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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 Bankruptcy Code Section 365(h)

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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 BANKRUPTCY CODE SECTION 365(H)

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Abstract

The question examined in this Article is a simple one—Can a tenant with a right to possession under section 365(h) of the Bankruptcy Code be ousted from possession by a free and clear sale of the real property by the debtor-landlord pursuant to section 363(f) of the Bankruptcy Code? The Seventh Circuit, the only court of appeals to have considered the issue, said "yes" in Precision Industries, Inc. v. Qualitech Steel SBQ, LLC and authorized a sale free and clear of the lease and the tenant's right to remain in possession. Subsequent decisions from the district and bankruptcy courts are split, and most say "no."

This Article concludes that the answer 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. The answer has nothing to do with whether one of sections 365(h) or 363(f) trumps the other, and the Code does not show that either does. Rather, on a free and clear sale the tenants, mortgagees and other holders of interests against the property should be treated in accordance with the priorities of their respective bargained-for, prepetition state law property interests against the property. Thus, if the lease has first priority, the sale should be subject to the lease and the tenant's possessory rights under section 365(h), or if the tenant whose lease has priority consents to the sale it should

be paid the first proceeds of the sale in an amount up to the value of the lease. If instead the lease is subordinate to a monetary lien or other encumbrance, the sale should be free and clear of the subordinate lease and of the tenant's possessory rights, provided that the tenant is paid the value of its lease after payment to the holders of liens and encumbrances that are prior to the lease. Admittedly, the tenant under a subordinate lease will receive nothing if the lease is out-of-the-money and there are no sale proceeds remaining after payment of the prior liens and encumbrances. But that outcome, as cold as it may appear, represents the value of the tenant's interest in the property sold.

This result is compelled: (1) by the Supreme Court's decisions in Butner and Nobleman, under which the property rights of parties in a bankruptcy case are determined by state law; (2) by 130 years of unequivocal pre-Code law and practice that characterized free and clear bankruptcy sales as hypothetical foreclosure sales under which the parties were treated in accordance the state law priorities of their interests in the property in sold, which Congress has never indicated it changed by enacting the Code; and (3) by the Code's text regarding sales free and clear, adequate protection of interests in property that is sold in a bankruptcy case, and lease rejections, by the Code's purposes of uniform and equitable distribution to creditors and maximization of the value of the debtor's estate, and by the Code's legislative history. This conclusion preserves to the tenant in each case the value of its interest in the property sold. In the case of a first priority lease this may be the full value of the lease and in the case of a subordinate lease this may be zero. But in each case, this rule vindicates the state law rights that the parties bargained for prior to the commencement of the bankruptcy case.

I. INTRODUCTION

The stakes were high in the recent chapter 11 bankruptcy sale of the Revel Casino. Revel asked the court to approve the sale of its casino under Bankruptcy Code section 363(f), free and clear of its tenants' leases.[1] The tenants objected, asserting that another Code provision—section 365(h), which gives a tenant the right to remain in possession under a lease that a debtor-landlord has rejected—trumped any power of the debtor and the court to eject them on the sale.[2]

A section 363 bankruptcy sale free and clear of a lease and the tenant's possessory rights suggests a narrative in which a "mom and pop" tenant is forced out of its space by the bankruptcy court at the urging of the debtor and its big bank lender, as well as other large creditors who reap a higher price and distribution on a sale of the real estate free of the lease. The parties affected by the sale could just as easily be a tenant that is a national retailer with annual revenues in the billions, a community bank that holds the mortgage against the property, or other creditors that are local businesses whose needs are more compelling. The Bankruptcy Code makes no distinction between the two scenarios. Decisions on the law have gone both ways. The Revel Casino contest went to the tenants, who were allowed by the district court's ruling to remain in possession after the free and clear sale.[3] Some commentators reveled in reporting that the tenants had reveled in their triumph.[4]

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1. IDEA Boardwalk v. Revel Entm't Grp. (*In re* Revel AC), 532 B.R. 216, 227 (Bankr. D.N.J. 2015) (citing 11 U.S.C. § 363(f) (2012)).

2. *Id.* at 221 (citing 11 U.S.C. § 365(h) (2012)).

3. *Id.* at 227 ("[A] § 363 sale does not and could not trump the rights granted to the Tenants by § 365(h)."). The procedural history of *Revel* is fairly complex. The Third Circuit ultimately stayed the sale free and clear of IDEA's interest in the property, but did not reach the question of whether a § 363(f) sale can be made free and clear of a tenant's § 365(h) rights. *In re* Revel AC, 802 F.3d 558, 575 (3d Cir. 2015).

4. Francis J. Lawall & Michael J. Custer, *Casino Tenants Revel in Victory Enforcing Section*

The question examined in this Article is a simple one—Can a tenant be ousted from possession by a free and clear sale of the real property pursuant to Bankruptcy Code section 363(f)? The Seventh Circuit, the only court of appeals to have considered the issue, said "yes" in *Precision Industries, Inc. v. Qualitech Steel SBQ, LLC* and authorized a sale free and clear of the lease and the tenant's right to remain in possession.[5] Subsequent decisions from the district and bankruptcy courts are split. At least one bankruptcy court has characterized as a "vast majority" the lower court decisions—which now includes the district court's in *In re Revel AC, Inc.*—that have concluded that a tenant's right to possession is always protected on a free and clear sale under section 363(f). Those courts have held that the debtor or trustee in a bankruptcy case cannot use a free and clear sale to "get around" the possessory rights of a tenant under section 365(h).[6] Most reviewers have similarly criticized the *Precision Industries* decision, some scathingly.[7]

This Article considers this question and concludes that the answer lies in affording the tenant the same protection and priority against the property and the sale proceeds that the tenant would have under state law had no bankruptcy ensued. The answer has nothing to do with whether one of sections 365(h) or 363(f) trumps the other. The Code does not designate either section as supreme. Instead, on a free and clear sale the tenants, mortgagees, and other holders of interests against the property should be treated in accordance with the priorities of their respective bargained-for, prepetition state law property interests against

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365(h) Rights; Bankruptcy Update, LEGAL INTELLIGENCER, July 17, 2015, http://www.thelegalintelligencer.com/id=1202732348904?slreturn=20161128132751 [https://perma.cc/UG9K-EZ5L].

5. Precision Indus., Inc. v. Qualitech Steel SBQ, LLC, 327 F.3d 537, 540 (7th Cir. 2003).

6. *In re* MMH Auto. Grp., 385 B.R. 347, 363 (Bankr. S.D. Fla. 2008).

7. *See, e.g.*, Daniel J. Ferretti, *Eviction without Rejection—The Tenant's Bankruptcy Dilemma: Bankruptcy Code Sections 363(f) and 365(h)(1)(A) and the Divergent Interpretations of* Precision Indus. v. Qualitech Steel SBQ *and* In Re Haskell, 39 CUMB. L. REV. 707, 708 (2008) (*Qualitech* "incorrectly construed the two statutes in light of congressional intent and relevant policy issues."); Bruce H. White & William L. Medford, *Rejection via Sale of Real Estate: Is Your Leasehold Interest Protected?*, 26 ABI J. 7, 28, 30 (2007) ("*Qualitech* and its progeny seem at odds with certain core bankruptcy concepts, such as that § 365 governs the treatment of leases and § 363 governs the sale of property."); 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. LAW. 475, 477 (2004) ("The Seventh Circuit rendered a substantively flawed decision completely opposite to the existing precedents" that "eviscerates a lessee's § 365(h) rights" and "creates an incentive for debtors to try to accomplish a stealth rejection of leases in an attempt to extinguish unwanted leaseholds."). *See also, e.g.*, Robert M. Zinman, Precision *in Statutory Drafting: The* Qualitech *Quagmire and the Sad History of § 365(h) of the Bankruptcy Code*, 38 J. MARSHALL L. REV. 97, 127 (2004) (In Professor Zinman's view, *Qualitech* "may well" have been rightly decided based on the statutory language notwithstanding the fact that, also in his view, "the *Qualitech* result was certainly not contemplated when the Bankruptcy Code was drafted.").

the property.

Thus, if the lease has first priority, the bankruptcy sale should be subject to the lease and the tenant's possessory rights under section 365(h).[8] If instead the first priority tenant consents to the free and clear sale, the tenant should be paid the first proceeds of the sale in an amount up to the value of the lease. That lease has value if the rent payable under it is below-market, so that a prospective buyer of the lease would pay the tenant the present value of the difference between the market rent and the lower rent under the lease.[9] Each of these treatments preserves for the tenant the value of the tenant's first priority interest in the property being sold.

If instead the lease is subordinate to a monetary lien or other encumbrance, the property may be sold free and clear of the subordinate lease and of the tenant's section 365(h) possessory rights, provided the tenant is paid the value of its lease after payment to the holders of liens and encumbrances which are prior to the lease. Admittedly, the tenant under a subordinate lease will receive nothing if the lease is out-of-the-money and there are no sale proceeds remaining after payment of the prior liens and encumbrances. But that outcome, as cold as it may appear, represents the value of the tenant's interest in the property sold and vindicates the state law rights that the parties bargained for prior to the commencement of the bankruptcy case, as does the different treatment of the tenant under the first priority lease.

This result is compelled by all of the appropriate analyses. First, under the 1978 Code and the bankruptcy acts that preceded it, the property rights of parties in a bankruptcy case are determined by state law.[10] This doctrine requires that the parties' prepetition, bargained-for, state law property rights in and against a debtor's property, and their respective priorities, generally remain effective against the debtor's property postpetition in the same order of priority.[11] Second, under Supreme Court constructions of all four U.S. bankruptcy acts in effect since the 1840s, courts sitting in bankruptcy always have had the power to order the sale of a debtor's property free and clear of subordinate interests in the property.[12] Those free and clear bankruptcy sales were characterized as hypothetical foreclosure sales, and the court could compel each holder of an

8. 11 U.S.C. § 365(h)(1)(A)(ii) (2012).

9. *See, e.g.,* RESTATEMENT (THIRD) OF PROP.: MORTGAGES, § 7.4, Reporter's Note (AM. LAW INST. 1997).

10. *See* sources cited *infra* note 16; Butner v. United States, 440 U.S. 48, 54 (1979) ("Congress has generally left the determination of property rights in the assets of a bankrupt's estate to state law.").

11. *Butner,* 440 U.S. at 55 n.9.

12. *See, e.g.*, Nugent v. Boyd, 44 U.S. 426, 436–37 (1845).

interest in the property to accept a money satisfaction of its interest, to the extent of available proceeds, and in accordance with the same state law lien priorities.[13] This result also is required by the text of Code sections 363(e) and (f)(1)–(5), 361 and 365(h), and nothing in the 1978 Bankruptcy Code or the amendments to it indicates that Congress made any change to the parties' prepetition state law rights or the deeply rooted pre-Code law of free and clear sales.[14] Finally, the purposes of the Code are furthered by this result, and the legislative history of the Code supports it.[15] In sum, *Precision Industries* was rightly and *Revel* in the district court was wrongly decided.

II. THE SCOPE OF THE APPARENT CONFLICT

The Bankruptcy Code[16] is a complex statute[17] that provides for the comprehensive financial resolution of an enterprise or person who has failed. This resolution entails the equitable distribution to creditors of a debtor's property, or the proceeds of or rights in that property.[18] The Code, by application of its

13. *See* discussion *infra* Part VII(f).

14. *See* 11 U.S.C. §§ 363(e), (f)(1)–(5), 361, 365(h) (2012).

15. *See* discussion *infra* Part VII.

16. The term the "Bankruptcy Code" or the "Code" when used in this Article refers to the Bankruptcy Reform Act of 1978, as amended, which is the present bankruptcy law in the U.S. and is codified at 11 U.S.C. § 101 et. seq. This Article considers pre-Code bankruptcy statutes and Supreme Court and lower court opinions under those earlier Bankruptcy Acts in reaching its conclusions. The broad historical sweep of federal bankruptcy statutes in the U.S. is as follows. The U.S. Constitution gives Congress the authority to "establish . . . uniform Laws on the subject of Bankruptcies throughout the United States." U.S. Const. art. 1, § 8, cl. 3. Bankruptcy laws were enacted pursuant to this power in 1801, 1841, and 1867, each of which was repealed after several years without Congress's replacing it, so that for most of the 19th century no federal bankruptcy law was in effect. Bankruptcy Act of 1800, ch. 19, 2 Stat. 19 (1800), *repealed by* Act of Dec. 19, 1803, ch. 6, 2 Stat. 248 (1803); Bankruptcy Act of 1841, ch. 9, 5 Stat. 440 (1841), *repealed by* Act of March 3, 1843, ch. 82, 5 Stat. 614 (1843); and Bankruptcy Act of 1867, ch. 176, 14 Stat. 517 (1867), *repealed by* Act of June 7, 1878, ch. 160, 20 Stat. 99 (1878). With the passage of the Bankruptcy Act of 1898 there has been no lapse in federal statutory bankruptcy law. Bankruptcy Act of 1898, ch. 541, 30 Stat. 544 (1898). The Bankruptcy Act of 1898 was substantially amended in the years following the onset of the Great Depression, most extensively by the Railroad Reorganization Act in 1935, ch. 774, 49 Stat. 911 (1935), and the Chandler Act in 1938, ch. 575, 52 Stat. 840 (1938). The Bankruptcy Act of 1898, as so amended, was repealed and replaced by the present Bankruptcy Code, which became effective in 1979, and has been amended several times since.

17. Cent. Va. Cmmty. Coll. v. Katz, 546 U.S. 356, 363–64 (2006) ("Critical features of every bankruptcy proceeding are the exercise of exclusive jurisdiction over all of the debtor's property, the equitable distribution of that property among the debtor's creditors, and the ultimate discharge that gives the debtor a 'fresh start' by releasing him, her, or it from further liability for old debts." (citing Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934))); Hanover Nat'l Bank v. Moyses, 186 U.S. 181, 186 (1902) ("The ideas attached to the word" bankruptcy "are numerous and complicated; they form a subject of extensive and complicated legislation.").

18. *See Katz*, 546 U.S. at 363–64.

many provisions, balances the often-conflicting goals of maximizing: (1) a debtor's opportunity to make a fresh start[19] and, in chapter 11, to reorganize; and (2) the value of the debtor's estate for equitable distribution to creditors,[20] based both on the pre-bankruptcy property rights of the parties,[21] and the adjustments to those rights and distributional priorities provided for in the Code.[22]

As with any extensive enactment, one provision may appear to conflict with another provision of the same law, both textually and with respect to the purposes of the statute, as well as with other laws. Sections 363 and 365 are two such provisions. Section 363 authorizes the sale of estate property, both in the ordinary course[23] of the debtor's business and, with court approval, out of the ordinary course of the debtor's business,[24] thus maximizing value.

Section 363(f) provides that the holders of "interests" in the property, including liens and leaseholds, can be stripped of those interests against their will on the sale, but only if those parties, on their request, are provided with "adequate protection" under section 363(e).[25] "Adequate protection" of an interest in property that is sold free and clear is the "value of such entity's interest in such property" under section 361.[26] Thus, for example, if a property is sold for

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19. Marrama v. Citizens Bank of Mass., 549 U.S. 365, 367 (2007) ("The principal purpose of the Bankruptcy Code is to grant a 'fresh start' to the 'honest but unfortunate debtor.'" (quoting Grogan v. Garner, 498 U.S. 279, 286–87 (1991))); Wetmore v. Markoe, 196 U.S. 68, 77 (1904) ("Systems of bankruptcy are designed to relieve the honest debtor from the weight of indebtedness which has become oppressive and to permit him to have a fresh start in business or commercial life, freed from the obligation and responsibilities which may have resulted from business misfortunes.").

20. Fla. Dep't of Revenue v. Piccadilly Cafeterias, 554 U.S. 33, 51 (2008) ("Chapter 11 strikes a balance between a debtor's interest in reorganizing and restructuring its debts and the creditors' interest in maximizing the value of the bankruptcy estate." (citing Toibb v. Radloff, 501 U.S. 157, 163 (1991))); Bank of Am. v. 203 N. LaSalle St. P'ship, 526 U.S. 434, 453 (1999) (Section 1129(b)(2)(B)(ii) of the Bankruptcy Code is "intended to reconcile the two recognized policies underlying Chapter 11, of preserving going concerns and maximizing property available to satisfy creditors."); Commodity Futures Trading Comm'n v. Weintraub, 471 U.S. 343, 352–53 (the trustee "has the duty to maximize the value of the estate," "an important goal of the bankruptcy laws"); Kothe v. R.C. Taylor Tr., 280 U.S. 224, 227 (1930) ("The broad purpose of the Bankruptcy Act is to bring about an equitable distribution of the bankrupt's estate among creditors holding just demands based upon adequate consideration. Any agreement which tends to defeat that beneficent design must be regarded with disfavor.").

21. Butner v. United States, 440 U.S. 48, 54 (1979) ("Congress has generally left the determination of property rights in the assets of a bankrupt's estate to state law.").

22. Midlantic Nat'l Bank v. N.J. Dep't of Envtl. Prot., 474 U.S. 494, 508 (1986) (the "overriding purpose of bankruptcy liquidation" is "the expeditious reduction of the debtor's property to money, for equitable distribution to creditors" (citing *Kothe*, 280 U.S. at 227)).

23. 11 U.S.C. § 363(c)(1) (2012).

24. 11 U.S.C. § 363(b)(1).

25. 11 U.S.C. § 363(e), (f).

26. 11 U.S.C. §§ 361, 363(e) (2012).

$1 million free and clear of a $700,000 first priority mortgage and a $500,000 second priority mortgage, the first mortgagee is entitled to payment of $700,000 but the second mortgagee is entitled only to the remaining $300,000 of the sale proceeds, because with respect to each mortgagee that is the value of the holder's interest in the property sold. The holder of a lease with a value of $100,000 that is subordinate to both the first and second mortgages will receive nothing, because all of the sale proceeds will be paid to the holders of the first and second mortgages, and the tenant's interest in the property sold has no value. This is the same treatment that will be afforded to the holder of a $100,000 third mortgage against the property. It too will receive nothing, because its interest in the property sold has no value.

Section 365, which gives the debtor the choice to either assume or reject a lease, also maximizes value.[27] Section 365(a) permits a debtor to assume an advantageous lease, and to include the lease and its value in the debtor's estate. If the lease instead is disadvantageous, the debtor under section 365(a) may reject it and thus be relieved of the financial burdens of it.[28] A debtor-tenant that rejects its lease simply walks away from its obligations under it, and is relieved of its duty to pay rent and its other responsibilities under the lease.[29] The landlord is left with nothing more than a rejection damage claim, which is payable at the same percentage as for other general unsecured claims.[30]

The situation is different when the debtor is the landlord. Though the debtor-landlord who rejects the lease is discharged from its obligations under the lease (such as its agreement to provide heat, water, utilities and janitorial services), section 365(h) gives the tenant whose lease has been rejected the right to elect to remain in possession against the wishes of the debtor, provided that the tenant under the rejected lease continues to pay the rent less any amounts that it expends to fulfill the landlord's obligations.[31]

Some courts have held that these possessory rights of a tenant under section 365(h) survive a section 363(f) free and clear sale of the real property, whether

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27. For ease of reference I often use the term "debtor" throughout this Article to refer to a "debtor in possession" in a chapter 11 case or a "trustee" in a chapter 7 or chapter 11 case. For readers less familiar with U.S. bankruptcy law, the debtor in a chapter 11 case remains in possession of its property and in charge of its own affairs as the "debtor in possession," subject to court approval when required, e.g., when rejecting a lease or selling property out of the ordinary course of its business or free and clear. By comparison, in a chapter 7 liquidation, or a case in which the court has appointed a chapter 11 trustee, the trustee has the authority to act for the debtor and its estate, subject again to any court approval where required. 11 U.S.C. §§ 1101(1), 1104(a), 1107(a) (2012).

28. 11 U.S.C. § 365(a) (2012).

29. 11 U.S.C. § 365(h).

30. 11 U.S.C. §§ 365(g), 502(b)(6) (2012).

31. 11 U.S.C. § 365(h)(1).

or not the lease already has been rejected or the lease is subordinate to liens and other interests in the property that exceed the value of the property.[32] Other courts have determined to the contrary that the property can be sold free and clear of both the lease and the tenant's section 365(h) possessory rights, provided that the tenant is paid to the extent of available proceeds following payment of any prior encumbrances, as adequate protection under section 363(e).[33]

The winners and losers in the resolution of this question can be considerably affected. If the debtor in all cases can sell the property free and clear of the lease and the tenant's possessory rights, then the tenant will be divested of an often-valuable asset.[34] The tenant also may suffer substantial incidental damages resulting from the loss of a business location and the need to pay relocation costs. If instead the lease or the debtor's possessory rights under it in all cases survive the sale, then the holders of those mortgages and other interests will suffer a similar loss in value.[35] A sale subject to the tenant's possessory rights often will decrease the number of willing buyers and the amount that any of them is prepared to pay for the property, will leave some properties unsalable, and will deprive creditors, including the holder of a mortgage that has lien priority over the lease, of the recovery that they would otherwise receive.

The difficulties in resolving this conflict came to the fore in the Seventh Circuit's opinion in *Precision Industries*.[36] In "this case of first impression at the circuit level," the court was "asked to reconcile" these "two distinct provisions of the Bankruptcy Code."[37] The bankruptcy court ruled that the free and clear sale order had "extinguish[ed]" Precision Industries' possessory rights as tenant under a lease that was subordinate under state law to existing mortgages against the property.[38] The district court disagreed and reversed.[39] It reasoned that sections 363(f) and 365(h) conflict, and that section 365(h) contains the more specific text that "trumps" the more general terms of section 363(f).[40] The

32. *See, e.g.*, *In re* Churchill Props. III, Ltd. P'ship, 197 B.R. 283, 288 (Bankr. N.D. Ill. 1996); Precision Indus. v. Qualitech Steel SBQ, 2001 WL 699881, at *11–13 (S.D. Ind. Apr. 24, 2001).

33. 11 U.S.C. §§ 361, 365(e) (2012). *See, e.g.*, *In re* Downtown Athletic Club of N.Y.C., 2000 WL 744126, at *4–5 (S.D.N.Y. June 9, 2000); Precision Indus. v. Qualitech Steel SBQ, 2001 WL 699881, at *13 (S.D. Ind. Apr. 24, 2001).

34. *See* 11 U.S.C. §§ 365(e), 361.

35. *See* 11 U.S.C. §§ 365(e), 361.

36. Precision Indus. v. Qualitech Steel SBQ, 327 F.3d 537, 540 (7th Cir. 2003).

37. *Id.*

38. *Id.*

39. *Id.* at 542.

40. Precision Indus. v. Qualitech Steel SBQ, 2001 WL 699881, at *13 (S.D. Ind. Apr. 24, 2001). The district court also noted that section 365(h) "does not expressly cross-reference any other provision of the Bankruptcy Code by way of limitation" and that the "available legislative history" discussed in

Seventh Circuit analyzed the text differently. It determined that nothing in either of the two sections suggests that one supersedes or limits the other.[41] The Seventh Circuit further reasoned that section 365(h) is confined to a situation in which the lease is rejected, which had not occurred in the case.[42] Section 363 by comparison provides a mechanism other than possession for protecting a tenant or other party who is affected by a free and clear sale: the tenant is entitled to "adequate protection" of its interest under section 363(e),[43] most commonly by cash payment from the sale proceeds to the tenant for the value of its lease, after payment to the holders of any prior encumbrances. The Seventh Circuit concluded that the property had been sold free and clear of Precision's possessory rights under the subordinate lease, and reversed the district court.[44]

Since *Precision Industries* was decided, no other court of appeals has addressed the issue, though many lower courts including the district court in *Revel* have.[45] Decisions have diverged. Most appear to have favored the tenant's rights to unassailable possession under section 365(h) over a debtor's section 363(f) authority to sell free and clear, without considering the prepetition priorities of the parties' state law property rights.[46]

Squaring these two provisions of the same statute requires consideration of divergent and evolving interpretive regimes applicable to statutes. One present battle line regarding the preferred approach for reconciling enactments that appear dissonant or ambiguous ostensibly divides textualists from purposivists. Textualists have been ascendant of late. The most severe textualists claim that any statute is best construed by resort to deductive reasoning and interpretive canons applied to the enacted words themselves, with minimal if any reference to extrinsic evidence regarding either purpose or intent.[47] The inquiry in their view should end there unless that analysis finds a statutory ambiguity or incongruity.[48] Purposivists generally assert that finding meaning can and should include at the outset a consideration of the purposes of the statute, discerned from

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other cases addressing the issue "also indicates that Congress intended to preserve the lessee's estate in the event of rejection by a bankrupt landlord." *Id.* at *14.

41. *Precision Indus.*, 327 F.3d at 547.

42. *Id.*

43. *Id. See also* 11 U.S.C. § 361 (2012).

44. *Precision Indus.*, 327 F.3d at 548.

45. *Revel AC*, 532 B.R. 216, 227–28 (Bankr. D.N.J. 2015).

46. *See infra* Part IV.

47. *See* discussion *infra* Part VIII(A).

