contemplated by section 365”).
2. *Precision Indus. Inc. v. Qualitech Steel SBQ, LLC*, 327 F.3d 537 (7th Cir. 2003) (holding Section 365(h)(1)(A) applies only when lease at issue was actually rejected under Section 365).
3. *Dishi & Sons v. Bay Condos LLC*, 510 B.R. 696 (S.D.N.Y. 2014) (holding that, although the two statutes could be viewed as conflicting, they can be read harmoniously as each serves a different purpose and adequate protection might offer sufficient protection for a lessee).

IV. The Lessee's Position

- A. If the debtor sells estate property under Section 363, the sale must be subject to the lessee's leasehold rights, including its right to retain possession of the property under Section 365(h)(1)(A).
1. When read in isolation, the two statutes do not conflict. However, when a debtor attempts to sell property free and clear of a lessee's leasehold interest, the statutes inherently conflict because the various sections of the Bankruptcy Code are, and should be interpreted as, part of a comprehensive scheme.
 2. *Qualitech* does not resolve the issue in favor of the debtor. In *Qualitech*, the Seventh Circuit concluded that the underlying lease between the debtor and lessee had been “repudiated,” a term not defined in the Bankruptcy Code. (Black's Law Dictionary defines “repudiate” to mean “reject.”) *Qualitech*, however, does not differentiate between a sale free and clear and a rejection.
 3. A sale free and clear of a leasehold interest in such property is a *de facto* rejection of the lease.
 4. Section 365(h) is an exception to the general rule of Section 363(f). Section 363(f) generally permits sales free and clear of interests, but Section 365(h) provides an exception for interests that are leasehold interests by preserving and protecting specific rights appurtenant to the lease such as the right to possession of the subject property. The specific statute supersedes the general statute. A debtor cannot circumvent these protections through Section 363(f) by “doing indirectly what it could not do directly, namely,

dispossessing [the lessee].” *In re Haskell L.P.*, 312 B.R. 1, 9 (Bankr. D. Mass 2005).

5. Because the statutes are in conflict, Congress’ intent should be consulted. A review of the legislative history confirms Congress’ clear intent to protect innocent lessees by ensuring that they are not deprived of their possessory rights. *See In re Taylor*, 198 B.R. 142, 165-66 (Bankr. D.S.C. 1996) (comprehensively examining legislative history).

B. Cases in support of the lessee’s position

1. *IDEA Boardwalk LLC v. Polo N. Country Club, Inc.*, 2017 WL 4927667 (D.N.J., Oct. 31, 2017) (holding that Section 365(h) precludes sale free and clear under Section 363(f) from extinguishing lessee’s right to possession).
2. *IDEA Boardwalk LLC v. Revel Entm’t Grp., LLC (In re Revel AC, Inc.)*, 532 B.R. 216 (Bankr. D.N.J. 2015) (granting relief to lessee under Section 365(h) in debtor’s sale proceeding).
3. *In re Zota Petroleums, LLC*, 482 B.R. 154 (Bankr. E.D. Va. 2012) (holding that Section 365(h) authorizes a sublessee to retain its rights under a sublease and that debtor may not extinguish those rights with a Section 363 sale free and clear).
4. *In re Haskell L.P.*, 321 B.R. 1 (Bankr. D. Mass. 2005) (concluding that lessee cannot be compelled to accept monetary satisfaction of its leasehold interest in contravention of Section 365(h) when property is sold pursuant to Section 363(f)).
5. *In re Taylor*, 198 B.R. 142, 165-66 (Bankr. D.S.C. 1996) (comprehensively examining legislative history and declining to allow sale free and clear of tenant’s leasehold interest under Section 363(f) because Section 365(h) was enacted to protect a lessee in that situation).
6. *In re Churchill Props., III, L.P.*, 197 B.R. 283 (Bankr. N.D. Ill. 1996) (granting lessee’s motion for relief and allowing lessee to retain its possessory rights under Section 365(h) due to plain language in statute and underlying intent of Congress).
7. *In re Lee Road Partners, Ltd.*, 155 B.R. 55, 60-61 (Bankr. E.D.N.Y. 1993) (holding that Section 365(h) protects sublessee’s rights when property is sold free and clear; in enacting Section 365(h)(1)(A), “Congress sought to codify a delicate balance between the rights of a debtor-lessor and the rights of tenants, by preserving certain expectations of parties to real estate transactions ... Specifically, Congress concluded that rejection of a lease by a debtor-lessor should not deprive a tenant of his estate for the term for which he bargained ... In accordance with the Code’s intent that a tenant not be deprived of his estate for the term for which he bargained, ... the

lessee's leasehold estate cannot be diminished, changed or modified due to bankruptcy's intervention ... In short, § 365(h) seeks to prevent forcible evictions whenever possible.”).

V. Questions

- A. Can a debtor avoid the conflict by selling the property when it has neither assumed nor rejected the lease? *Pinnacle* and *Spanish Peaks* hold that Section 365(h)(1)(A) applies only when the lease at issue was actually rejected under Section 365 of the Bankruptcy Code. Will debtors be incentivized to manipulate the Bankruptcy Code by cloaking rejections as sales free and clear?
- B. Can a debtor avoid the conflict by expressly stating that the sale is free and clear of existing leases in the bidding procedures and sale motions? See, e.g., *In re R.J. Dooley Realty, Inc.*, 2010 WL 2076959 (Bankr. S.D.N.Y., May 21, 2010) (holding that Section 365(h) does not apply when debtor sells property free and clear of leases under Section 363(f) and bid procedures clearly and unambiguously stated that sale was free and clear of existing leases).
- C. What would constitute adequate protection of the lessee's interest under Section 365(e)? The purpose of the adequate protection requirement is to ensure that a creditor with an interest in property “receives in value essentially what he bargained for,” even though he might not receive his bargain in kind. *La Jolla Morg. Fund v. Rancho El Cajon Assocs.*, 18 B.R. 283, 286 (Bankr. S.D. Cal. 1982). See also *Dishi & Sons v. Bay Condos LLC*, 510 B.R. 696, 711-12 (S.D.N.Y. 2014) (adequate protection could, but might not always, take form of continued possession). What does the “indubitable equivalent” look like in this scenario?
- D. What are the policy implications? Upon consummation of a sale free and clear, a lessee will presumably be subject to eviction proceedings in other forums without the benefit of any rights for which they bargained and to which they would otherwise be entitled under applicable nonbankruptcy law. An otherwise healthy business may be forced to relocate, disrupting its business operations, or possibly to cease operations.
- E. Is this issue ripe for consideration by the Supreme Court? One commentator suggests that it will take review by SCOTUS to resolve this issue. 27 No. 1 Norton J. Bankr. L. & Prac. (February 2018), *Bankruptcy Sales Free and Clear of Under 11 U.S.C.A. § 363(f) and Tenant Possessory Rights Under 11 U.S.C.A. § 365(h): A Progress Report on the Road to the United States Supreme Court*.