48. *See, e.g.*, ANTONIN SCALIA AND BRYAN A. GARNER, READING LAW: THE INTERPRETATION OF LEGAL TEXTS 16 (2012) [hereinafter SCALIA AND GARNER, READING LAW] ("Textualism, in its purest form, begins and ends with what the text says and fairly implies."); *see* discussion *infra* Part VIII(A).

both the text and extrinsic evidence, followed by an interpretation and application of the enactment that is in harmony with and furthers the purpose that has been thus determined.[49]

In practice the dispute is not so pointed. Most fundamentally, textualists consider purpose and purposivists construe text. Both take context into account, are bound by and acknowledge precedent, and draw from extrinsic sources.[50] The resulting pluralism is not anarchic.[51] Rather, judges "generally have a 'familiar framework for analysis and a stable set of concepts and tools that they use in explaining their statutory interpretation decisions.'"[52]

Moreover, battles between grand paradigms such as these often are fought in the midst of more pedestrian and specific rules on which there is consensus. A peculiarity in reading the Bankruptcy Code is that Congress has generally "left the determination of property rights in the assets of a bankrupt's estate to state law."[53] Thus, the Supreme Court has held that liens, leases, and other encumbrances and interests in property are not "analyzed differently simply because an interested party is involved in a bankruptcy proceeding" unless some "federal interest" or "controlling federal rule" requires a different result.[54] A second imperative that does not fit neatly into one interpretive regime or the other recognizes the significance of prior U.S. bankruptcy law. The Supreme Court consistently has stated in this regard that it "'will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure.'"[55]

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49. *See, e.g.*, HENRY M. HART, JR. AND ALBERT M. SACKS, THE LEGAL PROCESS: BASIC PROBLEMS IN THE MAKING AND APPLICATIONS OF LAW 1374 (William N. Eskridge, Jr. & Phillip P. Frickey eds., Foundation Press 1994) [hereinafter HART AND SACKS, THE LEGAL PROCESS] ("In interpreting a statute a court should: 1. Decide what purpose ought to be attributed to the statute and to any subordinate provision of it which may be involved; and then 2. Interpret the words of the statute immediately in question so as to carry out that purpose as best it can, making sure, however, that it does not give the words either – (a) a meaning they will not bear, or (b) a meaning which would violate any established policy of clear statement."); ROBERT A. KATZMANN, JUDGING STATUTES 31 (Oxford University Press 2014) [hereinafter KATZMANN, JUDGING STATUTES] (The purposive approach is "premised on the view that legislation is a purposive act, and judges should construe statutes to execute that legislative purpose.").

50. *See* KATZMANN, JUDGING STATUTES, *supra* note 49 at 31, 34–35, 46; SCALIA AND GARNER, READING LAW, *supra* note 48, at 20.

51. FRANK B. CROSS, THE THEORY AND PRACTICE OF STATUTORY INTERPRETATION 18 (Stanford Law Books 2009).

52. *Id.* (quoting Morell E. Mullins, Sr., *Tools, Not Rules: The Heuristic Nature of Statutory Interpretation*, 30 J. OF LEGIS. 1, 4 (2003)).

53. Nobleman v. Am. Sav. Bank, 508 U.S. 324, 329 (1993) (quoting Butner v. United States, 440 U.S. 48, 54–55 (1979)).

54. *Butner*, 440 U.S. at 54 (1898 Act case); *Nobelman*, 508 U.S. at 329 (1993) (1978 Code case). *See also* Lewis v. Mfrs. Nat'l Bank of Detroit, 364 U.S. 603, 609 (1961) (1898 Act case).

55. Hamilton v. Lanning, 560 U.S. 505, 517 (2010) (citations omitted).

The thorny thicket that has grown up around the intersection between sections 365(h) and 363(f) holds the following critical questions:

Does section 365(h) protect a tenant, even to the extent of disturbing state law lien priorities such that the tenant's section 365(h) possessory rights under a subordinated lease obtain priority over all mortgages and other liens and interests in the property, no matter their respective priorities under state law? Or instead does section 363(f) authorize a sale free and clear of a subordinate lease and the tenant's possessory interest on payment of adequate protection under sections 361 and 363(e) to the tenant and to the other parties who have an interest in the real property in accordance with those priorities?;

Do sections 363(f)(1) or (5) authorize a sale free and clear of a subordinate lease because "applicable nonbankruptcy law permits" such a sale or because the tenant under a subordinate lease could be compelled to accept a money satisfaction of its interest in a hypothetical legal or equitable proceeding, such as a state foreclosure sale, without regard to whether such proceeding is actually and presently available to the debtor in possession or trustee?; and

Is a tenant under a subordinate lease entitled, even if the sale is made free and clear of its interest, to adequate protection consisting of post-sale possession because that is the "indubitable equivalent" under section 361(3) of its interest in the property sold?

This Article's thesis is that *Precision Industries* was rightly decided and Bankruptcy Code sections 363(f) and 365(h) conflict not at all. This reconciliation is compelled by the state law that determines both the interests in real property under the Code and the priorities of those interests. It is supported by more than 130 years of unbroken, pre-Code bankruptcy law and practice that authorized the sale of real property free and clear of encumbrances and other interests, as though in a state law foreclosure proceeding, and without any requirement that such an action was actually available to the debtor or trustee. Congress has never indicated, clearly or otherwise, that it was changing this law and practice in its enactment of the Code in 1978 or in any amendment since. This conclusion is reached whether one takes a textualist or purposivist approach or applies the more pluralistic method that I argue has been and continues to be favored by both the Supreme Court and the lower courts in interpreting the Bankruptcy Code.

This Article proceeds as follows. Part II summarizes the applicable provisions of Bankruptcy Code, including sections 365(h) (regarding a non-debtor tenant's right to elect to remain in possession on rejection), 363(f) (regarding free and clear sales), and 363(e) and 361 (regarding adequate protection). Part III considers the district court's and Seventh Circuit's decisions in *Precision Industries*. Part IV briefly summarizes the post-*Precision* decisions. Part V considers leasehold estates as state-law property interests under the Bankruptcy

Code, which have priority over some—and are subordinate to other—encumbrances and other interests in the same real property, and the absence of a clear congressional command that alters those priorities on a bankruptcy sale of the encumbered property. Part VI traces pre-Code Supreme Court and lower court precedents regarding free and clear sales and a tenant's right to possession after rejection of the lease, in light of the Supreme Court's interpretative rule that it will not read the Code to erode existing pre-Code law absent a clear indication that Congress intended such a departure. These consistent pre-Code rulings, which date to the 1840s, established unequivocal authority for a court-ordered sale of a debtor's real estate in a bankruptcy case, likened to a hypothetical state law foreclosure sale, free and clear of both monetary liens having priority and other interests including leasehold estates, liens and other encumbrances that were subordinate to that monetary lien. Part VII briefly explores the textualist and purposivist schools of statutory interpretation, and the approaches to construing the Bankruptcy Code taken by the Supreme Court in key cases. While there are genuine differences between these two interpretive regimes and among the Justices in their interpretive inclinations, they are few and less significant than is often asserted, and both approaches support the view that the Bankruptcy Code authorizes a sale free and clear of a subordinate lease. This Part then examines sales free and clear of a lease and the tenant's possessory rights on consideration of the text, purposes and legislative history of the Bankruptcy Code.

This Article concludes in Part VIII that a tenant under a lease that the debtor rejects should be entitled to remain in possession. On a sale of the property under section 365(f), though, the tenant's rights to continue in possession should depend on whether the lease has priority over or is subordinate to monetary liens against the property.

If the lease is subordinate to such liens that have priority, then the tenant should be subject to dispossession but should be entitled, on its request under section 363(e), to a monetary satisfaction as adequate protection under sections 363(e) and 361(1).[56] By the clear text of section 361(1), this adequate protection is "the value such entity's interest in . . . property," and equates to the value of the tenant's leasehold estate in relation to the other interests and liens against the property in the order of their respective state law priorities.[57] While this rule may result in the ejectment of a tenant under an out-of-the-money subordinated lease without compensation for its loss, that outcome is a consequence of the parties' respective, bargained-for prepetition state law property rights, and

56. 11 U.S.C. §§ 363(e), 361(1) (2012).

57. 11 U.S.C. § 361(1).

is identical to the result in a state law foreclosure proceeding.[58] The opposite conclusion produces inconsistent and at times absurd results, including transforming a subordinate lease and any leasehold mortgage that is secured by it into first priority encumbrances, while subordinating the encumbrances that previously had priority over the lease. This outcome is in derogation of state law and the priorities that the parties bargained for prepetition when they entered into these transactions.

With respect to a lease that has priority over a mortgage or other monetary lien, the outcome should be different. On a sale of such property, the tenant should be entitled to remain in possession of the leased premises. This is the result that would obtain in a state law foreclosure proceeding on a mortgage or other monetary lien over which the lease had priority, and respects and preserves the parties' bargained-for, prepetition interests.[59] The tenant under a lease with priority also may be adequately protected if it consents to the free and clear sale of the lease, in which event the tenant—which has first priority—will be entitled to be paid as adequate protection the first proceeds up to the value of the lease.[60] In either event, this treatment gives the tenant the value of its first priority interest and first claim to value in the property.

This approach provides the tenant with "the value of [its] interest in such property"[61] being sold, as required by sections 361(1) and 363(e) and (f), generally mirrors the result that would be obtained in a state law foreclosure proceeding, and consistently vindicates the parties' bargained-for, prepetition state law property rights.

III. KEY ASPECTS OF A LANDLORD-DEBTOR'S LEASE REJECTION, A FREE AND CLEAR SALE, AND THE PROTECTIONS GIVEN TO THE NON-DEBTOR PARTY UNDER THE BANKRUPTCY CODE

Section 365(a) enables a debtor to reject a disadvantageous lease whether the debtor is the tenant or the landlord.[62] A debtor-landlord may opt to reject a lease if the tenant is paying less than market rental.[63] But in such case section 365(h) protects the non-debtor tenant by providing that on rejection it may elect to retain its rights under the lease, including the right of possession, for the

58. *See* discussion *infra* Part VII(C)(3).

59. *See* discussion *infra* Part VII(C)(3).

60. *See* 11 U.S.C. § 363(f).

61. 11 U.S.C. § 361(1). *See also* 11 U.S.C. § 363(e), (f).

62. 11 U.S.C. § 365(a) (2012).

63. *Id.* A debtor in possession in a chapter 11 case has most of the powers given by the Code to a trustee. 11 U.S.C. § 1107(a) (2012).

balance of the term of the lease and any renewals so long as it continues to pay the rent.[64] If the tenant elects to remain in possession, though, the debtor-landlord and its estate have no further liability for performance under the lease and the tenant may offset against the rent the cost of such performance.[65]

What if the debtor in possession or trustee elects to sell the property? Code section 363 sets forth the rules.[66] A debtor may sell its property "free and clear of any interest in such property of an entity other than the estate," but only if one of the five conditions listed in section 363(f)(1)-(5) has been satisfied.[67] These conditions are: (1) that "*applicable nonbankruptcy law*" permits the sale of such property free and clear; (2) that the other entity with an interest in the property has consented to a sale free and clear of its interest in the property; (3) that such interest is a lien and the sale price for the property is greater than the aggregate value of all liens on such property; (4) that there is a bona fide dispute with respect to the other entity's interest in the property; or (5) if the party with an interest in the property being sold "*could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.*"[68]

The entity with an interest in the property is not stripped of the value of its interest on a free and clear sale. Section 363(e) provides to the contrary that an entity is entitled to "adequate protection" of its interest on request.[69] Adequate protection on a sale may be provided by one of three means: (1) a cash payment or cash payments "to the extent that" the sale "results in a decrease in the value of such entity's interest in such property;" (2) "an additional or replacement lien to the extent that" the sale "results in a decrease in the value of such entity's interest in such property" (which likely is not applicable to a sale free and clear of a lease, since the lease by most accounts is not a lien); or (3) by granting such other relief "as will result in the realization by such entity of the indubitable equivalent of such entity's interest in such property."[70]

A free and clear sale order typically gives adequate protection to the holder of the lien or other interest in the property that was sold by a cash payment in accordance with the first alternative of section 361.[71] By the terms of the free

64. 11 U.S.C. § 365(h)(1)(A)(ii).

65. 11 U.S.C. § 365(h)(1)(A)(ii), 365(h)(1)(B).

66. *See* 11 U.S.C. § 363. Section 363 also includes the statutory provisions applicable to the debtor's use and lease of estate property. *Id.*

67. 11 U.S.C. § 363(f).

68. 11 U.S.C. § 363(f)(1)–(5) (emphasis added).

69. 11 U.S.C. § 363(e).

70. 11 U.S.C. § 361(1)–(3) (2012).

71. *See, e.g.*, Reeves v. Callaway, Ch.7 Case No. 12-2127 (4th Cir. filed Nov. 20, 2013) (unpublished per curiam opinion).

and clear sale order entered by the bankruptcy court, the interest is stripped from the asset sold, and the value of that interest in the property sold is then attached to the proceeds of sale in the same order and priority that it had against the property prior to the sale, as adequate protection of the parties' interests.[72]

By the same or a subsequent order of the court, the proceeds of sale are then distributed in the order of the priority of those interests until the proceeds are exhausted.[73] If, then, the only encumbrances against a property sold for $10 million are a $7 million first mortgage and a $5 million second mortgage, the purchaser at closing would own the property free of those liens, and the two liens simultaneously would attach to the proceeds of sale as adequate protection for the loss of the value of each lienholder's interest in the property that was sold. The proceeds would be distributed as follows: $7 million to the first mortgagee, and the $3 million balance on account of the interest of the second mortgagee, with nothing left for the debtor's estate. If the property in this example only sold for $7 million, then the holder of the second lien or any lease that was subordinate to the first mortgage would be out-of-the-money, and would receive nothing from the sale proceeds. This makes sense because the subordinate lienor or subordinate tenant is entitled to nothing more in bankruptcy than "the value of such entity's interest in such property"[74] as adequate protection under section 361(1) or (2), and the value each of the those party's interest in the property that sold for only $7 million is zero.[75]

This practice of reducing an estate asset to cash by a free and clear sale and protecting the holders of liens and other interests by attaching their interests to the proceeds in the order of their priority is long-standing, and predates both the 1978 Bankruptcy Code and its predecessor, the 1898 Bankruptcy Act, as discussed more fully in Part VI.[76]

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72. *See id.*

73. *See infra* text accompanying notes 146–52.

74. 11 U.S.C. § 361(1).

75. The holder of the $5 million claim who received $3 million in the first example also will have a $2 million general, unsecured claim for the balance of its claim. See 11 U.S.C. § 506(a) (2012). The holder of the $5 million out-of-the-money claim in the second example will have a $5 million general, unsecured deficiency claim. But while a payment on account of an in-the-money interest in property will be paid dollar-for-dollar, the general, unsecured claim of the holder of an interest in the property sold that is partially or entirely out-of-the-money will be paid only the pennies-on-the-dollar amount that general, unsecured claims are paid in the case.

76. *See, e.g.*, Ray v. Norseworthy, 90 U.S. 128, 134 (1874) (1867 Bankruptcy Act case—"So where the bankrupt court ordered the mortgaged premises to be sold, and directed that the mortgages should be cancelled and that the property should be sold free from incumbrance, rendering to the parties interested their respective priorities in the proceeds, this court decided that the bankrupt court did not exceed their jurisdiction, and affirmed their action.").

IV. THE *PRECISION INDUSTRIES* DECISIONS

Qualitech Steel Corporation owned a steel mill on 138 acres in Hendricks County, Indiana, encumbered by a first and second mortgage securing $380 million of debt.[77] About an acre of the facility also was subject to a ten-year land lease with Precision Industries, Inc., entered into weeks before the bankruptcy filing.[78] Precision had built a warehouse on that parcel that it agreed to operate for ten years for Qualitech's apparent benefit and in consideration of Qualitech's payments under a related "Integrated Supply Agreement."[79] Rent under the land lease was a nominal $1 per year and Qualitech had the right to purchase the warehouse for $1 after the expiration of the lease.[80] Precision did not record its ten-year lease against the parcel on which it had built the warehouse.[81]

A. The Bankruptcy Court's Decision in Precision Industries

Qualitech sold the entire 138-acre facility at an auction authorized by the bankruptcy court.[82] The high bid was the senior secured lenders' credit bid in the amount of $180 million, which was about $200 million less than the total mortgage debt secured by the facility.[83] The bankruptcy court approved the credit bid and issued its sale order.[84] The senior lenders subsequently transferred their interest in the assets to New Qualitech.[85]

Precision's land lease was not assumed in connection with the sale, and New Qualitech took possession of the leased property and the warehouse by changing the locks without Precision's consent, authorization, or knowledge.[86] New Qualitech then filed a motion in the bankruptcy court seeking to enforce and clarify the terms of the sale order.[87]

The bankruptcy court ruled in New Qualitech's favor, finding that the original sale order had unambiguously extinguished Precision's lease.[88] Precision

77. Precision Indus. v. Qualitech Steel SBQ, 2001 WL 699881, at *1–2 (S.D. Ind. Apr. 24, 2001).
78. *Id.* at *2
79. *Id.*
80. *Id.*
81. *Id.*
82. *Id.*
83. *Id.*
84. *Id.* at *3.
85. *Id.* at *2–3.
86. *Id.* at *4.
87. *Id.*
88. *Id.* at *5.

appealed to the district court.[89]

B. The District Court's Decision in Precision Industries

Precision argued before the district court that the debtor's failure to assume the land lease amounted to a *de facto* rejection of the lease, thereby giving Precision the option under section 365(h) to remain in possession for the remainder of the term and renewal terms.[90]

New Qualitech claimed that the free and clear sale order trumped Precision's possessory rights under section 365(h).[91] It reasoned that at the time of the sale the lease was subject to the two prior, recorded mortgages and that the sale proceeds were insufficient to satisfy the mortgage debt.[92] Precision's unrecorded lease—"which was at least third in priority—would have been extinguished under Indiana law if the sale had been conducted by foreclosure."[93] Further, New Qualitech argued, references in both sections 363(f) and 365(h) to "applicable nonbankruptcy law" demonstrated Congress's intent "to ensure that the result of a bankruptcy sale would be identical to the result of a state foreclosure sale."[94]

The court considered the handful of authorities under the Bankruptcy Code. The district court in *In re Downtown Athletic Club of New York City, Inc.* had held squarely that a free and clear sale under section 365(f) "overrides a tenant's possessory rights," and that section 365(h) applies only when a debtor-lessor rejects a lease and retains the property rather than selling it.[95]

In sharp contrast, the bankruptcy courts in *In re Churchill Properties III, Ltd. Partnership* and *In re Taylor* had held that a section 363(f) free and clear sale by a debtor-landlord could not divest a tenant of its possessory rights under section 365(h), reasoning that the specific provision of section 365(h) regarding a tenant's possessory rights following rejection of the lease governed the general legislation of section 365(f) regarding a sale free and clear of interests.[96] Those courts also found that the Code's legislative history evinced a clear intent

89. *Id.*

90. *Id.* at *9 (citing 11 U.S.C. § 365(h)).

91. *Id.* at *10.

92. *Id.*

93. *Id.*

94. *Id.* (citing 11 U.S.C. §§ 363(f)(1), 365(h)(1)(A)(ii)).

95. *Id.* at *13 (citing *In re* Downtown Athletic Club of N.Y.C., 2000 WL 744126, at *4 (S.D.N.Y. June 9, 2000)).

96. *In re* Taylor, 198 B.R. 142, 164–65 (Bankr. D.S.C. 1996) (citing *In re* LHD Realty Corp., 20 B.R. 717, 719 (Bankr. S.D. Ind. 1982)); *In re* Churchill Props. III, Ltd. P'ship, 197 B.R. 283, 288 (Bankr. N.D. Ill. 1996).

by Congress to protect a tenant's interest when its landlord is in bankruptcy.[97]

The district court considered commentary critical of those decisions that contended that allowing a tenant to retain a possessory right under a lease that was subordinate to a monetary lien was unfair to other creditors and would not maximize the value of the debtor's estate.[98] However," the court continued, "whether granting lessees strong possessory rights is the most sensible way to deal with a debtor-lessor's unexpired leases matters little if Congress intended that result."[99] The district court held that "the more specific Section 365(h) overrides Section 363(f)" and that there was "no statutory basis for allowing the debtor-lessor to terminate the lessee's possession by selling the property out from under the lessee."[100]

C. The Seventh Circuit Court of Appeals' Decision in Precision Industries

The Seventh Circuit characterized the question on appeal as a "case of first impression."[101] It defined its task to be to construe the two statutory provisions "in such a way as to avoid conflicts between them, if such a construction is possible and reasonable,"[102] and "to 'give effect to each if we can do so while preserving their sense and purpose.'"[103]

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97. *In re Taylor*, 198 B.R. at 165–66; *In re Churchill Props. III, Ltd. P'ship*, 197 B.R. at 288. The district court in *Precision Industries* also considered *In re LHD Realty Corp.* and *In re Bedford Square Associates*. In *LHD Realty* the district court denied the debtor's motion to modify or terminate a lease, stating its view that Congress in enacting section 365(h) intended "to make that section the exclusive remedy available to a debtor in an executory lease situation." *Precision Indus.*, 2001 WL 699881, at *9, 13 (quoting *In re* LHD Realty Corp., 20 B.R. 717, 719 (Bankr. S.D. Ind. 1982)). The district court in *In re Bedford Square Associates* ruled that a debtor could sell property free and clear of a covenant against the landlord's altering a shopping center parking lot without the tenant's consent. *In re Bedford Square Associates*, 247 B.R. 140, 146 (Bankr. E.D. Pa. 2000). The *Bedford Square* court reached this conclusion after "weighing the interests of a debtor-lessor in maximizing its use of its property against the interests of a tenant in enforcing lease provisions." *Id.* at 141. The district court in *Precision* thought that the "relatively narrow holding" in *Bedford Square* provided only "weak support" that section 363(f) prevailed over 365(h) for the purpose of dispossessing Precision from its warehouse facility. *Precision Indus.*, 2001 WL 699881, at *13 (citing *Bedford Square*, 247 B.R. at 141, 145 (Bankr. E.D. Pa. 2000), *appeal dismissed as moot,* Wal-Mart Real Estate Bus. Tr. v. Bedford Square Assocs., LP, 259 BR 831 (E.D. Pa. 2001)).

98. *Precision Indus.*, 2001 WL 699881, at *14.

99. *Id.* (citing Steven R. Haydon & Nancy J. March, *Sale of Estate Property Free and Clear of Real Property Leasehold Interests Pursuant to § 365(f): An Unwritten Limitation?*, 19 AM. BANKR. INST. J. 20 (2000); and Peter A. Alces, *Unexpired Leases in Bankruptcy: Rights of the Affected Mortgagee,* 35 U. FLA. L. REV. 656, 674–75 (1983)).

100. *Id.*

101. Precision Indus. v. Qualitech Steel SBQ, 327 F.3d 537, 540 (7th Cir. 2003).

102. *Id.* at 544 (citing Morton v. Mancari, 417 U.S. 535, 551 (1974)).

103. *Id.* (first quoting Watt v. Alaska*,* 451 U.S. 259, 267 (1981); then citing United States v. Fausto, 484 U.S. 439, 453 (1988)).

The term "any interest" in section 363(f) was sufficiently broad in the court's view to include Precision's possessory interest under the lease, a point that both parties conceded.[104] Where the parties locked horns was whether the terms of section 365(h) conflict with and override those of section 363(f).[105]

The Seventh Circuit determined that they did not. "First, the statutory provisions themselves do not suggest that one supersedes or limits the other."[106] Second, the plain language of section 365(h) has a limited scope and applies only "[i]f the trustee [or debtor-in-possession] *rejects* an unexpired lease of real property . . . ."[107] Third, each of sections 363(f) and 365(h) protects the tenant: section 363(f) by entitling the tenant, on its request, to adequate protection on a free and clear sale, and section 365(h) by giving the tenant a right to continued possession following the landlord's rejection of the lease.[108]

The court reasoned that the two statutory provisions thus could be "construed in a way that does not disable section 363(f) vis à vis leasehold interests."[109] The property could be sold "free and clear of a lessee's possessory interest—provided that the lessee (upon request) is granted adequate protection for its interest."[110] But where the property was not sold, and the debtor rejected the lease, section 365(h) came "into play and the lessee retain[ed] the right to possess the property. So understood, both provisions may be given full effect without coming into conflict with one another and without disregarding the rights of lessees."[111]

The Seventh Circuit viewed its interpretation as being "consistent" with the express terms of each of sections 363(f) and 365(h) and as avoiding "the unwelcome result of reading a limitation into section 363(f) that the legislature itself did not inscribe onto the statute. Congress authorized the sale of estate property free and clear of '*any* interest,' not 'any interest *except* a lessee's possessory interest.'"[112] This interpretation was "also consistent with the process of marshaling the estate's assets for the twin purposes of maximizing creditor recovery and rehabilitating the debtor, which are central to the Bankruptcy Code."[113] The Seventh Circuit reversed the district court, holding that section

104. *Id.* at 545.
105. *Id*. at 546.
106. *Id.* at 547.
107. *Id.* (quoting 11 U.S.C. § 365(h)(1)(A)).
108. *Id*. at 547–48 (citing 11 U.S.C. §§ 363(f), 355(h)).
109. *Id.* at 548.
110. *Id.*
111. *Id.*
112. *Id.*
113. *Id.* (citing Steven R. Haydon & Nancy J. March, *Sale of Estate Property Free and Clear*

363(f) permitted the sale unencumbered by Precision's possessory interest.[114]

V. THE DIVIDED POST-*PRECISION INDUSTRIES* CASE LAW ON SALES FREE AND CLEAR OF A TENANT'S POSSESSORY RIGHTS UNDER THE LEASE

No court of appeals since the Seventh Circuit in *Precision Industries* has decided whether a free and clear sale under section 363(f) can deprive a tenant of its lease and possessory rights under section 365(h).[115] A large number of district courts and bankruptcy courts have considered the question. None of these opinions has taken issue with whether a lease or a tenant's post-rejection possessory rights is an "interest" under section 363(f).[116] Other than this area of agreement, the lower courts remain divided and no consistent line of authority has emerged.[117]

A. Decisions Holding that a Proposed Sale Free and Clear Can Deprive a Tenant of its Possessory Rights under Section 365(h)

Several cases have followed the Seventh Circuit in *Precision Industries* by harmonizing section 365(h) with section 363(f).[118] Other cases have held categorically that a free and clear sale extinguishes a lease.[119] A number of these

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of Real Property Leasehold Interests Pursuant to § 363(f): An Unwritten Limitation?, 19 AM. BANKR. INST. J. 20, 22–23 (2000)).

114. *Id.*

115. The Third Circuit in *Revel* ultimately reversed the district court's denial of a stay of the sale free and clear of IDEA's lease. The debtor argued on appeal that it could sell the property free and clear because the question of whether IDEA's interest was a lease was "in bona fide dispute" under section 363(f)(4). The debtor apparently failed to assert that any of the conditions for a free and clear sale under section 363(f)(1)–(5) were satisfied. The Third Circuit ruled that there was no bona fide dispute about the characterization of IDEA's agreement as a lease, and thus that IDEA was likely to succeed on the merits, because none of the conditions of section 363(f)(1)–(5) were satisfied. The court did not reach the issue of whether section 365(h) trumped section 363(f). *In re* Revel AC, 802 F.3d 558, 573–75 (3d Cir. 2015).

116. *See, e.g.*, *In re* Scimeca Found., 497 B.R. 753, 786–88 (Bankr. E.D. Pa.); *In re* Extra Room, 2011 WL 846448, at *2 (Bankr. D. Ariz. Mar. 7, 2011); *In re* Haskell, 321 B.R. 1, 6 (Bankr. D. Mass. 2005); and *In re* Hill, 307 B.R. 821, 826 (Bankr. W.D. Pa.). *See also*, *In re* Downtown Athletic Club of N.Y.C., 2000 WL 744126, at *4 (S.D.N.Y. June 9, 2000); *In re* Taylor, 198 B.R. 142, 162 (Bankr. D.S.C. 1996).

117. At least one district court has concluded, in considering a request for a stay of a sale, that the legal authority on this issue is in "equipoise." *See, e.g.,* IDEA Boardwalk v. Revel AC, (*In re* Revel AC), 525 B.R. 12, 26 (Bankr. D.N.J. 2015), *rev'd*, 802 F.3d 558 (3d Cir. 2015).

118. *In re* R.J. Dooley Realty, 2010 WL 2076959, at *1–2, 7 (Bankr. S.D.N.Y. May 21, 2010); *Downtown Athletic Club*, 2000 WL 744126, at *4; *In re* MMH Auto. Grp., 385 B.R. 347, 362–64 (Bankr. S.D. Fla. 2008) (citing Precision Indus. v. Qualitech Steel SBQ, 327 F.3d 537, 548 (7th Cir. 2003)).

119. *In re* Hill, 307 B.R. at 823, 825–26 (citing Precision Indus. v. Qualitech Steel SBQ, 327 F.3d 537 (7th Cir. 2003)); *In re* Ng, 2007 WL 4365564, at *1 (Bankr. N.D. Cal Dec. 13, 2007) (citing

and other cases have concluded that a hypothetical legal or equitable proceeding satisfies the condition of section 363(f)(5) or found that the parties agreed to the terms of a money satisfaction.[120] Some of these cases have expressly denied the tenant's request for continued possession as adequate protection on the sale free and clear.[121]

B. Decisions Holding That a Proposed Sale Free and Clear Cannot Deprive a Tenant of its Possessory Rights under Section 365(h) and the Grounds for Those Decisions

Most courts that have ruled that a free and clear sale under section 363(f) cannot divest the tenant of its possessory rights under section 365(h) have done so on one or more of three grounds. First, a number of courts have concluded that section 365(h) trumps section 363(f), essentially following the view of the district court in *Precision Industries* (that the Seventh Circuit reversed) and the bankruptcy court in *In re Haskell*.[122] Some of these decisions have directly referred to the general/specific canon of statutory interpretation and/or the view that a debtor cannot do indirectly, i.e., dispossess a tenant by a free and clear

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Precision Indus. v. Qualitech Steel SBQ, 327 F.3d 537 (7th Cir. 2003)); Hewlett v. U.S. Bankr. Court, 2007 WL 3232239, at *1 (Bankr. N.D. Cal. Oct. 31, 2007); *Extra Room*, 2011 WL 846448, at *1–2.

120. *See* EEOC v. Knox-Schillinger *(In re* Trans World Airlines) ("TWA"), 322 F.3d 283, 291–92 (3d Cir. 2003); *In re* WK Lang Holdings, 2013 WL 6579172, at *8 (Bankr. D. Kan. Dec. 11, 2013) (section 363(f)(5) was satisfied because the creditor "could be compelled to accept less than payment in full of the debt in a state law foreclosure and, to the extent the proceeds of the foreclosure sale were insufficient to pay the claims in full, . . . would receive an unsecured deficiency"); *In re* Bost. Generating, 440 B.R. 302, 333 (Bankr. S.D.N.Y. 2010); *In re* Jolan, 403 B.R. 866, 870 (Bankr. W.D. Wash. 2009); *In re* MMH Auto. Grp., 385 B.R. 347, 370–72 (Bankr. S.D. Fla. 2008); *In re* Gulf States Steel, of Ala., 285 B.R. 497, 508–09 (Bankr. N.D. Ala. 2002) (a hypothetical judicial or non-judicial sale or chapter 11 cramdown satisfies section 363(f)(5) (citing *In re* Terrace Chalet Apartments, Ltd., 159 B.R. 821, 829 (Bankr. N.D. Ill. 1993) and *In re* P.K.R. Convalescent Ctrs., 189 B.R. 90 (Bankr. E.D. Va. 1995))); *In re* Lady H Coal Co., 199 B.R. 595, 609 (S.D.W. Va. 1996) ("[I]t is a 'hypothetical' satisfaction under (f)(5), since the subsection uses 'could be' compelled and not 'must be' or 'shall be' compelled." (quoting *In re* WBQ P'ship, 189 B.R. 97, 107 (Bankr. E.D. Va. 1995))); *WBQ P'ship,* 189 B.R. at 107 (chapter 11 cramdown satisfies section 363(f)(5)); *In re* Healthco Intern., 174 B.R. 174, 176 (Bankr. D. Mass. 1994) (The words "could be compelled" require only that the interest in question be subject to final satisfaction on a hypothetical basis, not that there be an actual payment, and the hypothetical payment referred to means also that a chapter 11 plan cramdown falls within section 363(f)(5) "even in a chapter 7 case such as the present case."); and *In re* Terrace Chalet Apartments, Ltd., 159 B.R. 821, 829 (N.D. Ill. 1993) (a hypothetical chapter 11 cramdown satisfies section 363(f)(5)).

121. *In re R.J. Dooley Realty*, 2010 WL 2076959, at *8, 10 (citing 11 U.S.C. § 363(p) (2012)); *In re MMH Auto. Grp.*, 385 B.R. at 372.

122. *See In re* Haskell, 321 B.R. 1, 9–10 (Bankr. D. Mass. 2005); Precision Indus. v. Qualitech Steel SBQ, 2001 WL 699881, at *13–14 (S.D. Ind. Apr. 24, 2001).

sale, what the debtor is restricted from doing directly by rejecting the lease.[123] Following this reasoning, the courts have held that section 365(h) protects a tenant's present or inchoate possessory rights upon a free and clear sale under section 363(f).[124] Second, the same and other cases have denied a motion to sell free and clear of a lease and the tenant's section 365(h) rights on the ground that section 363(f)(1) and/or 363(f)(5) permit a sale free and clear only if at the time of the bankruptcy sale a proceeding is actually available to the debtor-landlord by which the tenant might be dispossessed of its lease and possessory rights.[125] Third, the same and other courts have found that the tenant was enti-

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123. *See In re* Revel AC, 532 B.R. 216, 227–28 (Bankr. D.N.J. 2015) (citing *In re* Churchill Props. III, Ltd. P'ship, 197 B.R. 283, 288 (Bankr. N.D. Ill. 1996)); *In re* Crumbs Bake Shop, 522 B.R. 766, 777–78 (Bankr. D.N.J. 2014)). *Cf. Haskell*, 321 B.R. at 6–7.

124. *In re Revel AC*, 532 B.R. at 227–28 (citing *In re Churchill Props. III, Ltd. P'ship*, 197 B.R. at 288, and the district court's own opinion in *In re Crumbs Bake Shop*, 522 B.R. at 777–78 (addressing section 365(n), which gives a licensee of intellectual property similar rights on rejection to those of a tenant under section 365(h): "The specific language in § 365(n) should not be overcome by the broad text of § 363(f)")). *Compare Revel*, *with* Compak Companies v. Johnson, 415 B.R. 334, 342 (N.D. Ill. 2009) (approvingly citing Precision Indus. v. Qualitech Steel SBQ, 327 F.3d 537 (7th Cir. 2003) to stand for the proposition that "§ 365(n) would not prevent the trustee or debtor-in-possession from extinguishing a license in a sale of intellectual property free and clear of interests *provided that* one of § 363(f)'s conditions was satisfied"); *In re* Zota Petroleums, 482 B.R. 154, 161 (Bankr. E.D. Va. 2012) (citing *In re Churchill Props. III, Ltd. P'ship*, 197 B.R. at 288); *In re* Samaritan All., 2007 WL 4162918, at *4–5 (Bankr. E.D. Ky. 2007) (following *Haskell*); *In re Haskell*, 321 B.R. 1, 6–7 (Bankr. D. Mass. 2005). Significantly, the *Haskell* court might have concluded that the tenant was entitled to remain in possession of the leased premises under contracts among the parties, rather than by the court's construction of sections 365(h) and 363(f) with which I take issue in this Article. The tenant in *Haskell* had obtained from the mortgagee a valid non-disturbance agreement with respect to its subordinated lease that provided that the lease could not be terminated by a foreclosure, judicial sale or similar proceeding under the mortgage. Had the court based its analysis on the legal effect of this bargained-for, non-disturbance agreement, the lease and the tenant's possessory rights under it would have survived the sale, vindicating the parties' prepetition state law property rights per *Butner* and *Nobleman*. *In re Haskell*, 321 B.R. at 4.

125. Dishi & Sons v. Bay Condos, 510 B.R. 696, 708–11 (Bankr. S.D.N.Y. 2014) (considering at length what it characterized as the "substantial and material differences" between a foreclosure sale and a voluntary sale, and holding that section 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.'" (quoting *In re* Jaussi, 488 B.R. 456, 458 (Bankr. D. Colo. 2013)), and that section 363(f)(5) "should be read to reach only those legal or equitable proceedings that could be brought by the trustee as owner of the property"); *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," and failing to consider *TWA*); *In re Haskell*, 321 B.R. at 8–9 (*Haskell* cited but did not attempt to distinguish *TWA*, decided the year before, in which the Third Circuit held that a hypothetical chapter 7 bankruptcy proceeding, in which the entity could be compelled to accept a money satisfaction (in that case zero), fulfilled the requirement of section 365(f)(5)). *Compare In re* PW, 391 B.R. 25, 41, 45–46 (9th Cir. BAP 2008) ("*Clear Channel*") (a free and clear sale under section 363(f)(5) requires "at least three elements: that

tled to post-sale possession as adequate protection under section 363(e), because the substantial claim secured by a mortgage having priority over the lease made it improbable that the tenant would receive any compensation from the sale proceeds, or because it was difficult to value the tenant's lease and possessory rights.[126]

VI. LEASEHOLD ESTATES AS STATE LAW PROPERTY INTERESTS UNDER THE BANKRUPTCY CODE AND THE TREATMENT OF SUCH PROPERTY INTERESTS IN A STATE LAW FORECLOSURE SALE

"Property interests are created and defined by state law" in a bankruptcy case, under the Supreme Court's holdings in *Butner v. United States* and *Nobleman v. American Savings Bank*.[127] State law establishes the extent, validity, and priority of mortgages, leasehold estates, and other liens and interests in the debtor's property, including real property that is sold free and clear sale under section 363(f).[128] State law recordation acts and related real property and contract law (such as that applicable to subordination agreements) determine which lien or other encumbrance has priority and which is subordinate.[129] *Butner* made clear that "[t]he law of the State where the property is located accordingly governs a mortgagee's right to rents during bankruptcy, and a federal bankruptcy court should take whatever steps are necessary to ensure that a mortgagee is afforded in federal bankruptcy court the same protection he would have under state law had no bankruptcy ensued."[130] The continuation of state law property interests extends beyond secured creditors, and its purpose is broader than the protection of prepetition liens under nonbankruptcy law.[131] The Court

(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;" the term "proceeding" means and is limited to a non-bankruptcy proceeding currently available to the debtor (emphasis added)), *with TWA*, 322 F.3d 283, 291 (3d Cir. 2003), in which the Third Circuit (J. Fuentes) affirmed the bankruptcy court's determination that if (1) the third-party's "interest" is "subject to monetary valuation," that (2) in a liquidation proceeding under chapter 7 "would have been converted to dollar amounts," then (3) § 363(f)(5) is satisfied. *Id.* at 291. None of *Dishi*, *Patriot Place* or *Haskell* analyzed the Third Circuit's decision in *TWA*, which reached the conclusion that a hypothetical chapter 7 proceeding sufficed. *TWA*, 322 F.3d at 291.

126. *Dishi,* 510 B.R. at 711–12 (citing *In re Haskell,* 321 B.R. at 10); *In re Haskell*, 321 B.R. at 9–10.

127. Butner v. United States, 440 U.S. 48, 55 (1979) (1898 Act case); Nobelman v. Am. Sav. Bank, 508 U.S. 324, 329 (1993) (1978 Code case).

128. *Butner,* 440 U.S. at 55 n.5.

129. *See id*. at 55.

130. *Id.* at 49.

131. *Id.* at 55.

in *Butner* reasoned that, in a bankruptcy case, the "[u]niform treatment of property interests by both state and federal courts within a State serves to reduce uncertainty, to discourage forum shopping, and to prevent a party from receiving 'a windfall merely by reason of the happenstance of bankruptcy.'"[132] This general protection and preservation of state law property rights in bankruptcy cases that was reiterated in *Butner* and *Nobleman* originates in the 1800s, long predating the Code.[133]

The Supreme Court in *Butner*, *Nobleman*, and the cases decided under the earlier Bankruptcy Acts recognized that applying state law to determine property rights in bankruptcy furthers the fundamental purpose of the bankruptcy process as a predictable and orderly collective debt-collection device based on the parties' prepetition bargained-for property rights.[134] In the words of a more recent commentator: "Bankruptcy provides a collective forum for sorting out the rights of 'owners' (creditors and others with rights against a debtor's assets) and can be justified because it provides protection against the destructive effects of an individual remedies system when there are not enough assets to go around."[135] Giving these creditors and others greater rights in bankruptcy than they would have outside of it conflicts with the collectivization goal, because such changes "create incentives for particular holders of rights in assets to resort to bankruptcy in order to gain for themselves the advantages of those changes, even when a bankruptcy proceeding would not be in the collective interest of the investor group."[136]

To put this another way, in its role as a collective debt-collection device, bankruptcy law should not create rights. Instead, it should act to ensure that

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132. *Id.* (quoting Lewis v. Mfrs. Nat'l Bank, 364 U.S. 603, 609 (1961) (1898 Act Case)).

133. *See, e.g.,* Nugent v. Boyd, 44 U.S. 426, 436 (1845) ("It is quite clear that the liens and mortgages which are valid under the state law must be protected by the District Court of the United States, sitting in bankruptcy."). The last clause of section 2 of the 1841 Act stated: "*And provided, also*, That nothing in this act contained shall be construed to annul, destroy, or impair any lawful rights of married women, or minors, or any liens, mortgages, or other securities on property, real or personal, which may be valid by the laws of the States respectively, and which are not inconsistent with the provisions of the second and fifth sections of this act." Bankruptcy Act of 1841, ch. 9, 5 Stat. 440 (1841); Bd. of Trade of City of Chi. v. Johnson, 264 U.S. 1, 10 (1924) ("Congress derives its power to enact a bankrupt law from the Federal Constitution, and the construction of it is a federal question. Of course, where the bankrupt law deals with property rights that are regulated by the state law, the federal courts in bankruptcy will follow the state courts; but when the language of Congress indicates a policy requiring a broader construction of the statute than the state decisions would give it, federal courts cannot be concluded by them.").

134. *See Butner*, 440 U.S. at 55; Nobelman v. Am. Sav. Bank, 508 U.S. 324, 329 (1993).

135. THOMAS H. JACKSON, THE LOGIC AND LIMITS OF BANKRUPTCY LAW 20 (Harvard University Press, 1986).

136. *Id.* at 21.

such rights that exist are vindicated to the extent possible. "Only in this way can bankruptcy law minimize the conversion costs of transferring an insolvent debtor's assets to its creditors."[137]

That is not to say that the Bankruptcy Code is in all regards beholden to state law in a bankruptcy proceeding. The court in *Butner* also observed that: "The constitutional authority of Congress to establish 'uniform Laws on the subject of Bankruptcies throughout the United States' would clearly encompass a federal statute" changing those rights.[138] *Butner* recognized that a "congressional command" or other "identifiable federal interest" (as distinguished from merely equitable considerations) can alter the effect of state law.[139]

How do these principles apply to a real property lease, and to the rights of the tenant on a sale of the property? Under state law, a lease differs from other contracts because it is both a conveyance of an estate in and against real property and a contract, whether the term of the lease is a month or a century.[140] "The concept that a lease was a conveyance was said to have been firmly established by 1500 . . . . Adding covenants to a lease made the lease a conveyance *and* a contract."[141]

State law also establishes proceedings for the liquidation of real property that is encumbered by liens, leases, and other interests, and for the satisfaction of those property interests from the proceeds of sale.[142] The most common action is a foreclosure sale. In a state law foreclosure proceeding, a leasehold estate is treated as an encumbrance that either is subordinate to or has priority over a mortgage and other encumbrances against the real property.[143] A foreclosure of a mortgage terminates a junior interest, such as a subordinate leasehold interest, if the holder of the junior interest is joined in the action and notified.[144] By contrast, a foreclosure of the mortgage "does not terminate interests in the foreclosed real estate that are senior to the mortgage being foreclosed."[145]

Thus, if a mortgage is first granted and recorded against the property, and the property owner later enters into a lease (which being later in time is subordinate to the first mortgage), then upon foreclosure of the first mortgage the

137. *Id.* at 22.

138. *Butner*, 440 U.S. at 54.

139. *Id.* at 55.

140. MILTON R. FRIEDMAN, FRIEDMAN ON LEASES 1–16, 1–17 (Patrick A. Randolph Jr. ed., 5th ed. 2015), https://www.bloomberglaw.com//document/6905785896.

141. *Id.* at 1–15.

142. *Butner*, 440 U.S. at 54 (1979).

143. *Id.* at 55.

144. RESTATEMENT (THIRD) OF PROP.: MORTGAGES, § 7.1 (AM. LAW INST. 1997).

145. *Id.*

purchaser at the foreclosure sale will own the property free and clear of the subordinate lease and the tenant's interest.[146] If by comparison a second mortgage is given and recorded after the first mortgage and the tenant's execution of and possession under the lease, and the foreclosure is on the second mortgage, then both the first mortgage and the lease will survive. The purchaser at the foreclosure sale will own the property free and clear of the second mortgage and the owner's interest, but subject to the first mortgage and the lease.[147]

The Restatement (Third) of Property: Mortgages sets forth the current state law rule.[148] The foreclosure sale proceeds are first paid in satisfaction of the mortgage obligation foreclosed on, and any surplus is then paid to the holders of subordinate liens and other interests terminated by the foreclosure, in the order of their priority, as follows:

> 7.4 Effect of Priority on the Disposition of Foreclosure Surplus
> When the foreclosure sale price exceeds the amount of the mortgage obligation, the surplus is applied to liens and other interests terminated by the foreclosure in order of their priority and the remaining balance, if any, is distributed to the holder of the equity of redemption.[149]

"Non-lienors who hold interests in the real estate that are terminated by foreclosure are also entitled to share in any foreclosure surplus. Such persons include junior easement holders and lessees. To the extent that surplus is available, such persons are entitled to receive, in order of their pre-foreclosure priority, the fair market value of their interests as of the date of foreclosure."[150] Thus, on extinguishment of a subordinate lease, any surplus after satisfaction of the prior mortgage obligation "is first applied to pay Tenant the fair market value of leasehold terminated by the foreclosure," and then, if any of the surplus still remains, to holder of the equity of redemption, i.e., the owner.[151]

Cases and treatises pre-dating the Restatement (Third) of Property: Mortgages pronounced the same rules. The New York Court of Appeals in the 1871 case of *Clarkson v. Skidmore*, for example, stated that:

> A lessee for years of mortgaged premises, . . . upon foreclosure and sale under the mortgage, is entitled to receive, out of the surplus moneys, the value of the use of the premises for the

146. *Id.* at § 7.1 cmt. a, illus. 4.
147. *Id.* at § 7.1 cmt. a, illus. 7.
148. *See id.* at introductory cmt.
149. RESTATEMENT (THIRD) OF PROP.: MORTGAGES, § 7.4 (AM. LAW INST. 1997).
150. *Id.* at § 7.4 cmt. b, illus. 3.
151. *Id.* at § 7.4 cmt. b, illus. 5.

> remainder of his term, less the rents reserved and other payments to be made by him under the lease.[152]

Aron in *The Gist of Real Property Law* wrote in 1916 that the "tenant must yield" unless "his lease is prior to the mortgage and he is in possession or the lease is recorded, if required by statute to be recorded, as in New York and New Jersey, when for over three years."[153] Wiltsie in his 1913 *A Treatise on the Law and Practice of Foreclosing Mortgages on Real Property: and of Remedies Collateral Thereto: with Forms* stated:

> If a tenant is made a party and his rights are cut off by the action, he will be entitled from the surplus money, if any, to the value of his unexpired term and damages for ejectment . . . .[154]

The question under *Butner* and *Nobleman* then is whether the Bankruptcy Code contains a clear "congressional command" or protects an "identifiable federal interest" that alters the effect of state law on a court-ordered sale.[155] The answer is clearly "no."

It is true that section 365(h) contains a "congressional command" to protect a tenant whose debtor-landlord rejects the lease.[156] That section prevents a debtor from stripping a disadvantageous lease from the real property and retaining, as a windfall, the property unburdened by those leases.[157]

But Congress also has commanded, in sections 363(e) and (f) and 361, that if the debtor instead sells the property free and clear the parties are entitled to the value of their state law interests in the property sold, in accordance with the respective priorities of those interests.[158] "Adequate protection" must be given

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152. Clarkson v. Skidmore, 4 N.Y. 297, 297 (N.Y. 1871). *Accord* Standard Livestock Co. v. Bank of Cal., Nat'l Ass'n, 227 P. 962, 968 (Ill. App. Ct. 1924); First Nat'l Bank v. Briggs, 22 Ill. App. 228, 231 (Ill. App. Ct. 1886) ("[P]arties who had estates, interests or liens in the land which were subordinate to the sale are entitled to be paid out of this surplus the equivalent of their respective interests, estates and liens, in the order of their priority."); Mich. Mut. Life Ins. Co. v. Sheridon, 11 Ohio App. 29, 32 (Ohio Ct. App. 1918). The same distributional rule applies to other interests in the property foreclosed upon, such as an easement. Winthrop v. Welling, 2 A.D. 229, 233 (N.Y. App. Div. 1896).

153. HAROLD G. ARON, THE GIST OF REAL PROPERTY LAW 156 (Writers Publishing Company 1916).

154. 1 CHARLES HASTINGS WILTSIE, A TREATISE ON THE LAW AND PRACTICE OF FORECLOSING MORTGAGES ON REAL PROPERTY: AND OF REMEDIES COLLATERAL THERETO, WITH FORMS 264 (rev. Henry Clifford Spur & Hiram Morris Rogers, Williamson Law Book Co. 1913), (citing Clarkson v. Skidmore, 46 N.Y. 297 (N.Y. 1871)).

155. Butner v. United States, 440 U.S. 48, 55 (1979). *See also* Nobleman v. Am. Sav. Bank, 508 U.S. 324, 329 (1993).

156. *See* 11 U.S.C. §365(h) (2012).

157. *Id.*

158. 11 U.S.C. §§ 361, 363(e), (f) (2012).

to each entity in the amount by which the termination of the interest by the free and clear sale "results in a decrease in the value of such entity's interest in such property."[159] The interest of a tenant under a first priority lease is the value of its position, i.e., its leasehold or the first proceeds from the sale.[160] By contrast, the holder of a subordinate, out-of-the-money interest is entitled to nothing as adequate protection, because the value of the holder's interest in the property being sold was zero both before and after the sale, the same outcome as in a state law foreclosure proceeding.

An identifiable federal interest also is missing. Neither the Bankruptcy Code nor case law has articulated a federal interest that generally protects or elevates the rights of tenants over the state law rights of the holders of mortgages and other liens who have priority over the lease, or against other creditors whose distributions would be diminished by grafting section 365(h) onto section 363(f) in derogation of state law.

Federal interests in bankruptcy proceedings are, instead, the maximization of the value of the debtor's estate and payments to the debtor's creditors, equality in the distribution of estate assets, and the efficient resolution of the debtor's estate and financial affairs.[161] Preserving possession by a tenant under a subordinate lease on a free and clear sale of the property undermines all of these federal interests.

Straining 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. Such a radical departure from state law and the parties' bargained-for, prepetition rights might be justified if it furthered federal interests. But the divergence championed by the district courts in *Revel* and *Precision* accomplishes the opposite result, upsetting the equitable distribution that otherwise would have been made with respect to the encumbrances that were bargained-

159. 11 U.S.C. §§ 361(1), 363(e). Section 361(1) states that, on a sale, adequate protection can be provided by payment. Section 361(2) states that, on a sale, adequate protection also may be provided by granting a lien or replacement lien, though this latter alternative is rarely utilized, and in any event would not change the state law priorities. 11 U.S.C. § 361(2).

160. One ground for a sale free and clear of an interest under section 363(f) is the consent of the holder of the interest. 11 U.S.C. § 363(f)(2). The stronger argument is that, if the tenant under a first priority lease does not consent, then the sale should be subject to the lease. *See* discussion *infra* Part VIII.C.2. If the tenant does consent, though, it is entitled to the first proceeds of sale, prior to payment to the holders of any other liens, encumbrances, or other interests in the property.

161. *See e.g.*, Fla. Dep't of Revenue v. Piccadilly Cafeterias, 554 U.S. 33, 35 (2008); Cent. Va. Cmmty. Coll. v. Katz, 546 U.S. 356, 363–64 (2006); Bank of Am. v. 203 N. LaSalle St. P'ship, 526 U.S. 434, 453 (1999); Toibb v. Radloff, 501 U.S. 157, 163 (1991).

for prepetition under state law, by transferring value from the holders of prior liens and encumbrances to the tenant under a subordinate, out-of-the-money lease.

The reading by which section 365(h) trumps section 363(f) undermines still another federal interest. The resolution of the debtor's estate and financial affairs becomes woefully inefficient with respect to any property of the debtor that is subject to a mortgage or other lien having priority over a lease. In such a case, the first mortgagee can be expected to seek relief from the automatic stay in the bankruptcy case, in order to foreclose in state court and thus, obtain the treatment afforded to its first priority mortgage under state law.[162] The "[u]niform treatment of property interests by both state and federal courts within a State"—that "serves to reduce uncertainty, to discourage forum shopping, and to prevent a party from receiving 'a windfall merely by reason of the happenstance of bankruptcy'"—is thus lost.[163]

State law determines the rights of the owners and holders of encumbrances against real property in a bankruptcy case, absent a congressional command or other identifiable federal interest that alters state law. Congress has issued no such command nor is there an identifiable federal interest that would alter the state law rights of mortgagees, tenants, or other persons holding interests in or against real property on a free and clear sale under section 363(f). Interpreting section 365(h) to preserve a subordinate lease on a section 363(f) free and clear sale turns bargained-for, prepetition state law property rights on their head and undermines the efficiency and predictability of bankruptcy as a collective debt-collection device, in contradiction of *Butner* and *Noblemen*.

VII. THE AUTHORITY TO SELL FREE AND CLEAR OF LIENS AND OTHER INTERESTS INCLUDING A SUBORDINATE LEASE UNDER PRE-CODE BANKRUPTCY ACTS AND CASE LAW

The Supreme Court consistently has held that it "will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure."[164] Pre-Code bankruptcy case law and practice that is "sufficiently widespread and well recognized" justifies "the conclusion of implicit adoption by the Code" because it is "the type of 'rule' that . . .

162. 11 U.S.C. § 362(d) (2012).

163. Butner v. United States, 440 U.S. 48, 55 (1979) (quoting Lewis v. Mfrs. Nat'l Bank, 364 U.S. 603, 609 (1961)).

164. Hamilton v. Lanning, 560 U.S. 505, 517 (2010) (citations omitted).

Congress was aware of when enacting the Code."[165] This interpretive presumption applies and "informs" the Court's "understanding of the language of the Code," where the text is not clear but is "subject to interpretation" or ambiguous.[166] I consider in Part VII the pre-Code law and practice of sales free and clear of liens and other encumbrances including leases. Part VIII analyzes the text of the 1978 Code to determine whether Congress clearly indicated a departure from this pre-Code law and practice, as well as the purposes and legislative history of the Code.

Supreme Court precedents extending back to the 1840s unequivocally authorized courts sitting in bankruptcy to order the sale of estate property free and clear of liens and other encumbrances as though in a hypothetical foreclosure proceeding.[167] The courts established this doctrine under each of the Bankruptcy Acts of 1841, 1867, and 1898, notwithstanding the absence of any express statutory authority in those enactments.[168] These precedents support both the power to sell free and clear of a subordinate lease, and the corollary right of a tenant whose lease has priority to remain in possession. Nothing in sections 363(f) or 365(h) of the 1978 Bankruptcy Code indicates that Congress made any change to this practice.[169]

The Supreme Court first established the free and clear sale doctrine under the Bankruptcy Act of 1841 in *Ex Parte Christy*, describing the power as a judicially-created foreclosure sale conducted for the purpose of reducing estate assets to cash for distribution to creditors.[170] Courts sitting in bankruptcy, the court held, have the power "to redeem or foreclose, or to enforce, or to set aside such a lien, mortgage, or other security."[171] The practice continued without

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165. Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A., 530 U.S. 1, 10 (2000) (first quoting United States v. Ron Pair Enters., 489 U.S. 235, 246 (1989); then citing Dewsnup v. Timm, 502 U.S. 410, 418 (1992) (relying on "clearly established" pre-Code practice); and then citing Kelly v. Robinson, 479 U.S. 36, 46 (1986) (giving weight to pre-Code practice that was "widely accepted" and "established")).

166. *Id.* at 10–11 (first quoting *Kelly*, 479 U.S. at 50; then quoting *Dewsnup*, 502 U.S. at 417; and then quoting BFP v. Resolution Tr. Corp., 511 U.S. 531, 546 (1994)); United States v. Noland, 517 U.S. 535, 539 (1996) (looking to pre-Code practice in interpreting Code's reference to "principles of equitable subordination"); Midlantic Nat'l Bank v. N.J. Dep't of Envtl. Prot., 474 U.S. 494, 501 (1986) (codification of trustee's abandonment power held to incorporate established exceptions).

167. *Ex Parte* Christy, 44 U.S. 292 (1845).

168. *See id*. *See also* Bankruptcy Act of 1841, ch. 9, 5 Stat. 440 (1841), *repealed by* Act of March 3, 1843, ch. 82, 5 Stat. 614 (1843); Bankruptcy Act of 1867, ch. 176, 14 Stat. 517 (1867), *repealed by* Act of June 7, 1878, ch. 160, 20 Stat. 99 (1878); Bankruptcy Act of 1898, ch. 541, 30 Stat. 544 (1898).

169. 11 U.S.C. §§ 363(f), 365(h) (1978).

170. *Ex Parte Christy*, 44 U.S. at 312 (1845).

171. *Id.* at 316–17.

interruption under the Bankruptcy Acts of 1867 and 1898.[172]

Under this free and clear sale doctrine, the trustee, referee, or assignee sold the property in the bankruptcy free and clear of liens and other encumbrances, and satisfied those liens and other encumbrances from the sale proceeds in accordance with their respective priorities.[173] These precedents authorized the district courts sitting in bankruptcy to order the sale of the property free and clear by a "hypothetical" foreclosure proceeding, rather than by a proceeding that was actually and presently available to the trustee, referee, or assignee, and to compel the holders of interests that were subordinate to monetary liens against the property to accept a money satisfaction.[174]

A. Free and Clear Sale Cases under the Bankruptcy Act of 1841

The Supreme Court established the power in a bankruptcy case to sell estate property free and clear of liens and other interests in *Ex Parte Christy* under the Bankruptcy Act of 1841.[175] The authority cannot be found in any express provision the 1841 Act.[176] Instead, the Court in *Christy* shaped the courts' authority from the equity jurisdiction granted by the Act, and from the powers given to the districts courts under the Act to sell the debtor's property, to satisfy the interests against the property, and to distribute the sale proceeds.[177]

Justice Story, writing for the majority in *Christy*, reasoned that the purpose of the 1841 Act "was to secure a prompt and effectual administration and settlement of the estate of all bankrupts within a limited period."[178] For this purpose "it was indispensable that an entire system adequate to that end should be provided by Congress, capable of being worked out through the instrumentality

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172. *See* discussion *infra* Parts VI.B, VI.C.. *See also* Bankruptcy Act of 1867, ch. 176, 14 Stat. 517 (1867), *repealed by* Act of June 7, 1878, ch. 160, 20 Stat. 99 (1878); Bankruptcy Act of 1898, ch. 541, 30 Stat. 544 (1898).

173. *See* discussion *infra* Parts VI.B, VI.C.

174. *See* discussion *infra* Parts VI.B, VI.C.

175. *Ex Parte Christy*, 44 U.S. at 312; Bankruptcy Act of 1841, ch. 9, 5 Stat. 440 (1841), *repealed by* Act of March 3, 1843, ch. 82, 5 Stat. 614 (1843). The Bankruptcy Act of 1841 was enacted in the midst of the economic depression that followed the Panic of 1837, the deepest U.S. downturn prior to the Great Depression of the 1930s.

176. *See generally* Bankruptcy Act of 1841, ch. 9, 5 Stat. 440 (1841), *repealed by* Act of March 3, 1843, ch. 82, 5 Stat. 614 (1843).

177. *Ex Parte Christy*, 44 U.S. at 311–12 (1845). The court also noted that, but for the jurisdiction given by the 1841 Act, "the District Courts of the United States possess no equity jurisdiction whatsoever." *Id.*

178. *Id.* at 312.

of its own courts, independently of all aid and assistance from any other tribunals over which it could exercise no effectual control."[179] Thus, the essential powers and duties of a court in a bankruptcy case included authority to promptly liquidate and distribute the estate's assets "to ensure a speedy settlement and close" of a bankruptcy case, to "to sell, manage, and dispose of the estate and property of the bankrupt," and "to redeem and discharge any mortgage."[180]

Justice Story emphasized the broad sweep of jurisdiction and authority given by Congress to the district courts under section 6 of the 1841 Act, which extended "to all acts, matters, and things, to be done under and in virtue of the bankruptcy until the final distribution and settlement of the estate of the bankrupt, and the close of the proceedings in bankruptcy."[181] Further, "[s]ound policy . . . dictated to Congress the propriety of vesting in the District Court full and complete jurisdiction over all cases arising, or acts done, or matters involved, in the due administration and final settlement of the bankrupt's estate."[182] A court sitting in bankruptcy thus had "jurisdiction over liens and mortgages existing upon the property of a bankrupt, so as to inquire into their validity and extent, and grant the same relief which the state courts might or ought to grant,"[183] and the authority "to redeem or foreclose, or to enforce, or to set aside such a lien, mortgage, or other security."[184]

The Supreme Court's view on the subject of sales free and clear was clarified in *Nugent v. Boyd*[185], decided in the same year and term as *Christy*.[186] In *Nugent* as in *Christy* property was sold in a state court foreclosure proceeding while the bankruptcy case was pending.[187] Chief Justice Taney writing for the Court stated: "I wish it . . . to be distinctly understood, that I am fully of opinion that the District Court of the United States is vested with jurisdiction over mortgaged property belonging to the bankrupt, and that when a proper case is shown, it has power to foreclose a mortgage, and to do all other acts necessary to bring about a final distribution and settlement of the bankrupt estate."[188]

The Court put the issue to rest yet again in *Houston v. City Bank of New*

179. *Id.*
180. *Id.* at 312–13.
181. *Id.* at 313.
182. *Id.* at 321.
183. *Id.* at 292.
184. *Id.* at 316–17.
185. *See* Nugent v. Boyd, 44 U.S. 426, 436 (1845).
186. *See Ex Parte* Christy, 44 U.S. 292 (1845).
187. *Nugent*, 44 U.S. at 434–35.
188. *Id.* at 437.

Orleans in 1848.[189] The debtor had been declared a bankrupt under the Bankruptcy Act of 1841.[190] The district court in the bankruptcy case ordered his "mortgaged premises to be sold, and directed that the mortgages should be cancelled, and the property sold free from encumbrance, rendering to the parties interested their respective priorities in the proceeds."[191] The sale transaction closed.[192]

Subsequently, the City Bank of New Orleans, which held a third mortgage against the property, brought an action in state court seeking to enforce its mortgage.[193] The case worked its way to the Louisiana Supreme Court, which "adjudged that the property should be seized by the sheriff, and sold to satisfy the demand of the bank."[194] The Louisiana judgment was brought before the U.S. Supreme Court for revision in *Houston v. City Bank of New Orleans*.[195]

Chief Justice Taney framed the question before the court as "simply this: Are the purchasers under the sale . . . entitled to hold the property free and discharged from the mortgage and encumbrance of the City Bank?"[196] Taney, with apparent impatience, answered "yes."[197] The power of the federal court over mortgages in cases of bankruptcy, he reiterated, had been fully argued and considered in *Christy* and *Nugent*.[198] The Court was "unanimously of opinion" that the assignee's sale of the property was valid, and that "the purchasers [were] entitled to hold it free and discharged from the mortgage to the City Bank, and from all other encumbrances mentioned in the proceedings."[199]

B. Free and Clear Sale Cases under the Bankruptcy Act of 1867

The Bankruptcy Act of 1867 became law fourteen years after the repeal in 1843 of the 1841 Act. The 1867 Act similarly contained no express provision that gave the district court or an assignee of the debtor's assets in a bankruptcy case the authority to sell estate property free and clear of liens and other interests.[200]

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189. Houston v. City Bank of New Orleans, 47 U.S. 486, 506 (1848).
190. *Id.* at 504 .
191. *Id.*
192. *Id.* at 504–05.
193. *Id.* at 505.
194. *Id.* at 506.
195. *Id.* at 505–06.
196. *Id.* at 506.
197. *See id.*
198. *Id.*
199. *Id.*
200. Bankruptcy Act of 1867, ch. 176, 14 Stat. 517 (1867), *repealed by* Act of June 7, 1878, ch.

Yet the district courts consistently ordered sales of estate property free and clear of encumbrances under the 1867 Act.[201] And in 1874 the Supreme Court in *Ray v. Norseworthy* held that the power to sell free and clear under the 1867 Act was "necessarily involved in the due administration and settlement of the bankrupt's estate."[202] It had been "conferred upon the bankrupt courts by the former Bankrupt Act" of 1841, "because they were matters arising under the act and were necessarily involved in the due administration and settlement of the bankrupt's estate."[203] The court, citing *Ex Parte Christy*, held that a district court sitting in bankruptcy could order the sale of property "free from incumbrances, rendering to the parties interested their respective priorities in the proceeds."[204]

C. Free and Clear Sale Cases under the Bankruptcy Act of 1898

1. Pre-Chandler Act Cases

The Bankruptcy Act of 1898, yet again, contained no express provision for the free and clear sale of estate property.[205] Yet the district courts and the circuit courts, again, consistently determined that courts sitting in bankruptcy had such jurisdiction and authority.[206]

The Supreme Court finally considered the issue in 1931, in *Van Huffel v.*

160, 20 Stat. 99 (1878); Bankruptcy Act of 1841, ch. 9, 5 Stat. 440 (1841), *repealed by* Act of March 3, 1843, ch. 82, 5 Stat. 614 (1843).

201. *In re* Barrow, 2 F. Cas. 941, 942 (D. La. 1868); *In re* Kahley, 14 F. Cas. 71, 73 (W.D. Wis. 1870) (first citing Houston v. City Bank of New Orleans, 47 U.S. 486 (1848); and then citing *Ex Parte* Christy, 44 U.S. 292 (1845)); *In re* Kingon, 14 F. Cas. 579, 580 (S.D.N.Y. 1870); Davis v. Anderson, 7 F. Cas. 103, 108 (E.D. Mo. 1872); Whitman v. Butler, 29 F. Cas. 1063, 1065 (D.R.I. 1873); *In re* Brinkman, 4 F. Cas. 145, 148 (S.D.N.Y. 1884) ("The court has power, on the application of the assignee or trustee, to order the sale of encumbered property, free from encumbrances, transferring the liens from the property to the fund realized from its sale."). *See also,* Foster v. Ames, 9 F. Cas. 527, 529 (C.C.D. Mass. 1869).

202. Ray v. Norseworthy, 90 U.S. 128, 134 (1874).

203. *Id.*

204. *Id.* (citing *Ex Parte Christy*, 44 U.S. at 313 (1845)). *Accord* Factors' & Traders' Ins. Co. v. Murphy, 111 U.S. 738, 739 (1884).

205. *See generally* Bankruptcy Act of 1898, ch. 541, 30 Stat. 544 (1898).

206. *In re* Union Tr. Co., 122 F. 937, 938 (1st Cir. 1903); *In re* E.A. Kinsey Co., 184 F. 694, 696 (6th Cir. 1911); *In re* Roger Brown & Co., 196 F. 758, 761 (8th Cir. 1912); *In re* Franklin Brewing Co., 249 F. 333, 335 (2d Cir. 1918) (citing *In re* Haywood Wagon Co., 219 F. 655, 662–63 (2d Cir. 1914); *In re* Kohl-Hepp Brick Co., 176 F. 340, 343 (2d Cir. 1910)); Gantt v. Jones, 272 F. 117, 118 (4th Cir. 1921); *In re* Gimbel, 294 F. 883, 885 (5th Cir. 1923); Broadway Tr. Co. v. Dill, 17 F.2d 486, 486 (3d Cir. 1927). *See also* Smith v. McKenna Brass Mfg. Co., 98 F.2d 537, 538 (3d Cir. 1938); *In re* Pittelkow, 92 F. 901, 904 (E.D. Wis. 1899); S. Loan & Tr. Co. v. Benbow, 96 F. 514, 521 (W.D.N.C. 1899); *In re* Sanborn, 96 F. 551, 552 (D. Vt. 1899); *In re* Barber, 97 F. 547, 552 (D. Minn. 1899); *In re* Goldsmith, 118 F. 763, 767 (N.D. Tex. 1902); *In re* Keet, 128 F. 651, 651 (M.D. Pa. 1903).

Harkelrode.[207] Justice Brandeis, writing for a unanimous court, stated that under the Bankruptcy Act of 1898 the power to sell free and clear of encumbrances against the property was "granted by implication."[208] The court reasoned that "[l]ike power had long been exercised by federal courts sitting in equity when ordering sales by receivers or on foreclosure,"[209] and "must be implied from the general equity powers of the court and the duty imposed by § 2 of the Bankruptcy [1898] Act to collect, reduce to money and distribute the estates of bankrupts, and to determine controversies with relation thereto."[210] The issue of a subordinate out-of-the-money lease was considered by the Second Circuit in *In re Hotel Governor Clinton, Inc*., decided months prior to the effective date of the Chandler Act amendments in 1938.[211] The court acknowledged that the state law priorities of prepetition encumbrances, including leases, continued in bankruptcy.[212] A "lease creates an estate in the land but this is subject to prior mortgages and encumbrances."[213] "If a second mortgage or subsequent encumbrance behind a first mortgage could be wiped out in reorganization, then a lease could be."[214] Accordingly, it was within the court's power to terminate the lease in conjunction with the bankrupt's plan of reorganization.[215] The court

207. Van Huffel v. Harkelrode, 284 U.S. 225, 227 (1931).

208. *Id.*

209. *Id.* at 227 (citing inter alia First Nat'l Bank of Cleveland v. Shedd, 121 U.S. 74, 87 (1887) (foreclosure sale); Mellen v. Moline Malleable Iron Works, 131 U.S. 352, 367 (1889) (sale by receiver); Seaboard Nat'l Bank v. Rogers Milk Prods. Co., 21 F.2d 414, 416 (2d Cir. 1927) (sale by receiver); Murray Rubber Co. v. Wood, 11 F.2d 528 (3d Cir. 1926); Broadway Tr. Co. v. Dill, 17 F.2d 486, 486 (3d Cir. 1927) (sale by receiver); City of New Orleans v. Peake, 52 F. 74, 75 (5th Cir. 1892) (sales by receiver); and Mercantile Tr. Co. v. Tenn. Cent. R.R. Co., 294 F. 483, 484 (6th Cir. 1923) (foreclosure sale)). *See also* Hoehn v. McIntosh, 110 F.2d 199, 202 (6th Cir. 1940) ("The uniform rule prevails that a court of bankruptcy, under the general equity powers conferred on it by the Bankruptcy Act, has authority to order a sale of the bankrupt's property, free from all liens and encumbrances." (citing Van Huffel v. Harkelrode, 284 U.S. 225 (1931))). Curiously, the Court in *Van Huffel v. Harkelrode* stated that the 1898 Act, "unlike the Act of 1867, contain[ed] no provision which in terms confer[red] upon bankruptcy courts the power to sell property of the bankrupt free from incumbrances." *Van Huffel*, 284 U.S. at 228. This appears to be an inaccurate construction of the 1867 Act, which also contained no express grant of such authority.

210. *Van Huffel,* 284 U.S. at 228 (citing inter alia *In re* Pittelkow, 92 F. 901, 902 (E.D. Wis. 1899); S. Loan & Tr. Co. v. Benbow, 96 F. 514, 527 (W.D.N.C. 1899)).

211. *In re* Hotel Governor Clinton, 96 F.2d 50 (2d Cir. 1938), *cert. denied*. 305 U.S. 613 (1938). The case was decided prior to the effective date of the Chandler Act.

212. *Id.* at 51.

213. *Id.* (citation omitted).

214. *Id.*

215. *Id.*

drew the "obvious distinction between depriving a lienor of the right to foreclose a security without giving him equivalent value,"[216] and "refusing him foreclosure where his lien is concededly worthless."[217] The court concluded that the lien of the lease arose "to no greater dignity than a second mortgage on the premises," and held that the district court's order directing the transfer free of the lease was proper.[218]

2. Post-Chandler Act Cases

A trustee's power to either assume or reject a lease was expressly established by Congress in 1938 in section 70b of the Chandler Act.[219] The tenant's possessory rights were preserved on rejection, much as they are by the current section 365(h), by the Act's providing that a rejection did not "deprive the lessee of his estate" unless the lease expressly provided to the contrary.[220] Section 70b—like its replacement section 365(h)—made no reference to what might occur on a free and clear sale.[221]

An early case applying the new section 70b in the context of a sale was *In re Freeman*.[222] One of the debtors in *Freeman* owned a small house and a lot that were subject to both a mortgage and a lease, with a remaining term of less than two years.[223] The debtor rejected the lease.[224] The court held that the tenant's "estate" preserved by section 70b was nothing more than a tenancy at will, terminable under state law on two months' notice, which had been given.[225] The court did not order payment to the tenant of the value of its lost leasehold estate from the sale proceeds after payment of the first mortgage, in contradiction of the position advocated by this Article.[226] The *Freeman* decision was criticized by the Fifth Circuit thirty-five years later in *Matter of Garfinkle*, not for ordering the sale free and clear, but for ruling that a post-rejection "estate" under section 70b was a tenancy at sufferance.[227]

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216. *Id.* at 52 (citing Louisville Joint Stock Land Bank v. Radford, 295 U.S. 555, 601–02 (1935)).

217. *Id.* (citing *In re* Witherbee Court Corp., 88 F.2d 251, 253 (2d Cir. 1937)).

218. *Id.* at 52.

219. Chandler Act, ch. 575, § 70b, 52 Stat. 840 (1938).

220. *Id.*

221. *Compare* Chandler Act § 70b, *with* 11 U.S.C. § 365(h) (2012).

222. *In re* Freeman, 49 F.Supp. 163, 164 (S.D. Ga. 1943).

223. *Id.*

224. *Id.*

225. *Id.* at 164–65 n.4.

226. *Id.* at 168.

227. Commercial Trading Co. v. Lansburgh (Matter of Garfinkle), 577 F.2d 901, 904 n.4 (5th Cir. 1978).

The district court in *Matter of New York Investors Mutual Group, Inc.*, by comparison, characterized the tenant's possessory estate as a lien while recognizing nonetheless the court's power to authorize a sale free and clear.[228] The bankrupt, New York Investors Mutual Group, Inc., acquired the fee estate in 1954, subject to a mortgage.[229] At the time of the bankruptcy filing in 1956, East Netherland Holding Co. was the tenant in possession under a 1914 ground lease that had been renewed for an additional twenty-one-year term in 1935.[230] The 1914 lease and a 1953 assignment of the lease to East Netherland Holding Co. were recorded prior to the bankruptcy case.[231] The 1935 extension was not recorded until 1956, after the bankruptcy case was filed.[232]

The lease required the landlord, at the end of the current term, to either renew for a "further term of 21 years or to pay to the lessee the value of the buildings" that had been constructed on the leased premises, failing which the tenant could not be compelled to surrender possession.[233] The trustee sought to reject the lease and sell the property free and clear without paying for the buildings.[234] The referee ruled that East Netherland was entitled to remain in possession until payment was made, and that it had a lien on the real property for the payment of the value of the buildings.[235] The district court confirmed the report of the referee, holding that the continuation of the tenant's possessory rights until payment was made was part of the tenant's "estate" that could not be destroyed by rejection.[236]

But the district court, citing the free and clear sale authority of *Van Huffel v. Harkelrode*,[237] entered its judgment "without prejudice to a further application by the trustee for leave to sell the premises free of any lien for the value which may be determined for the buildings and free of any right of possession in favor of the tenant upon condition that an appropriate provision is contained in the order which shall fully protect the tenant so as to provide for the actual payment of the valuation."[238]

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228. Matter of N.Y. Inv'rs Mut. Grp., 153 F.Supp. 772, 775 (S.D.N.Y. 1957).
229. *Id.* at 774.
230. *Id.* at 773–74.
231. *Id.* at 774.
232. *Id.* at 774, 776.
233. *Id.* at 773.
234. *Id.*
235. *Id.* at 773–74.
236. *Id.* at 774–75.
237. *Id.* at 777 n.14.
238. *Id.* at 777. Though the opinion indicates that there also was a mortgage against the property, it does state whether the mortgage was subordinate or prior to the lease.

The trustee appealed.[239] The Second Circuit in *Cohen v. East Netherland Holding Co.* stated the main question to be "whether a lien on real property owned by the bankrupt," created by the unrecorded 1935 lease, "was so far perfected prior to the bankruptcy that it could not be deemed a voidable preference under § 60 of the Bankrupty Act."[240] The court held that it was so "perfected" by the tenant's continued possession of the leased premises from 1935, and affirmed.[241] The court took no issue with the district court's proviso that the trustee nonetheless could sell free and clear of the lease.[242]

The district court in *Matter of Penn Central Transportation Company* reached a similar conclusion, in what was then the largest bankruptcy case in U.S. history.[243] Penn Central's proposed "disaffirmance" under its reorganization plans of some thirty-seven ground leases and other leases, in anticipation of its selling the underlying properties, "met strenuous opposition from the lessees."[244]

Some of the ground leases were for lengthy initial periods.[245] The lessees under those leases had constructed large office buildings on their leaseholds, financed through leasehold mortgages "aggregating very substantial amounts" that were held by various insurance companies and the New York State pension fund.[246]

The ground lease rentals were below market.[247] The trustees' purpose in rejecting the ground leases was to increase the rentals to the present fair market level, thus dramatically increasing the value of the trustees' interest in the properties.[248] The trustee planned to sell the properties in the bankruptcy proceeding.[249] The net effect of approving the trustees' proposal thus would be to "quite substantially" increase the proceeds that would be paid to the estate on the bankruptcy sale of the properties.[250]

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239. Cohen v. E. Netherland Holding Co., 258 F.2d 14, 15 (2d Cir. 1958).

240. *Id.*

241. *Id.*

242. *Id.* at 15, 17.

243. *See generally* Wikipedia, Penn Central Transportation Company, https://en.wikipedia.org/wiki/Penn_Central_Transportation_Company [https://perma.cc/47YB-HCVG]; Matter of Penn Cent. Trans. Co., 458 F.Supp. 1346 (E.D. Pa. 1978).

244. *Matter of Penn Cent. Trans. Co.*, 458 F. Supp. at 1349–50, 1353.

245. *Id.* at 1353.

246. *Id.* at 1353–54.

247. *Id.* at 1353.

248. *Id.*

249. *Id.*

250. *Id.* at 1354.

The case presented two issues that had "long occasioned debate among bankruptcy experts—(1) What is the 'estate' of which the lessee may not be deprived;" and (2) Did section 70b apply in reorganization proceedings?[251] The court held that, even in a liquidation proceeding, to which section 70b was "clearly applicable," the bar against depriving a lessee of his estate could not "reasonably be interpreted as an absolute bar against all interference with the lessee's rights in the event of the lessor's bankruptcy. If that were the congressional intent, the language would no doubt have limited the power of rejection of leases to those instances in which the bankrupt [was] the lessee."[252]

The key issue for the district court was whether the leasehold estates were subordinate or prior to the mortgages against the properties.[253] In a "straight liquidation proceeding, for example, if the lease is subordinate to a mortgage, and the property burdened by the lease is worth less than the amount due on the mortgage, the leasehold is undoubtedly vulnerable," notwithstanding the protection on rejection of section 70b.[254] In such a case, the "absolute priority rule would be violated if the lessee's rights remained untouched, while the rights of a senior mortgagee secured by the leased property were adversely affected in various ways."[255]

Because all of the mortgages against the fee estates had been subordinated to the mid-Manhattan ground leases, no conflict with these priorities arose.[256] There was therefore "no compelling reason for failing to apply the strictures of § 70(b)."[257] That the leases were below market did not change the court's analysis, since they had lien priority over the mortgages.[258] The court denied the trustees' proposed disaffirmance of the leases.[259]

The district court in *Matter of Outrigger Club, Inc.* applied the same analysis to a case that was decided under the Act but after the effective date of the

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251. *Id.*

252. *Id.*

253. *Id.*

254. *Id.* at 1355–56.

255. *Id*. at 1356.

256. *Id.*

257. *Id.*

258. *Id.*

259. *Id.* Non-sale cases emphasizing that the tenant's "estate" under section 70(b) survived a *rejection* include: Matter of Garfinkle, 577 F.2d 901 (5th Cir. 1978) (citing with approval *In re* N.Y. Inv'rs Mut. Grp., 153 F.Supp. 772 (S.D.N.Y.1957), *aff'd sub. nom.,* Cohen v. E. Netherland Holding Co., 258 F.2d 14 (2d Cir. 1958)); Matter of Minges, 602 F.2d 38, 41–42 (2d Cir. 1979). This interpretation of section 70b was not construed to reorder the bargained-for state law priority of the lease in relation to the other liens against and interests in the property on a free and clear sale, as set forth above.

Code and section 365(h).[260] The rejection of the lease was made pursuant to a plan.[261] The court dismissively noted that a subordinate lease "may be rejected and the lessee may be deprived of possession not because of the rejection of an executory contract but 'because of the superior rights of the mortgagee,' where the lease is subordinate to the mortgage."[262] The thirty-year lease at issue was executed after the debtor's mortgage to the bank and the mortgage expressly provided that subsequent leases of more than five years were subordinate to the mortgage.[263] The lease accordingly was expressly subordinated.[264] The bank was undersecured.[265] Citing the Second Circuit's *Hotel Governor Clinton* with approval, the Florida district court in *Outrigger* stated that the "essence of *Governor Clinton* is that a lease, junior to an undersecured mortgage and therefore valueless, can be eliminated in bankruptcy just as it could in foreclosure."[266] The court rejected the tenant's argument that a lease provision barring termination of the lease on foreclosure protected it from ejectment because the holder of the mortgage to which the lease was subordinate had not agreed to such provision.[267] The court found that the rejection of the lease pursuant to the plan resulted in its termination and ordered the tenant to "vacate the premises forthwith."[268]

As shown in this Part, pre-Code bankruptcy law and practice consistently characterized a free and clear sale of the debtor's real property as the equivalent of a state law foreclosure sale, under all three Bankruptcy Acts that preceded the Code, from *Ex Parte Christy* and *Nugent v. Boyd* under the 1841 Act, through to *Ray v. Norseworthy* under the 1867 Act and *Van Huffel* under the 1898 Act. The treatment of a lease on such a sale was in accordance with the priority of its encumbrance against the property. That priority was established by the parties' bargained-for, prepetition state law rights, and this pre-Code law and practice vindicated those rights in the bankruptcy proceeding as required by *Butner* and *Nobleman*.

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260. Matter of Outrigger Club, 9 B.R. 152, 153 (Bankr. S.D. Fla. 1981).

261. *Id.*

262. *Id.*

263. *Id.*

264. *Id.*

265. *Id.* at 153–54 (citing 6 COLLIER ON BANKRUPTCY 603–604, ¶3.24(1.1) (14th ed. 1978)); *In re* Hotel Governor Clinton, 96 F.2d 502 (2d Cir. 1938) *cert. denied*. 305 U.S. 613 (1938)).

266. Matter of Outrigger Club, 9 B.R. 152, 153 (Bankr. S.D. Fla. 1981).

267. *Id.* at 154.

268. *Id.*

VIII. SALES FREE AND CLEAR OF A LEASE AND THE TENANT'S POSSESSORY RIGHTS ON CONSIDERATION OF THE TEXT, PURPOSES AND LEGISLATIVE HISTORY OF THE BANKRUPTCY CODE

The Supreme Court "will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure."[269] This doctrine does not compel slavish adherence to pre-Code law and practice. Rather it proceeds from the reasoning that Congress has the power to alter the law. The absence of a clear indication from Congress in the text that it was changing well-established law, especially when reenacting a comprehensive statute such as the bankruptcy law, indicates a congressional acceptance of the continuing efficacy of settled law. By comparison, if the text of the reenacted statute is clear or if the pre-Code practice was insufficiently established, then such presumption is unwarranted.[270]

Has Congress clearly indicated that it intended to depart from or "erode prior bankruptcy practice" on a free and clear sale with respect to leases, liens, and other encumbrances? Does the text of the 1978 Code as subsequently amended elevate a lease that is subordinate to a monetary lien under state law to the status of a first priority encumbrance against the property that the debtor seeks to sell?

A. Textualism, Purposivism, and Pluralistic Interpretive Regimes

A close consideration of the text is required to answer these questions and reconcile sections 365(h) with 363(f). That textual analysis is informed by a brief account of a loudly proclaimed and ongoing conflict between interpretative modes. This battle between textualism and purposivism was waged with

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269. Hamilton v. Lanning, 560 U.S. 505, 517 (2010) (quoting Travelers Cas. & Sur. Co. of Am. v. Pac. Gas & Elec. Co., 549 U.S. 443, 454 (2007) (citations omitted)).

270. *Compare* discussion *supra* Part VI (the unbroken 100-plus year pre-Code practice and law under Supreme Court precedent for sales free and clear under each Bankruptcy Act, that treated a bankruptcy sale free and clear as a state law foreclosure sale, with payment to holders of liens, leases, and other encumbrances, in order of priority), *with* United States v. Ron Pair Enters., 489 U.S. 235, 237, 246, 251 (1989) (deciding the issue of whether postpetition interest is payable on oversecured, nonconsensual claims, e.g., tax claims, under Code section 506, in which Blackmun for a 5–4 majority concluded that the text was clear and that pre-Code practice not sufficiently established and "certainly not the type of 'rule' that we assume Congress was aware of when enacting the code; nor was it of such significance the Congress would have taken steps other than enacting statutory language to the contrary." Justice O'Connor, in a dissent joined by Justices Brennan, Marshall, and Stevens, determined that the text was not clear, the pre-Code practice was sufficiently established, and "*Midlantic* counsels against inferring congressional intent to change pre-Code bankruptcy law.").

great vigor in the last decades of the 20th and the first years of the 21st centuries.[271]

The late Justice Antonin Scalia and Garner have written: "Textualism, in its purest form, begins and ends with what the text says and fairly implies. Its principal tenets have guided the interpretation of legal texts for centuries."[272]

Justice Scalia and Garner and other textualists decry nontextualism and purposivism in particular, which in their view "frees the judge from interpretive scruple."[273] "So-called purposivism," they contend, "facilitates departure from the text in several ways. Where purpose is king, text is not—so the purposivist goes around or behind the words of the controlling text to achieve what he believes to be the provision's purpose."[274] "The purposivist, who derives the meaning of text from purpose and not purpose from the meaning of text, is free to climb up this ladder of purposes" and, ultimately, "disregard text."[275]

Hart and Sachs, arguably the leading purposivists against whom the textualists have railed, would first:

> 1. Decide what purpose ought to be attributed to the statute and to any subordinate provision of it which may be involved; and then 2. Interpret the words of the statute immediately in question so as to carry out the purpose as best [one] can . . . .[276]

Hart and Sachs claimed that purposivism, and not textualism, has the historical high ground, citing to the "time-tested but time-and-again-forgotten wisdom" of the 1584 *Heydon's Case* under which view a statute is best interpreted by first considering the "mischief" sought to be remedied by the legislature in passing it.[277]

Supporters of Hart and Sachs's approach have not been silent over the last

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271. *See supra* sources accompanying notes 48, 39. *See also* John P. Figura, *Against the Creation Myth of Textualism: Theories of Constitutional Interpretation in the Nineteenth Century*, 80 MISS. L.J. 587, 588 (2010).

272. SCALIA AND GARNER, READING LAW, *supra* note 48, at 16.

273. *Id.* at 18.

274. *Id.*

275. *Id*. at 19.

276. HART AND SACKS, THE LEGAL PROCESS, *supra* note 49, at 1374 (C).

277. *Id*. at 1211, 1378 (citing Heydon's Case, 76 Eng. Rep. 637 (Ex. 1584)). Insightful characterizations of the basis for earlier approaches to statutory interpretation include Manning's assertion that the "faithful agent theory" appears to more accurately describe the earlier judicial role. He draws on the research of scholars who "maintain, in particular, that the judicial power 'to say what the law is' originally encompassed an *inherent* equitable power to reshape statutes without regard to legislative intent." John F. Manning, *Textualism and the Equity of the Statute*, 101 COLUM. L. REV. 1, 7 (2001).

three decades. A few examples suffice. Posner, in a practical rebuke of ascendant textualism in the 1980s[278] objected "to the proposition that one must always begin with the words," and was "reasonably confident that more often than not the judge—the good judge as well as the bad judge—in fact begins somewhere else."[279] Eskridge and Frickey asserted in the 1990s that the "tougher version of textualism" takes "a dogmatic and often bizarre view of what is clear," adheres to dictionaries at the expense of common sense, restrains the realization of definable and democratically-driven legislative goals, and "ultimately serves as a cover for the injection of conservative values into statutes."[280] More recently Katzmann has asserted that "to jettison the inquiry" into what Congress intended "altogether, because of the difficulty in particular cases, means that judges will interpret statutes unmoored from the reality of the legislative process and what the legislators were seeking to do."[281] He argues, in support of his own use of legislative history as a Second Circuit Court of Appeals judge, that: "When courts construe statutes in ways that respect what legislators consider their work product, the judiciary not only is more likely to reach the correct result, but also promotes comity with the first branch of government."[282]

Cross and others have drawn the 100-year interpretative arc as beginning with a primary devotion to purposivism in the early 20th century, culminating in the legal process school of Hart and Sacks, and shifting dramatically to textualism toward the end of the century.[283] The battle continues, with no unequivocal resolution in sight. Yet, putting claims to 18th and 19th century historic legitimacy aside for now, the present distance between the two camps is not the great divide that is often described. Comparing Justice Scalia and Garner's approach to that of Hart and Sacks, it would appear that many of the differences between them are more rhetorical than real, and that most are bridged by easy steps rather than athletic leaps. A few examples demonstrate this.

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278. Richard A. Posner, *Statutory Interpretation—In the Classroom and in the Courtroom*, 50 U. CHI. L. REV. 800, 808 (1983).

279. *Id.*

280. William N. Eskridge, Jr. & Philip P. Frickey, *Foreword: Law as Equilibrium*, 108 HARV. L. REV. 26, 77–78 (1994).

281. KATZMANN, JUDGING STATUTES, *supra* note 49, at 35.

282. *Id.* at 36.

283. CROSS, *supra* note 51, at 136. Figura has argued based on his review of legal treatises that purposivism is a still older interpretive school, and the 19th century was dominated "by purpose-based, not text-based, approaches" to interpreting both the Constitution and statutes. John P. Figura, *Against the Creation Myth of Textualism: Theories of Constitutional Interpretation in the Nineteenth Century*, 80 MISS. L.J. 587, 588 (2010).

Justice Scalia and Garner, notwithstanding their emphasis on the text, advance the presumption against ineffectiveness that requires that "an interpretation that furthers the document's purpose should be favored."[284] Hart and Sacks assert, notwithstanding their starting point of determining purpose, that the "words of the statute are what the legislature has enacted as law, and all that it has the power to enact."[285] Hart and Sacks, using phrases that the late Justice Scalia himself might proudly have penned, posit that "[u]nenacted intentions or wishes cannot be given effect as law. . . . Humpty Dumpty was wrong when he said that you can make words mean whatever you want them to mean."[286] Justice Scalia and Garner and Hart and Sacks are united in their view that the words of the statute cannot be given "a meaning they will not bear."[287]

Under the ordinary-meaning canon of the textualist school: "Words are to be understood in their ordinary, everyday meanings—unless the context indicates that they bear a technical sense."[288] This proposition too has its purposivist counterpart: "In various types of situations wise policy counsels against giving words an unusual meaning even though it may be linguistically permissible."[289] Hart and Sacks acknowledge, as do the textualists, that "dictionaries are historical records (as reliable as the judgment and industry of the editors) of the meanings with which words have in fact been used by writers of good repute. They are often useful in answering hard questions of whether, in an appropriate context, a particular meaning is linguistically permissible."[290]

Justice Scalia and Garner eschew a mechanistic use of canons, emphasizing that "[n]o canon of interpretation is absolute" and "[e]ach may be overcome by the strength of differing principles that point in other directions."[291] Hart and Sacks recognize that canons are "useful as reassurances" about what meanings words have in particular configurations and contexts.[292]

Returning to the present state of the conflict, Cross suggests that a quiescent closure has come to pass between the opposing camps.[293] Based on his statistical analysis of Supreme Court decisions he concludes that Justices do not tend

284. SCALIA AND GARNER, READING LAW, *supra* note 48, at 168.
285. HART AND SACKS, THE LEGAL PROCESS, *supra* note 49, at 1375 (E).
286. *Id.*
287. *Id.* at 1374 (C); SCALIA AND GARNER, READING LAW, *supra* note 48, at 3.
288. SCALIA AND GARNER, READING LAW, *supra* note 48, at 69.
289. HART AND SACKS, THE LEGAL PROCESS, *supra* note 49, at 1376 (F).
290. *Id.* at 1375–76 (E).
291. SCALIA AND GARNER, READING LAW, *supra* note 48, at 59.
292. HART AND SACKS, THE LEGAL PROCESS, *supra* note 49, at 1376 (E).
293. CROSS, *supra* note 51, at 154–55.

toward any single interpretive mode, but most often attempt to make the strongest case for their opinion's outcome by citing numerous bases for the result.[294] Consequently, "the justices appear to be pluralist in their statutory interpretations, frequently supporting their decisions with multiple interpretive theories."[295]

B. The Supreme Court's Pluralistic Approach to Interpreting the Bankruptcy Code

The Supreme Court's construction of the Bankruptcy Code since its 1979 effective date supports this conclusion. The sound and fury of the seeming hostilities between the interpretive redoubts signify far less disagreement among the Justices, at least in cases construing the Bankruptcy Code, than is often thought. Textual and semantic analysis, the divination of statutory purposes and intent (from general principles, textual inference and legislative history), the examination of the text in light of those purposes, and consideration of pre-Code bankruptcy law and of past and present state law in relation to the current Bankruptcy Code—all and more have served Justices in their attempts to interpret and apply the Bankruptcy Code in a controversy before the Court.

Examples of this general consensus on essentially pragmatic interpretive approaches abound in the hundred or so bankruptcy cases decided by the Supreme Court since the 1979 effective date of the Bankruptcy Code. The following summaries of a few of the more significant cases from the 1980s through to the 2010s delineate the narrow width of the divide.

In the mid-1980s, Chief Justice Rehnquist in *NLRB v. Bildisco & Bildisco* relied on the Code's text, statutory design, and rehabilitative purpose, as well as the bankruptcy courts' equitable jurisdiction, to decide that a debtor in possession could reject a collective bargaining agreement.[296] Justice Brennan in his concurrence and dissent, joined by three Justices, did not take issue with Rehnquist's interpretative approach but with the majority's failure to reconcile the Bankruptcy Code with the provisions of the National Labor Relations Act.[297]

Justice Powell in *Midlantic National Bank v. New Jersey Department of Environmental Protection*, considered the scope of a trustee's abandonment

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294. *Id.*

295. *Id.* at 155. *See also, e.g.*, JOHNATHAN O'NEILL, ORIGINALISM IN AMERICAN LAW AND POLITICS: A CONSTITUTIONAL HISTORY 212 (2005) ("The bulk of the [Rehnquist] Court's opinions cohere[d] around a pragmatic, incremental centrism, not adherence to original intent at any cost.").

296. NLRB v. Bildisco & Bildisco, 465 U.S. 513, 516 (1984).

297. *Id.* at 535–54 (Brennan, J., concurring in part and dissenting in part).

power under Code section 554, which neither expressly authorizes nor expressly limits a trustee's power to abandon property that poses a risk to public health or safety.[298] Powell in his 5–4 opinion concluded that "[n]either the Court nor Congress ha[d] granted a trustee in bankruptcy powers that would lend support to a right to abandon property in contravention of state or local laws designed to protect public health or safety."[299] In so doing, he relied primarily on the absence of any express provision in the Code that *preempted* such environmental law in a bankruptcy case, his view of Congress's intent, and the scope of a trustee's abandonment power under pre-Code case law.[300] Chief Justice Rehnquist in dissent emphasized the absence of an express provision in the Code that made the abandonment power *subject to* environmental law, his contrary view of Congress's intent, and the "overriding purpose of bankruptcy liquidation: the expeditious reduction of the debtor's property to money, for equitable distribution to creditors."[301]

In 1988, Justice Scalia for a unanimous Court held in *United Savings Association of Texas v. Timbers of Inwood Forest Associates, Ltd*. that the right of an undersecured creditor, i.e., a secured creditor whose collateral is worth less than the amount of its claim, is not entitled to interest on its claim under section 362(d)(1) as compensation for the delay caused by the automatic stay that prevents it from foreclosing on the property.[302] Justice Scalia reasoned that neither the legislative history of the Code nor pre-Code practice were adequate to overcome the plain textual meaning of sections 362 and 506 of the Code.[303]

In the same year, Justice White in his unanimous decision in *Norwest Bank Worthington v. Ahlers*, determined that the new value exception to the absolute priority rule that might enable the debtor's owners to keep their equity interests in the reorganized debtor under a cram-down plan could not be based on a contribution of "sweat equity," i.e., the debtor's owners agreeing to provide services to the reorganized debtor.[304] In reaching this conclusion White considered the Code's text and legislative history, pre-Code practice, and his view that the bankruptcy courts' general equity powers must be exercised within the confines of the Code.[305]

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298. Midlantic Nat'l Bank v. N.J. Dep't of Envtl. Prot., 474 U.S. 494, 501–02 (1986).

299. *Id.* at 502.

300. *Id.* at 501–02.

301. *Id*. at 508.

302. United Sav. Ass'n of Tex. v. Timbers of Inwood Forest Assocs., Ltd., 484 U.S. 365, 371 (1988).

303. *Id.* at 380.

304. Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 199 (1988).

305. *Id.* at 206–10. A court's confirmation of a chapter 11 plan requires creditor voting and

The following year Justice Blackmun in *United States v. Ron Pair Enterprises, Inc.* decided the "narrow statutory issue" that the IRS was entitled to postpetition interest on its oversecured, nonconsensual prepetition tax lien pursuant to section 506(b).[306] He began with the text, which in his view was clear.[307] Blackmun purported to end his inquiry there,[308] yet he continued, rejecting the chapter 7 trustee's reference to pre-Code practice.[309] He did so first because he saw no ambiguity in section 506(b), and second because the practice of allowing interest only on oversecured consensual liens "was an exception to an exception, recognized by only a few courts" under pre-Code law that was more of a "guide" than it was a "rule" under prior law.[310] In his view, it "was certainly not the type of 'rule'" that the Court could assume Congress was aware of when enacting the Code.[311] Justice O'Connor dissented, with three of her colleagues.[312] She asserted that the text was not so clear and interpreted it differently.[313] Further, even assuming that the text was clearer, she considered pre-Code law to be well established on this question and that *Midlantic* (discussed above) counseled against the inference of a congressional intent to change it.[314]

In the mid-1990s, Justice Scalia in *BFP v. Resolution Trust Corp.* held that a purchase of real property at a prepetition foreclosure sale was *not* subject to avoidance as a fraudulent transfer, even though the price paid was less than 70% of what the bankruptcy court later determined was the "fair market value"

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approval. Voting is on a class basis, and the plan designates the classes of creditors in accordance with the requirements of the Bankruptcy Code. A cramdown plan is a plan that has not received the acceptance of all voting classes. A cramdown plan may be confirmed but the court, but only if at least one other class of impaired claims has voted to accept the plan, and only if the plan satisfies the absolute priority rule. The absolute priority rule in this application requires, among things, that the owners of the debtor neither receive nor retain anything under the plan "on account of" their ownership interests unless unsecured creditors are paid *in full*. The "new value exception" to the absolute priority rule permits the debtor's owners to receive the equity in the reorganized debtor if they contribute sufficient new value to the debtors, the essential reasoning being that debtor's owners are buying the equity interests in the reorganized debtor and are not retaining or receiving the new equity on "account of" their old equity. *See* 11 U.S.C. §§ 1129(a)(8), (10), 1129(b)(2)(B) (2012).

306. United States v. Ron Pair Enters., 489 U.S. 235, 237 (1989).

307. *Id.* at 241.

308. *Id.*

309. *Id.* at 243–45.

310. *Id.* at 246, 248.

311. *Id.* at 246.

312. *Id.* at 249 (O'Connor, J., dissenting) (Justice O'Connor was joined by Justice Brennan, Justice Marshall, and Justice Stevens).

313. *Id.* at 249–51.

314. *Id.* at 251.

of the property.[315] The debtor had sought avoidance of the transfer on the ground that the prepetition sale was made when the debtor was insolvent at a price that was less than the "reasonably equivalent value" of the property and thus was avoidable Code section 548.[316] Justice Scalia reasoned that "fair market value" and "reasonably equivalent value" were not the same terms, citing to Black's Dictionary.[317] He then considered the law of fraudulent transfers beginning with the Statute of 13 Elizabeth in 1570 and the history of foreclosure law in England,[318] and majestically summarized the grand sweep of centuries of interplay between state law and bankruptcy law regarding fraudulent transfers, all the while leaving the text struggling in his wake.[319]

Justice Scalia held that the term "reasonably equivalent value" in the fraudulent transfer provision of section 548 of the Bankruptcy Code does not require a foreclosure sale to yield a certain minimum price beyond what state foreclosure law requires.[320] A higher degree of clarity in the Code's text was required to demonstrate that Congress, when it enacted the Code, meant to depart from pre-Code state law.[321] Surely, he acknowledged, Congress has the power under its constitutional grant of authority to enact uniform bankruptcy laws that would "disrupt the ancient harmony that foreclosure law and fraudulent conveyance law, those two pillars of debtor-creditor jurisprudence, have heretofore enjoyed. But absent clearer textual guidance than the phrase 'reasonably equivalent value'—a phrase entirely compatible with pre-existing practice"—the court would "not presume such a radical departure."[322] "To displace traditional state regulation" of property rights, "the federal statutory purpose must be 'clear and manifest.'"[323] The Code "will be construed to adopt, rather than to displace, pre-existing state law," absent such manifest clarity.[324] He concluded that "reasonably equivalent value" could not be interpreted to mean any certain value, but only "the price in fact received at the foreclosure sale, so long as all the requirements of the State's foreclosure law have been complied with."[325]

Justice Souter's dissent was a textualist critique of Justice Scalia's extra-

315. BFP v. Resolution Tr. Corp., 511 U.S. 531, 533–34, 548 (1994).
316. *Id.* at 533–34.
317. *Id.* at 538 (quoting *Market Value*, BLACK'S LAW DICTIONARY (6th ed. 1990)).
318. *Id.* at 540 (citing 13 Eliz., c. 5 (1570)).
319. *Id.* at 541–42.
320. *Id.* at 542–43.
321. *Id.* at 543.
322. *Id.*
323. *Id.* at 544 (quoting English v. Gen. Elec. Co., 496 U.S. 72, 79 (1990)).
324. *Id.* at 545.
325. *Id.*

textualist approach. In Justice Souter's view, reference to centuries-long jurisprudence that preceded enactment of the text was unnecessary.[326] The words and meaning of section 548(a)(2)(A) are plain, and authorize a trustee "to avoid certain recent prebankruptcy transfers, including those on foreclosure sales, that a bankruptcy court determines were not made in exchange for 'a reasonably equivalent value.'"[327] In Justice Souter's view the Court, uncomfortable with the "eminent sense of the natural reading," had sought "finally to place this case in a line of decisions in which we have held that something more than mere plain language is required."[328]

In the 2000s Justice Ginsburg held in *Howard Delivery Services* that workers' compensation premiums are not entitled to priority as "claims for contributions to an employee benefit plan" under Code sections 507(a)(4) or (5).[329] Justice Ginsburg relied on the text and context of the applicable Code provisions, and the bankruptcy objective of equal distribution.[330] She emphasized that unlike pension provisions and group insurance plans, which are negotiated or granted as "pay supplements or substitutes," workers' compensation prescriptions "have a dominant employer-oriented thrust: They modify, or substitute for, the common-law tort liability to which employers were exposed for work-related accidents."[331] Justice Kennedy, relying primarily on the text of the Code and ERISA, reasoned to the contrary that "'employee benefit plan,' whether viewed as a term of art or in accordance with its plain meaning," *did* include workers' compensation.[332]

The following year in *Marrama v. Citizens Bank of Massachusetts*, Justice Stevens, an unwavering critic of the textualists' criticism of the use of legislative history,[333] himself rejected a debtor's urging that he resort to it to interpret

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326. *Id.* at 549 (Souter, J., dissenting).

327. *Id.* at 552.

328. *Id.* at 565 (internal citation omitted).

329. Howard Delivery Serv., v. Zurich Am. Ins. Co., 547 U.S. 651, 658 (2006).

330. *Id.* at 655.

331. *Id.* at 662.

332. *Id.* at 676 (Kennedy, J., dissenting).

333. *See* John Paul Stevens, *Law Without History?*, The New York Review of Books (2014) (reviewing ROBERT A. KATZMANN, JUDGING STATUTES (Oxford University Press 2014)) http://www.nybooks.com/articles/archives/2014/oct/23/law-without-history/ [https://perma.cc/U7ZY-43AU] ("The risk that a lobbyist-inspired comment by an individual legislator during a floor debate will have an impact on a judge's evaluation of legislative history is trivial. But the text of bills is often not self-explanatory, and it is necessary to read committee reports to understand the issues."). Compare Scalia and Garner, one of whose "Thirteen Falsities Exposed" is "[t]he false notion that committee reports and floor speeches are worthwhile aids in statutory construction." Justice Scalia and Garner nonetheless recognize the validity of certain uses of legislative history, including for the purpose of

Code section 706(a).[334] The debtor sought to convert his case from chapter 7 to chapter 13 pursuant to section 706(a).[335] Section 706(a) provides that a debtor "may convert" from chapter 7 to another chapter without any express requirement of "good faith."[336] Justice Stevens relied on the entire text of the Bankruptcy Code in reaching his conclusion that the debtor's "good faith" nonetheless is required by section 706(a).[337] He began by emphasizing that section 706(d) provides that "a case may not be converted to a case under another chapter [e.g., chapter 13] unless the debtor may be a debtor under such chapter."[338] Pursuant to section 1307(c), a chapter 13 case can be dismissed if the debtor is acting in "bad faith."[339] A debtor who is acting in "bad faith," it followed, also is ineligible to convert his case to chapter 13.[340] Justice Alito joined by two Justices dissented, arguing that the text of section 706(a) was clear and said nothing of "bad faith."[341]

The next year Justice Thomas, surely the firmest textualist on the present Court, extensively analyzed section 1146 of the Bankruptcy Code in *Florida Department of Revenue v. Piccadilly Cafeterias, Inc.*[342] Section 1146(a) provides that "the making or delivery of an instrument of transfer under a plan confirmed under section 1129" of the Code "may not be taxed under any law imposing a stamp tax or similar tax."[343] Justice Thomas concluded that section 1146 exempts from state property transfer tax only those transfers made pursuant to and *after confirmation* of a plan, and not transfers made merely in contemplation of a plan that is later confirmed.[344] In reaching his conclusion, Justice Thomas also invoked a "federalism canon" that he characterized as requiring statutory language to "be construed strictly in favor of the States to

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establishing linguistic usage and "to refute attempted application of the absurdity doctrine—to establish that it is indeed thinkable that a particular word or phrase should mean precisely was it says," since it "suffices that a single presumably rational legislator, or a single presumably rational committee, viewed the allegedly absurd result with equanimity." SCALIA AND GARNER, READING LAW, *supra* note 48, at 369, 388.

334. Marrama v. Citizens Bank of Mass., 549 U.S. 365, 374–75 (2007).

335. *Id.* at 367.

336. *See id.* at 376 (Alito, J., dissenting); 11 U.S.C. § 706(a) (2000).

337. *Marrama,* 549 U.S. at 374.

338. *Id.* at 371.

339. *See* 11 U.S.C. § 1307(c) (2000).

340. *Marrama,* 549 U.S. at 372–73.

341. *Id.* at 376–83 (Alito, J., dissenting).

342. Fla. Dept. of Revenue v. Piccadilly Cafeterias, 554 U.S. 33, 45–52 (2008).

343. 11 U.S.C. § 1146(a) (2012).

344. *Piccadilly Cafeterias,* 554 U.S. at 46.

prevent unwarranted displacement of their tax laws."[345] Justice Thomas rejected the debtor's argument that requiring the debtor to pay the tax would undermine its ability to reorganize, a fundamental purpose of the Code.[346] He reasoned that the Code's purposes are more complex and conflicting than those of a remedial statute and that "Chapter 11 strikes a balance between a debtor's interest in reorganizing and restructuring its debts and the creditors' interest in maximizing the value of the bankruptcy estate," and also accommodates "the interests of the States in regulating property transfers by 'generally [leaving] the determination of property rights in the assets of a bankrupt's estate to state law.'"[347] Justice Breyer (with Justice Stevens) dissented, on the ground that the text of section 1146 was temporally ambiguous, yet supplied "a clear enough rule—transfers are exempt when there is confirmation and are not exempt when there is no confirmation," without regard to whether the transfer or confirmation came first.[348] Statutory interpretation in Justice Breyer's view is not a game of "blind man's bluff."[349] A judge must consider a statute's basic purposes, and the "majority's failure to work with this important tool of statutory interpretation" led it to misconstrue section 1146 in a way that ran "contrary to what Congress would have hoped for and expected."[350]

In *Hall v. United States*, in the 2010s, Justice Sotomayor relied on the text, context, and structure of the Bankruptcy Code and provisions of the Internal Revenue Code to conclude that a capital gains tax on the sale of a farm in chapter 12 was not a liability "incurred by the estate" within the meaning of the administrative expense provision of Code section 503.[351] The tax thus was not payable by the estate, but was the debtors' nondischargeable responsibility to pay.[352] The majority rejected the debtors' argument that the purpose of Code section 1222(a)(2)(A) was "to provide debtors with robust relief from tax debts."[353] Justice Breyer with three fellow Justices dissented.[354] Justice Breyer

345. *Id.* at 48–50 (citing Nat'l Private Truck Council v. Okla. Tax Comm'n, 515 U.S. 582, 590 (1995) ("discussing principles of comity in taxation and the 'federal reluctance to interfere with state taxation' given the 'strong background presumption against interference'")).

346. *Id.* at 51.

347. *Id.* (quoting Travelers Cas. & Sur. Co. of Am. v. Pac. Gas & Elec. Co., 549 U.S. 443, 450–51 (2007)).

348. *Id.* at 59 (Breyer, J., dissenting).

349. *Id.*

350. *Id.*

351. Hall v. United States, 132 S. Ct. 1882, 1885 (2012); 11 U.S.C. § 503(b)(B)(i) (2012).

352. *Hall,* 132 S. Ct. at 1893.

353. *Id.*

354. *Id.* at 1894 (Breyer, J., dissenting) (Justice Breyer's dissent was joined by Justice Ginsburg and Justice Kagan).

would have interpreted the statute in a way that he considered more consistent with the Code's language and purposes, citing legislative history and reasoning that courts interpreting statutes should "make significant efforts to allow the provisions of congressional statutes to function in the ways that the elected branch of Government likely intended and for which it can be held democratically accountable."[355]

These opinions and others show that the Justices in their endeavors to interpret the Bankruptcy Code have differed less in their interpretive philosophies and more in the conclusions that they have reached applying substantially similar (though admittedly not identical) guides to construction. Majority and dissenting opinions consistently have taken into account the text, purposes, and policies of the Bankruptcy Code and other federal law, legislative history, state law, pre-Code bankruptcy practice and law, and extra-textual policies (including both a version of federalism that is deferential to state law and views of republicanism that emphasize democratic accountability to Congress at the federal level), and have weighed the results of each of these analyses in reaching their conclusions.[356]

This Article previously considered the state law and pre-Code practice applicable to a tenant's status on a sale of the real property that its lease encumbers. The remainder of Part VII considers the text, purposes and legislative history of sections 365(h), 363(e) and (f), and 361 of the Code with respect to the sale of real property free and clear of a lease and the tenant's possessory rights.

C. The Text of Sections 365(h) and 363(f)

A textualist analysis begins with the text. "The words of a governing text are of paramount concern, and what they convey, in their context, is what the text means."[357] Interpretative canons are one tool by which the meaning of text can be ascertained.

The whole-text or entire-text canon "calls upon the judicial interpreter to consider the entire text, in view of its structure and of the physical and logical

355. *Id.* at 1903.

356. In addition, other Constitutional doctrines and provisions may be invoked to determine whether a specific clause of the Bankruptcy Code is invalid, including separation of powers to limit the authority of bankruptcy courts as Article I courts to enter final judgments (Stern v. Marshall, 564 U.S. 462, 483 (2011)), the bankruptcy clause in Article I and Eleventh Amendment to determine the extent of state immunity from suit (Cent. Va. Cmmty. Coll. v. Katz, 546 U.S. 356, 359 (2006)), and the Seventh Amendment to establish the right to a civil jury trial with respect to certain avoidance actions (Granfinanciera, S.A. v. Nordberg, 492 U.S. 33, 42 (1989)).

357. SCALIA AND GARNER, READING LAW, *supra* note 48, at 56.

relation of its many parts."[358] Context is the "primary determinant of meaning" under a textualist analysis.[359] A "legal instrument typically contains many interrelated parts that make up the whole," and the "entirety of the document thus provides the context for each of its parts."[360]

1. Rejection and Sale under Sections 365(h) and 363(f)

The Code's entire text and structure includes sections 365(h) (tenant's elections on the debtor-landlord's rejection),[361] 363(f) (sales free and clear),[362] 363(e) (adequate protection of interest holders on a sale),[363] and 361 (how adequate protection is provided).[364] Section 365(h)[365] and section 363(f)[366] (read in conjunction with sections 363(e) and 361, which 363(f) expressly implicates) each contains a distinct statutory meaning, direction, and protection for affected parties.

Section 365(h) permits a debtor-landlord with court approval to reject a lease. The tenant is protected after rejection by its right to either treat the lease as terminated or remain in possession and continue to pay the rent.[367]

Section 363(f) authorizes a debtor, again with court approval, to sell the real property free and clear and to transform its value into cash, provided only that one of the five conditions of section 363(f)(1)–(5) is satisfied and that each holder of an interest in the property at the time of sale, including the holder of a lien or a leasehold estate, may request and be given adequate protection of its interest under sections 363(e) and 361.[368] Adequate protection on a sale typically is provided by a cash payment from the proceeds, in the amount by which the sale results in "a decrease in the value of such entity's interest in such property."[369] The text of section 361 expressly values the entity's interest based on its priority with respect to other interests.[370] The value of a first priority lien or other interest "in such property" will be the full value of its lien or interest,

358. *Id.* at 167.
359. *Id.*
360. *Id.*
361. 11 U.S.C. § 365(h) (2012).
362. 11 U.S.C. § 363(f) (2012).
363. 11 U.S.C. § 363(e).
364. 11 U.S.C. § 361 (2012).
365. 11 U.S.C. § 365(h).
366. 11 U.S.C. § 363(f).
367. 11 U.S.C. § 365(h).
368. 11 U.S.C. §§ 361, 363(e)–(f).
369. 11 U.S.C. § 361(1).
370. 11 U.S.C. § 361.

provided that the value of such property is sufficient, typically by payment of the first proceeds to the holder of the interest, prior to any value being paid to the holders of other interests.[371] At the other end of the priorities, the "decrease in the value" of an out-of-the-money subordinated lien, leasehold, or other interest "in such property" that occurs on a free and clear sale of the property will be zero, because the value of such holder's interest in the property is zero.[372] Accordingly, it will be entitled to nothing as adequate protection.

The text of section 365(h) does not mention what happens on a sale of the real property free and clear.[373] Similarly, the text of section 363(f) makes no reference to a lease rejection and makes no distinction between a tenant's interest and other interests in the property, such as monetary liens.[374] But a lease and the tenant's possessory rights under that lease, both before or after a rejection under section 365(h), are clearly "interests" under section 363(f) as all of the courts considering the issue have recognized.[375] Neither section 365(h) nor section 363(f) provides for any special treatment of a tenant's interest, as opposed to other interests, on a sale of the property.[376] As the Court stated in *Bildisco*, Congress knows "how to draft an exclusion" if its wants to —in this case by providing for special treatment of a tenant's interest on a 363(f) sale— and its failure to do so (in sections 365, 363, 361, or elsewhere) is an indication that Congress intended no such exclusion or special treatment.[377]

The surplusage canon also supports the construction of these provisions that treats a lease as an encumbrance and affords a tenant its bargained-for, prepetition state law rights on a sale of the property. The surplusage canon requires that "if possible no word should be rendered superfluous."[378] The words of a statute "cannot be meaningless"[379] and a provision should be given effect even

371. 11 U.S.C. § 363.

372. 11 U.S.C. §§ 363(1), 363(e), (f). The same law prevailed under the 1898 Act, as amended by the Chandler Act. *See In re* 620 Church St. Bldg. Corp, 299 U.S. 24, 27 (1936) (junior mortgage and shares in the debtor had no value because senior claims exceeded the value of the property; because there was "no value to be protected" the holders of those junior, out-of-the-money interests were not entitled to adequate protection under the plan). *See also* discussion *infra* Part VII, C., 3.

373. *See* 11 U.S.C. § 365(h) (2012).

374. 11 U.S.C. § 363(f).

375. *See, e.g.*, *In re* Scimeca Found., 497 B.R. 753, 786–88 (Bankr. E.D. Pa. 2013); *In re* Extra Room, 2011 WL 846448, at *2 (Bankr. D. Ariz. Mar. 7, 2011); *In re* Haskell, 321 B.R. 1, 6 (Bankr. D. Mass. 2005); *In re* Hill, 307 B.R. 821, 826 (Bankr. W.D. Pa. 2004). *See also e.g.*, *In re* Downtown Athletic Club of N.Y.C., 2000 WL 744126, at *4 (S.D.N.Y. June 9, 2000); *In re* Taylor, 198 B.R. 142, 162 (Bankr. D.S.C. 1996).

376. *See* 11 U.S.C. § 365(h); 11 U.S.C. § 363(f).

377. NLRB v. Bildisco & Bildisco, 465 U.S. 513, 523 (1984).

378. SCALIA AND GARNER, READING LAW, *supra* note 48, at 168.

379. United States v. Butler, 297 U.S. 1, 65 (1936).

if it "seems to the court unjust or unfortunate."[380] "If a provision is susceptible of (1) a meaning that gives it an effect already achieved by another provision, or that deprives another provision of all independent effect, and (2) another meaning that leaves both provisions with some independent operation, the latter should be preferred."[381]

Each of the words, "rejects" in section 365(h) and "sell" in 363(f), operates independently and achieves a different but complementary effect with respect to the affected tenant and debtor. Section 365(h) provides that a rejection of the lease by the debtor-landlord does not dispossess the tenant.[382] Section 363(f) allows for the sale of the property and protects the tenant in the property by payment of adequate protection in the amount of the value of the tenant's interest in the property.[383] The surplusage canon requires a construction that gives these different provisions—one that is applicable to a rejection and the other to a sale—independent meanings, and that does not render one or the other superfluous. That is the most natural reading of these provisions. Section 365(h) permits a tenant to "retain its rights" including "possession" if the landlord-debtor "rejects" the lease.[384] Section 363(f) authorizes a debtor to "sell" property free and clear of the tenant's interest,[385] and section 363(e) entitles a tenant, if the property is "sold," to the court's conditioning "such . . . sale . . . as is necessary to provide adequate protection of such interest."[386] Effect can be given, and under the surplusage canon must be given, to these very different words.

The harmonious reading canon, though, is preeminent. Justice Scalia and Garner assert that the "imperative of harmony among provisions is more categorical than most other canons . . . there can be no justification for needlessly rendering provisions in conflict if they can be interpreted harmoniously."[387] The canon teaches that one part of a statute "is not to be allowed to defeat another, if by any reasonable construction the two can be made to stand together."[388] Only if context and other considerations including the application of other canons "make it impossible to apply the harmonious-reading canon"

380. *Id.* at 174.
381. *Id.* at 176.
382. 11 U.S.C. § 365(h) (2012).
383. *See* 11 U.S.C. § 363(f) (2012).
384. 11 U.S.C. § 363(h).
385. 11 U.S.C. § 363(f).
386. 11 U.S.C. § 363(e).
387. SCALIA AND GARNER, READING LAW, *supra* note 48, at 180.
388. *Id.* (citations omitted).

does the general/specific canon apply.[389] As set forth in the preceding paragraphs, sections 365(h) and 363(f)—the former of which concerns a lease rejection and the latter of which applies to a sale of the property—can be, should be, and most naturally are construed in a way that results in their being compatible and not contradictory.

As discussed above, sections 365(h) and 363(f) can be harmoniously reconciled, and neither contradicts the other. But even if that were not the case, the general/specific canon does not lead to a different result, notwithstanding the reliance on it by the district court in *Precision Industries* (discussed in Part III.B above) and some post-*Precision* courts (discussed in Part IV.B above). The general/specific canon requires that, if conflicting provisions simply cannot be reconciled, then the specific provision prevails over the general.[390]

The "general/specific canon is not an absolute rule, but is merely a strong indication of statutory meaning that can be overcome by textual indications that point in the other direction."[391] Both text and context sweep away any assertion that section 363(f) is the general and 365(h) the specific. Textually, each addresses a different action by the debtor (the debtor-landlord's sale free and clear of the lease v. the debtor-landlord's rejection of a lease) and gives a different treatment to the tenant (adequate protection of the value of the tenant's interest in the property v. continued possession by the tenant).[392] Contextually, the two treatments afforded to the tenant do not exist side-by-side with respect to a single action taken by the debtor, as they did in *RadLAX Gateway Hotel* with respect to the fair and equitable treatment required under Code section 1129(b)(2)(A) for confirmation of a cramdown plan over the objection of a dissenting secured creditor.[393] To the contrary, the provisions regarding a free and clear sale and a rejection are found in completely different sections of the Code (363 and 365), that are concerned with distinct actions that a debtor may take, with court approval, under the Code. One of those actions does not necessarily implicate the other. A debtor can sell the property without ever rejecting the

389. *Id.*

390. *Id.* at 183 (citing 3 JEREMY BENTHAM, *A General View of A Complete Code of Laws*, in THE WORKS OF JEREMY BENTHAM 155, 210 (John Bowring ed., 1843)). The general/specific canon has been stated by Scalia and Garner as follows: "If there is a conflict between a general provision and a specific provision, the specific provision prevails (*generalis specialibus non derogant*)." *Id.*

391. RadLAX Gateway Hotel v. Amalgamated Bank, 132 S. Ct. 2065, 2072 (2012).

392. *Compare*, 11 U.S.C. § 363(f) (2012), *with* 11 U.S.C. § 365(h) (2012).

393. *RadLAX Gateway Hotel*, 132 S. Ct. at 2071–72. *See also, e.g., In re* Visteon Corp., 612 F.3d 210, 224 (3d Cir. 2010) (quoting United States v. Mobley, 956 F.2d 450, 452–53 (3d Cir. 1992) ("A 'fundamental canon of statutory construction' is that where a section of a statute does not include a specific term or phrase used elsewhere in the statute, 'the drafters did not wish such a requirement to apply.'")).

lease, and can reject the lease without ever selling the property. Neither section 363(f) nor 365(h) is a "general" or "residual" provision, such as a secured creditor's right in a cramdown plan to the "indubitable equivalent" of its claim under section 1129(b)(2)(A) (iii) as was the case in *RadLAX Gateway Hotel, LLC*.[394] Each of sections 363(f) and 365(h) instead is a free-standing and co-equal Code provision that addresses the treatment of a tenant's interest in a case in which the debtor is the landlord—the former on a free and clear sale, and the latter on a rejection.

That a debtor in some cases *may* both reject a lease and sell the property free and clear does not change this. The fact that cats sometimes climb trees and that crows sometimes walk on the ground does not make either phenomenon the general and the other the specific. Each is simply a different animal utilizing a different kind of locomotion.

2. The Disjunctive Requirements of Sections 363(f)(1)–(5)

As set forth above there is no basis on which section 365(h) should be interpreted to rearrange the bargained-for priorities of the parties' prepetition property rights on a sale under section 363(f).[395] This conclusion does not necessitate consideration of the five disjunctive conditions for a free and clear sale under sections 363(f)(1)–(5).[396]

Yet several courts since *Precision* have construed the first and/or fifth of those disjunctive requirements to preclude a sale free and clear of a lease. Those decisions also effectively elevate the priority of a subordinate leasehold estate, even one that is out-of-the-money, over prior encumbrances in contravention of the parties' prepetition bargained-for property rights.[397] Accordingly, I briefly consider next the text of sections 363(f)(1) and (5) in the context

394. *RadLAX Gateway Hotel*, 132 S. Ct. at 2073 (citing 11 U.S.C. § 1129(b)(2)(A)).

395. *See supra* Part VII.C.1.

396. *See* 11 U.S.C. § 363(f)(1)–(5).

397. Dishi & Sons v. Bay Condos, 510 B.R. 696, 708–12 (Bankr. S.D.N.Y. 2014) (considering both section 363(f)(1) and (5)); *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," and failing to consider *TWA* in which the Third Circuit held that a hypothetical chapter 7 bankruptcy proceeding, in which the entity could be compelled to accept a money satisfaction (in that case zero), fulfilled the requirement of section 365(f)(5)); *In re* Haskell, 321 B.R. 1, 8–9 (Bankr. D. Mass 2005) (which cited but did not attempt to distinguish *TWA*, decided the year before). The Ninth Circuit BAP also interpreted section 363(f)(5) to require an "actual" rather than a "hypothetical" proceeding. *In re* PW, 391 B.R. 25, 41, 45–46 (9th Cir. BAP 2008) ("*Clear Channel*"). It viewed section 363(f)(5) as requiring "at least three elements: that (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." *Id.* at 41 (emphasis added). The BAP then determined that the term "proceeding" meant and was limited to a non-bankruptcy proceeding currently available

of the state foreclosure law presently in force that also animated free and clear sales of real property in bankruptcy cases for more than 130 years prior to the enactment of the Code, which analysis further supports the vindication of the parties' bargained-for, prepetition rights.

A debtor in possession or trustee may sell property free and clear of any interest, including a lease, under section 363(f)(1) if: "(1) applicable nonbankruptcy law permits sale of such property free and clear of such interest."[398] Section 363(f)(5) permits a sale free and clear by the debtor in possession or trustee if: "(5) such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest."[399]

Interpreting the text of section 363(f)(1) requires inquiry into the meaning of the "applicable" "nonbankruptcy" law that permits the "sale" of property free of an interest. I will consider each in turn.

Merriam-Webster defines the term "applicable" to mean "capable of or suitable for being applied" or "able to be applied or used in a particular situation."[400] Black's Law Dictionary similarly construes "applicable" as "[c]apable of being applied; fit and right to be applied."[401] The term "capable" used in each definition means "able to do something: having the qualities or abilities that are needed to do something."[402]

"Nonbankruptcy" is a specialized term that has no common meaning other than "[n]ot of or pertaining to bankruptcy."[403] The Supreme Court has resolved this issue conclusively, though, holding in *Butner* that state law is the nonbankruptcy law applicable to the determination of the parties' respective property rights in a bankruptcy case.[404] Moreover, "[t]he justifications for application of state law are not limited to ownership interests" such as fee estates and leasehold estates.[405] "[T]hey apply with equal force to security interests . . . ."[406] The *Butner* court further acknowledged and embraced the consequence that

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to the debtor. Since no such proceeding was available to the debtor in the *Clear Channel* case the debtor could not sell fee and clear under § 363(f)(5). *Id.* at 45–46.

398. 11 U.S.C. § 363(f)(1).

399. 11 U.S.C. § 363(f)(5).

400. *Applicable,* MERRIAM WEBSTER DICTIONARY (11th ed. 2008), https://www.merriam-webster.com/dictionary/applicable [https://perma.cc/47BJ-FCVY].

401. *Applicable,* BLACK'S LAW DICTIONARY (10th ed. 2014).

402. *Capable,* MERRIAM WEBSTER DICTIONARY (11th ed. 2008), https://www.merriam-webster.com/dictionary/capable [https://perma.cc/ZTT6-9YGL].

403. *Nonbankruptcy,* INTERNATIONAL-DICTIONARY.COM, http://international-dictionary.com/definitions/?english_word=nonbankruptcy [https://perma.cc/D7UL-YXMC].

404. Butner v. United States, 440 U.S. 48, 55 (1979).

405. *Id.*

406. *Id.*

"[b]ecause the applicable law varies from State to State, the results in federal bankruptcy proceedings will also vary."[407] What follows from this doctrine, the court continued, "is that the federal bankruptcy court should take whatever steps are necessary to ensure that the mortgagee is afforded in federal bankruptcy court the same protection he would have under state law if no bankruptcy had ensued."[408]

But *which* "applicable nonbankruptcy" state law permits a "sale" of real property free and clear of an interest, such as a lease or a mortgage, under section 363(f)(1)? The decisions have focused on two: eminent domain and foreclosure law.[409] The first interpretation must be rejected on textual grounds upon consideration of the term "sale." A taking by eminent domain is not a "sale" under section 363(f)(1).[410] It is true that a state law condemnation proceeding results in a compulsory transfer to the state or its designee of property free of a party's rights in that property. But "'[e]minent domain,' in its simplest terms, is the inherent power of a governmental entity to take privately owned property and convert it to public use. More specifically, 'eminent domain' is the power of a governmental entity to take private property for a public use without the owner's consent, conditioned upon the payment of just compensation."[411] Eminent domain law does not operate by a "sale" to the state or its designee.[412] The law of condemnation thus, on construction of the Code's text, is not the "applicable nonbankruptcy law" that "permits sale of such property free and clear" under section 363(f)(1), because eminent domain accomplishes its ends by a "taking." It does not do so by a "sale," the term used in section 363(f)(1).

State foreclosure law by comparison qualifies as "applicable nonbankruptcy" state law that "permits a *sale*" of real property "free and clear" under section 363(f)(1).[413] Foreclosure achieves its purpose and effectuates transfer by a sale, either to a third party buyer or to the mortgagee who credit bids at the sale, and not by a taking.[414] A state law foreclosure sale can be made free and clear of any lease that is subordinate to the mortgage lien on which the foreclosure proceeding is based.[415] If the lease is subordinate to a mortgage securing

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407. *Id.* at 53 (1898 Act case); Nobelman v. Am. Sav. Bank, 508 U.S. 324, 329 (1993) (1978 Code case).

408. *Butner,* 440 U.S. at 56.

409. *See, e.g.*, *In re* Haskell, 321 B.R. 1, 9 (Bankr. D. Mass. 2005).

410. 26 AM. JUR. 2d *Eminent Domain* § 2 (2014).

411. *Id.*

412. *See id.* § 1.

413. 11 U.S.C. § 363(f)(1) (2012) (emphasis added).

414. RESTATEMENT (THIRD) OF PROP.: MORTGAGES, § 8.2 cmt. a (AM. LAW. INST. 1997).

415. *See supra* Part V.

a claim in excess of the sale proceeds, then the tenant will be paid nothing and the lease will end.[416]

But if the lease instead has priority over the monetary lien, then a state law foreclosure sale must be made subject to the lease, and the lease will survive the sale.[417] The lease with priority over the mortgage simply rides through, and again, none of the sale proceeds are paid to the tenant.[418] State foreclosure sale law was the "applicable nonbankruptcy" law utilized by the Supreme Court and lower courts prior to the Bankruptcy Code,[419] and the use of the term "sale" in section 363(f)(1) provides textual support for its continued application under the Code. This interpretation moreover preserves the parties' bargained-for, prepetition property rights, in the order of their respective priorities against the debtor's real property, and vindicates those rights as required under the Bankruptcy Code per *Butner*.

A textual analysis of the fifth disjunctive condition for a free and clear sale leads to the same result, but has its application to a different factual situation. Section 363(f)(5) provides that the trustee or debtor in possession may sell free and clear of "any interest" if the entity holding the interest "could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest."[420]

A lively debate has arisen regarding whether the "legal or equitable proceeding" by which the holder of an interest "could be" compelled "to accept a money satisfaction" under section 363(f)(5) must be an actual proceeding presently available to the trustee or debtor in possession.[421] The key terms here include "could be," the synonyms for which include "might be," "perhaps," "imaginably" and "conceivably."[422] These definitions support the view of some courts, including the bankruptcy courts in *Boston Generating* and *In re Jolan, Inc*. and the Third Circuit in *TWA*, that a *hypothetical* proceeding, such as a foreclosure proceeding under state law or a chapter 7 bankruptcy proceeding, satisfies section 363(f)(5).[423] That the antonyms for "could be" are "certainly,"

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416. *See supra* Part V.

417. *See supra* Part V.

418. *See supra* Part V.

419. *See supra* Part V.

420. 11 U.S.C. § 363(f)(5) (2012).

421. *See supra* note 76 and accompanying text.

422. *Could Be,* THEASURUS.COM, http://www.thesaurus.com/browse/could%20be?s=t (last visited Feb. 7, 2017).

423. EEOC v. Knox-Schillinger (*In re* Trans World Airlines), 322 F.3d 283, 290–91 (3d Cir. 2003); *In re* Bos. Generating, 440 B.R. 302, 333 (Bankr. S.D.N.Y. 2010); *In re* Jolan, 403 B.R. 866, 869–70 (Bankr. W.D. Wash. 2009).

"definitely," and "surely" further supports this view.[424] But other synonyms for "could be"—including "can be," "feasible," and "obtainable"—buttress the position taken by some courts that an *actual* proceeding must be available to the debtor in possession or the trustee.[425]

Additional though minor support for the "hypothetical" proceeding interpretation comes from the fact that the term "legal or equitable proceeding" is directly preceded and modified by "a," an indefinite article.[426] The indefinite article "a" is one "used in English to refer to a person or thing that is not identified or specified."[427] The phrase "in a legal or equitable proceeding" in context suggests a proceeding that is "hypothetical," one definition of which is "not real: imagined as an example."[428]

Of greater linguistic significance, though, the term "could be" precedes and modifies the word "compelled" in section 363(f)(5).[429] It does not directly qualify the phrase "in a legal or equitable proceeding."[430] It thus more accurately defines whether the holder of the interest "can be" compelled to accept a money satisfaction in "a legal or equitable proceeding," such as because the interest is subordinate to the interest being foreclosed upon,[431] and not whether that proceeding must be an "actual" proceeding.

Decisively, though, construing section 363(f)(5) to require an "actual" rather than a "hypothetical" proceeding makes little sense when section 365(f) is read in the context of section 541(a) of the Bankruptcy Code. Under section 541(a), the commencement of a bankruptcy case creates an estate "comprised of all . . . legal and equitable interests of the debtor in property as of the commencement of the case."[432] The scope of "property of the estate" is very broad, and includes causes of action that the debtor has at the commencement of the case or that it acquires after the commencement of the case.[433]

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424. *Could Be,* THEASURUS.COM, http://www.thesaurus.com/browse/could%20be?s=t (last visited Feb. 7, 2017).

425. *Id.*

426. *See* 11 U.S.C. § 363(f)(5) (2012).

427. *A,* MERRIAM WEBSTER DICTIONARY (11th ed. 2008).

428. *Hypothetical,* MERRIAM WEBSTER DICTIONARY (11th ed. 2008).

429. *See* 11 U.S.C. § 363(f)(5).

430. *See id.*

431. For example, in a state law foreclosure proceeding, the holder of an encumbrance against real property cannot be compelled to accept a money satisfaction if it has priority over the lien being foreclosed on, or if the foreclosing plaintiff elects not to "name" a subordinate encumbrance and the holder of it in the proceeding.

432. 11 U.S.C. § 541(a)–(a)(1) (2012).

433. 11 U.S.C. § 541(a)(1), (7). *See, e.g.*, La. World Exposition v. Fed. Ins. Co., 858 F.2d 233, 245 (5th Cir. 1988) (citing United States v. Whiting Pools, 462 U.S. 198, 205–06 (1983)).

Interpreting section 363(f)(5) to require an "actual" proceeding presently available to the debtor would make section 541(a) superfluous, because a debtor does not need section 363(f)(5) to bring and pursue a cause of action that already is property of the estate under section 541(a). The canon of surplusage dictates against an interpretation that requires an "actual" proceeding under section 363(f)(5), because section 541(a) renders section 363(f)(5) superfluous.[434]

Does adopting this construction of section 363(f)(5) to include a hypothetical foreclosure proceeding swallow up and make the other disjunctive conditions of section 363(f) superfluous? Several courts have reached that conclusion.[435] But the better argument with respect the sale of property encumbered by a lease is "no." Rather, the disjunctive provisions to a free and clear sale under section 363(f)(1), (2), and (5) appear to have been designed to afford the parties their respective state law property rights in the order of priority that would be obtained in a hypothetical foreclosure proceeding, with the additional feature that the tenant under a first priority lease, who would not be dispossessed in such a proceeding, can consent to the sale and "cash out" its position rather than remain in possession.

First, a tenant under a first priority lease is entitled to remain in possession unless it consents to the sale free and clear of its interest, for the following reasons. State foreclosure law, which I argue is "applicable nonbankruptcy law" under section 363(f)(1), does not permit sale of the property free and clear of a first priority lease.[436] The foreclosure sale by the junior lienor would instead be subject to that lease.[437] Using a hypothetical state law foreclosure proceeding as the "legal or equitable proceeding" referred to in section 363(f)(5), the first priority tenant also could not be compelled to accept a money satisfaction

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434. SCALIA AND GARNER, READING LAW, *supra* note 48, at 168. Moreover, these words in section 363(f)(5) also obtain a very certain meaning when read in the context of the bankruptcy law of free and clear sales that existed at the time the Bankruptcy Code was enacted. Several courts post-*Precision* courts have reasoned that section 363(f)(5) "does not refer to foreclosure proceedings because they are initiated by creditors, not the debtor." Dishi & Sons v. Bay Condos, 510 B.R. 696, 711 (Bankr. S.D.N.Y. 2014) (citing *In re* Scott, 2013 WL 4498987, at *2–3 (Bankr. E.D. Ky. Aug. 21, 2013)). The Supreme Court for more than a century prior to enactment of the Code considered a state law foreclosure sale precisely the kind of *hypothetical* proceeding applicable to a free and clear sale, by which the holder of an interest could be compelled to accept a money satisfaction of its interest. *See* discussion *supra* Part V.

435. *See, e.g.*, *Dishi*, 510 B.R. at 711 (citing *In re Scott*, 2013 WL 4498987, at *2–3; *In re* PW, 391 B.R. 25, 44 (9th Cir. BAP 2008)).

436. 11 U.S.C. § 363(f)(1) (2012). *See also* RESTATEMENT (THIRD) OF PROP.: MORTGAGES, § 7.1 cmt. a (AM. LAW INST. 1997).

437. RESTATEMENT (THIRD) OF PROP.: MORTGAGES, § 7.1 (AM. LAW INST. 1997). *See supra* Part V.

of its interest.[438]

But the tenant's power to consent to bankruptcy sale free and clear of its lease offers a different outcome for the tenant under a first priority lease. A tenant who consents to the sale free and clear of its first priority lease under section 363(f)(2) will be entitled to payment of the first proceeds as adequate protection under sections 361(1) and 363(e).[439] The tenant under a first priority lease who makes that election can cash out its position to the extent of the value of its lease.[440]

Second, the tenant under a subordinate lease is subject to two different treatments that again comport with both state foreclosure law and the provisions of section 363(f). If the subordinate lease is out-of-the-money because the prior liens and encumbrances against the property equal or exceed the value of the property, then the value of the tenant's interest for purposes of adequate protection under the Code and on a state foreclosure law sale is nothing.[441] On such facts, the property can be sold free and clear of the lease under section 363(f)(1), because "applicable nonbankruptcy law," i.e., a foreclosure proceeding, permits such sale free and clear without payment to the tenant.[442]

If, however, the lease is subordinate but is in-the-money because sale proceeds remain after payment of prior liens and encumbrances, then the sale can be made free and clear of the lease and the tenant can be compelled under 363(f)(5) to accept (and is entitled to) a money satisfaction.[443] This payment will consist of the lease value to the extent of remaining proceeds. This outcome, again, is the same that will be achieved on a state law foreclosure sale, which is the hypothetical legal or equitable proceeding recognized by the Supreme Court under all of the prior Bankruptcy Acts to be applicable to a free and clear sale in bankruptcy.[444]

Under the analysis that I urge, neither section 363(f)(1) nor (5) subsume one another or the other disjunctive conditions of 363(f)(2), (3), or (4) by permitting a sale free and clear of a lease under all circumstances. Section 363(f)(2) permits a sale free and clear of a first priority lease on the consent of the tenant, which neither 363(f)(1) or (5) ordinarily would allow. Section 363(f)(1) permits a sale free and clear of a subordinate lease that is out-of-the-

438. *See* 11 U.S.C. § 363(f)(5).
439. 11 U.S.C. § 361(1), 363(e) (2012).
440. 11 U.S.C. § 363(f)(2).
441. 11 U.S.C. § 363(f)(1).
442. 11 U.S.C. § 363(f)(1).
443. 11 U.S.C. § 363(f)(5).
444. *See* discussion *supra* Part V.

money.[445] Section 363(f)(5) permits a sale free and clear of a subordinate lease that is in-the-money, in whole or in part.[446] Each section addresses a different circumstance under which the sale is conducted.[447]

3. A Tenant under an Out-of-the-Money, Subordinate Lease Is Not Entitled to Adequate Protection as the "Indubitable Equivalent of its Lease"

What of possession as adequate protection—Should a tenant under an out-of-the-money subordinate lease be entitled to possession because possession is the "indubitable equivalent" of its interest in the property under section 361(3) and is the only means by which that interest can be adequately protected? Such a determination is contrary to the text of sections 361 and 363(e).

A dispossessed tenant is entitled to adequate protection of its interest under section 363(e), but only to the extent that, pursuant to section 361(1), the "sale" free and clear "results in a decrease in the value *of such entity's interest in such property*" that was sold.[448] The interest of a tenant under an out-of-the-money subordinate lease in the property being sold is zero, and the tenant should receive just that. The same treatment would be afforded to an out-of-the-money monetary lien or other encumbrance on a sale under section 363(f), on a bankruptcy sale under pre-Code law, and on a state law foreclosure sale.[449] If value of the property as reflected by the sale proceeds exceeds the amounts paid to the holders of prior liens, encumbrances, and other interests, then the interest of the tenant in the property still has value. The value is represented by the remaining proceeds of the property sold free and clear, capped at the value of the lease.[450]

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445. *See* 11 U.S.C. § 363(f)(1).

446. *See* 11 U.S.C. § 363(f)(5).

447. *See* 11 U.S.C. § 363(f)(1)–(5). Two remaining disjunctive conditions, also address different facts: section 363(f)(3) permits a sale free and clear of a lien if "the price at which such property is to be sold is greater than the aggregate value of all liens on such property," and section 363(f)(4) permits such sale if such "interest is in bona fide dispute."

448. 11 U.S.C. § 363(e), 361(1) (2012) (emphasis added).

449. *See* 11 U.S.C. § 363(f); RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 7.1 (AM. LAW. INST. 1996); Houston v. City Bank of New Orleans, 47 U.S. 486, 504–06 (1848) (applying pre-Code law).

450. Section 361(2) adds one wrinkle to this analysis, though it does not change the outcome. Under section 361(2), adequate protection may be provided to the entity by "an additional or replacement lien" to the extent that such . . . sale . . . results in a decrease in the value of such entity's interest in such property." 11 U.S.C. § 361(2). Unless a lease is characterized as a "lien," it is difficult to see how the tenant could be given an "additional or replacement lien" as adequate protection under 361(2). Section 101(37) defines a "lien" to mean a "charge against or interest in property to secure payment of a debt or performance of an obligation." 11 U.S.C. § 101(37) (2012). It is difficult to argue that a lease "secures the payment of a debt or performance of an obligation," and thus section 361(2) likely has no

The "indubitable equivalent" provision of 361(3) does not alter this result.[451] The entity that holds the interest is entitled only to "such *other relief* . . . as will result in the realization of the indubitable equivalent of such entity's *interest in such property*."[452] The "indubitable equivalent" of an out-of-the-money subordinate tenant's "interest in such property" being sold is zero.[453] The tenant under such a lease is not entitled to possession as the "indubitable equivalent" of its interest in the property as the courts in *Dishi* and *Haskell* determined, because that interest is, again, zero.[454] The out-of-the-money, subordinate lease is no different than an out-of-the-money subordinate mortgage or judgment lien. The holder has no remaining "interest in such property" and is entitled to nothing on the sale.[455]

4. Summary of the Code's Text Regarding a Sale Free and Clear of a Lease

Each of sections 365(h) and 363(f) therefore has particular applications with respect to a lease encumbering a debtor's property that does not render the other section superfluous. Textual analysis of these sections supports a construction that if the debtor "rejects" the lease, and that is all that has occurred, then the tenant is entitled to elect to remain in possession.[456] If instead the debtor determines to "sell" the property then, whether or not the lease has been

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application to a sale free and clear of a lease. Even if the term "lien" is interpreted to include a "lease," though, adequate protection would be limited to the value of the lease on the sale in relation to the other encumbrances against the property, i.e., the value of the tenant's "interest in such property," which is zero if the lease is subordinate and out-of-the-money.

451. 11 U.S.C. § 361(3).

452. *Id.*

453. *Id.*

454. Dishi & Sons v. Bay Condos, 510 B.R. 696, 711–12 (S.D.N.Y. 2014); *In re* Haskell, 321 B.R. 1, 10 (Bankr. D. Mass. 2005).

455. In addition, sections 361(1) and (2) each expressly refer to adequate protection resulting from a diminution in value on a "sale," while the "indubitable equivalent" standard in section 361(3) makes no reference to a "sale." Thus, section 361(3) is arguably a catchall provision, that has no application to a "sale."" The Supreme Court in *Radlax* made clear that the "indubitable equivalent" treatment to which a secured creditor is entitled under a cramdown plan under section 1129(b)(2)(A)(iii) is the "catchall" provision of section 1129(b)(2)(A), and cannot be used to alter the treatment on a "sale" pursuant to a plan as specified in section 1129(b)(2)(A)(ii). RadLAX Gateway Hotel v. Amalgamated Bank, 132 S. Ct. 2065, 2072 (2012). The "indubitable equivalent" provision of section 361(3) similarly may be characterized as a catchall provision that does not alter the treatment afforded to the holder of an interest on a "sale" under section 361(1). The argument is weaker here than for section 1129(b)(2)(A), though, because the introductory language of section 361 refers generally to section 363. Thus, it is conceivable that section 361 may be construed to make section 361(3) applicable to a free and clear sale under section 363(f). But even if section 361(3) has some application, the value of a tenant's "interest in such property" sold free and clear of its out-of-the-money subordinate lease remains zero, and the "indubitable equivalent" of zero remains zero.

456. 11 U.S.C § 365(h) (2012).

rejected, the tenant's treatment depends on the priority and value of the lease in relation to the value of the property and other encumbrances.[457]

Each of sections 363(f)(1), (2), and (5) also provides a specific function if the debtor determines to sell the property.[458] These depend on whether the lease is subordinate or has first priority, whether the tenant under a first priority lease has consented to the sale, and in both cases on the value of the property.[459]

Specifically, if the sale is free and clear of a lease that is subordinate to monetary liens, then under the "applicable nonbankruptcy law" of section 363(f)(1) the sale can be made free and clear of the tenant's interest under the lease even if the sale proceeds are insufficient to pay anything to the tenant.[460] But if sale proceeds remain available for distribution to the tenant under a subordinate lease, then the tenant is entitled to full or partial payment and the sale may go forward because the tenant "could be compelled" in a hypothetical foreclosure proceeding "to accept a money satisfaction" of its interest under section 363(f)(5).[461] Finally, if the lease has first priority, then the tenant is entitled to remain in possession, and neither 363(f)(1) nor 363(f)(5) can be used to oust it.[462] But if the first priority tenant consents to the sale under section 363(f)(2), or another condition of section 363(f) is satisfied, then the sale can be made free and clear of the lease,[463] on payment to the tenant of the first proceeds of sale in an amount not in excess of value of the tenant's leasehold.[464]

In each of these examples, the tenant is entitled to receive as adequate protection on a sale the amount that is equal to "the value of such entity's [the tenant's] *interest in such property*," nothing more and nothing less.[465] If the lease is subordinate and out-of-the-money, then the free and clear sale has not resulted in a "decrease in the value of such entity's interest in such property," and the "indubitable equivalent of such entity's interest in such property" is zero.[466] Accordingly, such tenant should not be entitled to remain in possession or be paid anything.

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457. 11 U.S.C. § 363(f).

458. 11 U.S.C. § 363(f)(1)–(2), (5).

459. 11 U.S.C. § 363(f)(1)–(2), (5).

460. 11 U.S.C. § 363(f)(1).

461. 11 U.S.C. § 363(f)(5).

462. *See* 11 U.S.C. § 363(f)(1), (5).

463. In such event, the tenant under such first priority lease will be entitled to the proceeds of sale in an amount up to the value of its lease, prior to any distribution to any other holders of interests against the property.

464. 11 U.S.C §§ 361, 363(e), 363(f)(1), 363(f)(5) (2012).

465. 11 U.S.C § 361(1), (3).

466. *Id.*

This construction, in addition to being consistent with state law property rights under *Butner* and pre-Code law and practice, adequately accounts for all of the applicable linguistic components[467] of sections 365(h) and 363(f) and renders no word of these statutory provisions superfluous, idle, or nugatory.[468] The text of sections 365(h) and 363(f) thus supports the conclusion that a debtor may sell real property free and clear of a subordinate lease and the debtor's possessory rights, whether or not the lease has been rejected. Permitting the tenant under a lease to remain in possession notwithstanding that the lease is subordinate to liens and other interests in the property finds no support in the text of the Bankruptcy Code.

D. Interpreting the Text of Sections 365(h) and 363(f) in the Context of the Purposes of the Bankruptcy Code

The Bankruptcy Code's purposes of equitable distribution, maximizing payments to creditors, and reorganization are furthered by a conclusion that a tenant cannot use section 365(h) to preserve its subordinate lease or possessory rights on a free and clear sale under section 363(f).[469]

A first priority tenant that either retains its leasehold interest in the property (as it would under state law) or is paid the value of its lease from the first proceeds of sale will receive the value of its prepetition state law interest in the debtor's property.[470] In the case of a subordinate lease, the distribution of the sale proceeds to the tenant up to the amount of the lease value, after the payment of prior liens and encumbrances, similarly affords the tenant the value of its prepetition state law interest in the debtor's property that is being sold, even when the amount is zero.[471] Each of these treatments results in the equitable distribution of the debtor's property in accordance with the non-debtor parties' prepetition state law rights per *Butner*, reduces uncertainty, discourages forum shopping, and prevents a party from receiving "a windfall merely by reason of the happenstance of bankruptcy."[472]

What of maximizing the value of the bankruptcy estate? This policy is furthered by a sale that is free and clear of any lease. A free and clear sale will

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467. SCALIA AND GARNER, READING LAW, *supra* note 48, at 174 (quoting E.D. HIRSCH, VALIDITY IN INTERPRETATION 236 (1967)).

468. SCALIA AND GARNER, READING LAW, *supra* note 48, at 168. *See also id.* at 174 (quoting THOMAS M. COOLEY, A TREATISE ON THE CONSTITUTIONAL LIMITATIONS WHICH REST UPON THE LEGISLATIVE POWER OF THE STATES OF THE AMERICAN UNION 58 (1868)).

469. *See* discussion *supra* Part I.

470. *See* discussion *supra* Part I.

471. *See* discussion *supra* Part I.

472. Butner v. United States, 440 U.S. 48, 55 (1979) (quoting Lewis v. Mfrs. Nat'l Bank, 364 U.S. 603, 609 (1961)) (1898 Act case).

generate bidders who want to use the property in addition to those who wish to purchase the property as an investment, thus increasing the likelihood that one or more of these potential purchasers will bid up the price. A sale subject to a lease will eliminate the potential buyers who want to occupy and use the property immediately following the closing of the sale and thus may repress bidding.

But for this factor of encouraging or discouraging bidding, if the distribution of the sale proceeds is made in accordance with the state law priorities of the encumbrances against the property, as proposed by this Article, the effect on the policy of maximizing the value of the estate for distribution to creditors is neutral. Consider a property the value of which is $1 million if it were sold free and clear of encumbrances. The property, though, is subject to a first priority lease, and the lease is at a below market rental, so that the value that a buyer would pay for the lease is $300,000 (the "lease value"). Assume also a $600,000 subordinate mortgage against the property. If the property is sold subject to the lease (but free and clear of the mortgage) a buyer will be expected to pay $700,000 (the $1 million value of the property if it was sold free and clear of the lease, minus the $300,000 lease value attributable to the below-market lease that will continue to encumber the property). The mortgagee will be entitled to receive $600,000 as adequate protection under section 363(e) and (f). The debtor's estate will be left with $100,000 from the sale.

If instead the tenant consents to the sale free and clear of the lease, the buyer will be expected to pay $1 million, but the $300,000 lease value will have to be paid to the tenant as adequate protection, in addition to the $600,000 that must be paid to the mortgagee. The debtor's estate again will be left with $100,000 from the sale.

If the priorities are reversed (the $600,000 mortgage has first priority and the lease with a $300,000 lease value is subordinate to the mortgage) then the distribution is reversed. The $100,000 is still distributed to the debtor. The economic effect on the debtor's estate is the same.

Assume instead that the free and clear value of the property is only $500,000 and the lease has first priority and the mortgage is subordinate to it. If the property is sold subject to the first priority lease, the expected sale price will be $200,000 ($500,000 minus the $300,000 lease value), all of which will be paid to the holder of the $600,000 mortgage. Instead, if the property is sold free and clear of the lease, then the $500,000 of sale proceeds will be paid as follows: $300,000 to the tenant for the lease value of its first priority lease that has been extinguished by the sale and, again, $200,000 to the mortgagee, and nothing to the debtor.

If the free and clear value of the property is only $500,000 and the lease with a $300,000 lease value instead is subordinate to the mortgage, then the

holder of the $600,000 mortgage will receive the entire $500,000 in sale proceeds, and the tenant and the debtor will receive nothing. In each of these scenarios, the tenant either retains the value of its lease or receives payment in an amount equal to the value of its interest in the property sold (which may be zero), the same aggregate amounts are distributed to the other entities that have an interest in the property sold, and the same amount is paid to the debtor's estate. The policy of equitable distribution is accomplished.

The policy of maximizing the value of the debtor's estate, by contrast, is undermined in some instances if the property must be sold subject to a lease, because the potential purchasers of the property will not include those who intend to buy the property in order to immediately occupy and use the tenant's space. Otherwise, the effect on the policy of maximizing value is neutral.

Finally, there is no generally discernible purpose in the Bankruptcy Code of protecting the non-debtor counterparty to a lease, whether landlord or tenant. The Code permits rejection of a lease that is burdensome to the debtor, in derogation of the contract between the parties and the non-debtor party's interests.[473] Beyond that general proposition, Congress has treated landlord-tenant issues with discrete provisions, some of which are advantageous[474] and some of which are disadvantageous[475] to the non-debtor party. Congress has addressed landlord-tenant issues by specific statutory terms aimed at specific situations.[476] It is difficult if not impossible to divine a congressional purpose of protecting the interests of tenants over those of lien holders in a debtor-landlord's bankruptcy proceeding that 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 distributions to creditors.

E. The Legislative History of Sections 365(h) and 363(f) Does Not Suggest Any Congressional Expectation that One Would Trump the Other

The legislative history of the Code does not indicate any congressional understanding that either section 365(h) or 363(f) trumps the other. The legislative history describes the protections for tenants under section 365(h) only in

473. *See, e.g.*, 11 U.S.C. § 365(d)(3) (2012).

474. *See, e.g.*, 11 U.S.C. § 365(d)(3) (debtor must timely perform prior to assuming or rejecting the lease); § 365(d)(4) (debtor must assume or reject within 120 days, which may be extended for no more than an additional 90 days, after which the lease is deemed rejected).

475. *See, e.g.*, 11 U.S.C. § 365(b)(2), (e), (f) (*ipso facto* provisions and prohibitions in lease against assignment are unenforceable); 11 U.S.C. § 502(b)(6) (2012) (cap on landlord's rejection damage claim).

476. *See, e.g.*, 11 U.S.C. § 365(b), (d).

the context of a rejection of the lease by the debtor-landlord, and does not address what priority a tenant's possessory interests have on a free and clear sale.[477] Explanations of the debtor's authority to sell free and clear of an interest and of the interest holders' rights to adequate protection include reference to "equitable as well as legal interests," but do not express any congressional concern for a special treatment of tenants on a sale.[478] The possible intersection between the two sections is not addressed.

The legislative history of the Code instead indicates a congressional direction that interests in the debtor's property should be determined based on the bargained-for, prepetition state law rights of the parties. "Bankruptcy policy strongly favors equality of treatment of all creditors and strongly disfavors the creation of property rights upon the filing of a bankruptcy case. . . Springing interests unfairly defeat legitimate expectations of other creditors who may have relied on the absence of any such prior interests in extending credit."[479] This bankruptcy policy accords with the continuation of the state law priorities of prepetition liens, leases, and other encumbrances against real property of the estate, per *Nobleman* and *Butner*.[480] Interpreting section 365(h) to trump the prepetition state law priorities of the holders of liens, leases, and other interests on a section 363(f) sale defeats those other parties' bargained-for legitimate expectations of what would they could expect to receive on account of their respective interests on a sale of the property. Nothing in the legislative history suggests a congressional intent to give a tenant an interest that springs into existence on the filing of a petition, that is so sacrosanct that on a sale of property free and clear of a subordinate lease the tenant's section 365(h) rights leapfrog and obtain priority over an existing mortgage the lender under which extended credit with the legitimate expectation that its lien would retain its priority. Yet that is precisely the result if section 365(h) is construed to trump section 363(f).

The cases citing legislative history or intent in support of the view that a subordinate tenant cannot be dispossessed by a free and clear sale cite to the congressional intent to protect a tenant on rejection under section 365(h).[481] But

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477. *See, e.g.*, H.R. REP. NO. 95-595, at 349 (1977); S. REP. NO. 95-989, at 60 (1978); H.R. REP. NO. 103-835, at 53 (1994).

478. *See, e.g.*, H.R. REP. NO. 95-595, at 345 (1977); S. REP. NO. 95-989, at 49, 56 (1978).

479. H.R. REP. NO. 95-595, at 456 (1977). *See also* S. REP. NO. 95-989, at 164 (1978).

480. Butner v. United States, 440 U.S. 48, 55 (1979) (1898 Act case); Nobelman v. Am. Sav. Bank, 508 U.S. 324, 329 (1993) (1978 Code case).

481. *See, e.g.*, *In re* Revel AC, 532 B.R. 216, 228 (Bankr. D.N.J. 2015); Dishi & Sons v. Bay Condos 510 B.R. 696, 705–06 (Bankr. S.D.N.Y. 2014) (stating that Section 70b of the Chandler Act rejected "the notion that the estate should be benefitted by removal of the tenant," and this purpose was

they give short (if any) shrift to the absence in the legislative history of any statements extending those protections to the tenant on a free and clear sale under section 363(f), or to the unequivocally enunciated policy in the legislative history against springing interests.[482] Those disfavored springing interests result, contrary to such policy, from an interpretation of a tenant's section 365(h) rights on rejection that reorders the priorities of liens and encumbrances on a sale free and clear.

F. Did Congress in the Bankruptcy Code Clearly Indicate a Departure from the Long-Established Bankruptcy Practice and Law of Free and Clear Sales?

Part VII began by asking if Congress clearly indicated that it "intended" to depart from or "erode prior bankruptcy practice" on a free and clear sale with respect to leases that are subordinate to liens and other encumbrances against the real property, and whether the text of the Bankruptcy Code elevates a lease that is subordinate under state law to the status of a first priority encumbrance against such property that the debtor seeks to sell. The answers are clear.

First, the pre-Code law and practice authorizing the sale of estate property free and clear of liens and encumbrances, including subordinate leases, was unequivocally established.[483] By this doctrine, a court sitting in bankruptcy, following the rule for a hypothetical foreclosure sale, could order the property to be sold free and clear of liens and other interests, could attach those liens and other interests to the sale proceeds, and could direct the distribution of those proceeds in accordance with state law lien priorities.[484] Most of the principal opinions, from *Ex Parte Christy* and *Nugent v. Boyd* in the 1840s construing the Bankruptcy Act of 1841 to *Van Huffel v. Harkelrode* interpreting the Act of 1898, actually described this as a power of foreclosure, or cited with approval

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reiterated in the House and Senate Reports to the 1978 version of § 365(h), which stated that, by operation of section 365(h), "the tenant will not be deprived of his estate for the term for which bargained." (citing S. REP. NO. 95-989, at 60 (1978) and H.R. REP. NO. 95-595, at 349 (1977))). As argued in this Article, the tenant also bargained for the priority of its leasehold estate, and the text and policies of the Code and pre-Code law and practice mandate the preservation of those priorities on application of sections 365(h) and 363(f)). *See also In re* Zota Petroleums, 482 B.R. 154, 161 (Bankr. E.D. Va. 2012); *In re* Haskell, 321 B.R. 1, 6–7 (Bankr. D. Mass. 2005); *In re* Taylor, 198 B.R. 142, 164–66 (Bankr. D.S.C. 1996); *In re* Churchill Props. III, Ltd. P'ship, 197 B.R. 283, 288 (Bankr. N.D. Ill. 1996); *In re* LHD Realty Corp., 20 B.R. 717, 719 (Bankr. S.D. Ind. 1982).

482. *See* cases cited *supra* note 481.

483. *See* discussion *supra* Part VI.

484. Ray v. Norseworthy, 90 U.S. 128, 134 (1874) (citing Houston v. City Bank of New Orleans, 47 U.S. 486, 506 (1848)).

those cases that so described the power.[485] The proceeding invoked was a hypothetical one exercised by the representative of the bankruptcy estate and not by any actual mortgagee.[486] The free and clear sale procedure established by the courts accomplished the stated purpose of reducing a bankrupt's assets to cash.[487]

State law determined the validity and priority of liens and other interests against the property sold, as it does under the present Code.[488] Then as now, under a state law foreclosure sale, the foreclosing mortgagee terminated only the liens and other interests that were subordinate to it.[489] Under that state law, if a lease had priority over the foreclosing mortgage the tenant could not be dispossessed and was entitled to remain in possession.[490] If instead the lease was subordinate to the foreclosing mortgage, the tenant could be dispossessed in the action, and would be entitled to payment of the value of its leasehold from the proceeds of sale after the payment of any prior mortgages and other liens and encumbrances.[491] If the lease was subordinate and was out of the money, the tenant would receive nothing.[492] The bankruptcy courts applied the same rules applicable to the priorities of the interests in the property being sold based on a hypothetical proceeding.

Pre-Code case law also established the power of the representative of the bankrupt's estate to reject leases and other executory contracts.[493] That authority ultimately was enacted by section 70b of the Chandler Act in 1938.[494] There

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485. *See generally Ex Parte* Christy, 44 U.S. 292 (1845); Nugent v. Boyd, 44 U.S. 426 (1845); Van Huffel v. Harkelrode, 284 U.S. 225 (1931).

486. *Ex Parte Christy*, 44 U.S. at 316–17 (1845) (Courts sitting in bankruptcy have the power "to redeem or foreclose, or to enforce, or to set aside such a lien, mortgage, or other security."); Nugent v. Boyd, 44 U.S. 426, 437 (1845); *Van Huffel*, 284 U.S. at 227–28 (1931) (The Bankruptcy Act of 1898 "contains no provision which in terms confers upon bankruptcy courts the power to sell property of the bankrupt free from encumbrances. We think it clear that the power was granted by implication. Like power had long been exercised by federal courts sitting in equity when ordering sales by receivers or on foreclosure. The lower federal courts have consistently held that the bankruptcy court possesses the power, stating that it must be implied from the general equity powers of the court and the duty imposed by § 2 of the Bankruptcy Act [11 USCA s 11] to collect, reduce to money and distribute the estates of bankrupts, and to determine controversies with relation thereto." (internal citations omitted)).

487. *See, e.g.*, *Van Huffel*, 284 U.S. at 228.

488. *See* cases cited *supra* note 486. *See also* Butner v. United States, 440 U.S. 48, 54 (1979).

489. *See supra* Parts V, VI.

490. *See supra* Parts V, VI.

491. *See supra* Parts V, VI.

492. *See supra* Part V.

493. *See* cases discussed *supra* Part VI.C.2.

494. Chandler Act in 1938, ch. 575, § 70(b), 52 Stat. 840 (1938).

are few opinions, either before or after the enactment of section 70b, that expressly considered the fate of a subordinated lease, whether or not previously disaffirmed or rejected, on a sale of the underlying property.[495] None was by the Supreme Court. But those decisions consistently recognized that though the debtor-landlord's rejection of the lease in and of itself might not end a tenant's possessory leasehold estate, the tenant's retained rights had the same priority that the lease had under state law and did not leapfrog prior liens, encumbrances, and other interests on a sale of the property.[496]

The Supreme Court consistently has held that it "will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure."[497] At the time the Code was enacted, the power of the courts in bankruptcy to order a sale free and clear in accordance with state law foreclosure principles, even though no such actual proceeding was available to the debtor, was established by the Supreme Court's construction of all three of the prior Bankruptcy Acts.[498] The courts in bankruptcy cases treated leases and other estates in land sold in bankruptcy proceedings in the same manner on a sale as did courts in a state law foreclosure proceeding, both before and after the enactment of section 70b of the Chandler Act.[499] Section 70b expressly preserved a tenant's "estate" on a landlord-debtor's rejection but, as is the case with the Code, said nothing of the fate on a sale of a subordinate leasehold estate or the debtor's possessory rights under it.[500]

Congress did not clearly indicate any change to existing bankruptcy law or practice regarding free and clear sales or the treatment of a lease on such a sale when it enacted the Bankruptcy Code in 1978 or in the subsequent amendments to it. Concerns arose following the decision in *In re Freeman*, discussed in Part VI.C.2 above, regarding precisely what the term "estate" under section 70b meant.[501] The judicial and scholarly consensus prior to enactment of the Bankruptcy Code in 1978 appears to have been that the clause in section 70b that provided that a debtor-landlord's *rejection* did "not deprive the lessee of his

495. *See* discussion *supra* Part VI.C.

496. Matter of Penn Cent. Trans. Co., 458 F. Supp. 1346, 1354–56 (E.D. Pa. 1978); Matter of N.Y. Inv'rs Mut. Grp., 153 F. Supp. 772, 777 (S.D.N.Y 1957); Cohen v. E. Netherland Holding Co., 258 F.2d 14, 16–17 (2d Cir. 1958); *In re* Freeman, 49 F. Supp. 163, 165 (S.D. Ga. 1943); Matter of Outrigger Club, 9. B.R. 152, 153 (Bankr. S.D. Fla. 1981). *See also In re* Hotel Governor Clinton, 96 F.2d 50, 51 (2d Cir. 1938) *cert. denied.* 305 U.S. 613 (1938) (pre-section 70b sale free and clear of subordinate lease).

497. Hamilton v. Lanning. 560 U.S. 505, 517 (2010) (citations omitted).

498. *See supra* Parts V, VI.

499. *See* discussion *supra* Part VI.

500. *See* discussion *supra* Part VI.C.2.

501. *See* discussion *supra* Part VI.C.2.

estate" meant that the tenant's "right to remain in possession for the reserved rent" was preserved for the remainder of the term.[502] Commentators had criticized *In re Freeman*, which held that the "estate" preserved was merely a tenancy at will, terminable under state law by the landlord on two months' notice, and that the trustee could alter the rent from that provided for in the lease and "charge and recover a reasonable rental for the demised premises until the end of the term."[503] Collier stated unequivocally that *Freeman* did "not represent the proper view of the effect of rejection of an unexpired lease by the debtor-landlord" under section 70b.[504]

Congress in 1978 clarified the tenant's treatment on a debtor-landlord's rejection, adopting in the Code the view that the key aspects of the "estate" preserved by section 70b were the tenant's right to possession for the remainder of the term at the rental stated in the rejected lease.[505] Under Code section 365(h) as enacted in 1978, the tenant could elect following rejection to "remain in possession for the balance of the term of such lease and any renewal or extension of such term that is enforceable by such lessee under applicable nonbankruptcy law."[506] The House Report explained that, by operation of section 365(h), if the debtor-landlord "rejects" the tenant can remain in possession and thus, is not "deprived of his estate for the term for which he bargained."[507]

In 1994, Congress clarified that if the tenant elects to remain in possession following the debtor-landlord's rejection, then the tenant's surviving rights under the rejected lease include "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

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502. *See* John J. Creedon & Robert M. Zinman, *Landlord's Bankrukptcy: Laissez Les Lessees*, 26 BUS. LAW. 1391, 1399, 1407, 1411–12 (1971) (citing JACOB L. WEINSTEIN, THE BANKRUPTCY LAW OF 1938—A COMPARATIVE ANALYSIS 159 (1938)); James Angell McLaughlin, *Amendment of the Bankruptcy Act*, 40 HARV. L. REV. 583 (1927)). Creedon and Zinman state that McLaughlin "thought that the tenant's 'estate' necessarily involved the right to stay in possession for the rent specified in the lease." *Id.* at 1407.

503. *In re* Freeman, 49 F. Supp. 163, 164–65 (S.D. Ga. 1943).

504. Creedon & Zinman, *supra* note 502, at 1431 (quoting 6 COLLIER ON BANKRUPTCY 603–04, ¶3.24(1.1) (14th ed. 1969)).

505. *Compare* 11 U.S.C. § 365(h) (1978), *with* Chandler Act, ch. 575, § 70(b), 52 Stat. 840 (1938).

506. 11 U.S.C. § 365(h).

507. H.R. REP. NO. 95-595, at 349 (1977).

applicable nonbankruptcy law."[508] The legislative history of the 1994 amendment indicates that it was enacted in response to some courts' strained limiting interpretation of the tenant's right to "possession" on rejection, and that Congress intended to protect a tenant from having its "rights stripped away if a debtor *rejects* its obligations as a lessor in bankruptcy."[509]

The 1994 amendment, similar to the 1978 Code that it amended, said nothing of the non-debtor tenant's rights on a free and clear sale, and was concerned only with the tenant's rights on rejection.[510] Nothing in section 365(h) or any other Code provision or the legislative history "clearly indicates" or even suggests any change to the pre-Code law and practice on a sale free and clear, under which the parties' prepetition state law lien and lease priorities remained in place, and continued to determine the non-debtor parties' respective interests in the sale property and the proceeds of sale.[511]

IX. CONCLUSION

The Bankruptcy Code on all of these analyses authorizes a debtor to sell property free and clear of a subordinate lease and the tenant's possessory rights under it, even if the lease has been rejected and the tenant has elected to remain in possession. Those decisions that utilize section 365(h) (or sections 363(f)(1) and (5) or 361(3)) to vault a subordinate lease ahead of prior mortgages and other interests are contrary to the text of section 363(f) regarding free and clear sales, sections 361 and 363(e) regarding adequate protection, and section 365(h). Those cases also are at odds with the Code's purposes of equitable distribution and maximizing value to creditors, and with more than 130 years of unvarying pre-Code law and practice that Congress has not indicated that it had changed by the Code or the amendments to it. Most significantly, those cases contravene the parties' bargained-for, prepetition state law property rights that *Butner* and *Nobleman* instruct must be preserved and vindicated on the filing of a bankruptcy case.

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508. Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, sec. 205, 108 Stat. 4106 (1994).

509. H.R. REP. NO. 103-835, at 45 (1994) (citing *In re* Carlton Rest., 151 B.R. 353, 354 (Bankr. E.D. Pa. 1993) (holding that the tenant's possessory rights on a rejection under the pre-1994 section 365(h) were personal, and could not be assigned by the tenant)).

510. Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, § 205, 108 Stat. 4106 (1994).

511. BFP v. Resolution Tr. Corp., 511 U.S. 531, 565–66 (1994) (Souter, J., dissenting) ("[W]hen the Bankruptcy Code is truly silent or ambiguous, it should not be read as departing from previous practice.") (citing Dewsnup v. Timm, 502 U.S. 410 (1992); Butner v. United States, 440 U.S. 48, 54 (1979)). Justice Scalia, in his dissent in *Dewsnup*, also stated his view that the Court should not venerate pre-Code law at the expense of plain statutory meaning. *Dewsnup*, 502 U.S. at 434 (Scalia, J., dissenting). As more particularly set forth in §§ IV and V, the text of sections 363(f) and 365(h) is clear and nothing in the Code suggests that a tenant's rights on a debtor-landlord's *rejection* change the priorities of liens, leases and other interests on a *sale*.

This does not mean that a tenant will always lose on a sale. A tenant will be entitled to the value its lease under section 361(1) or (3) if its lease has priority, or, if its lease is subordinate, to payment as adequate protection for the value of the lease to the extent that sufficient sale proceeds remain after payment of adequate protection to the holders of prior liens and other interests.

These outcomes preserve the pre-bankruptcy priorities of the parties' interests in the property sold and are those that would result from a foreclosure of a mortgage or other monetary lien against the property. Each of these results reflects the value of the parties' state law interests in the property per *Butner* and the adequate protection provisions of the Code.

The result in those cases that give special treatment to a subordinate lease on a free and clear sale is the windfall that *Butner* decried and the creation of a springing interest that Congress sought to prevent. If a bankruptcy sale can be made free and clear of monetary liens and other encumbrances including those having first priority against the property, but cannot be made free and clear of a subordinate lease, then the subordinate lease will ride through unscathed and the holders of liens and other encumbrances with priority will be penalized. A subordinate lease that is out-of-the-money will be magically transformed into a first priority encumbrance against the property, and the price that a buyer will be willing to pay for the property will be proportionately lower. If the sale proceeds are insufficient to pay in full the mortgages and other encumbrances that have lien priority over the lease, then their holders will be paid at a discount. The tenant under the below-market lease that is subordinate to those mortgages—who should receive nothing if the property is worth less than the claims secured by the mortgages—will remain in possession and thus, receive the full value of its lease ahead of the holders of those prior mortgages and encumbrances. These interpretations reverse the parties' state law priorities, undermine the uniformity required by *Butner*, and encourage forum-shopping both by a subordinate tenant who will prefer the bankruptcy proceeding because it will fare far better there and by a prior mortgagee who can be expected to seek stay relief from the bankruptcy court for the purpose foreclosing in a state court proceeding in which the priority of its lien will be recognized and preserved.

A lease encumbering a debtor's property should be treated on a free and clear sale as what it is: an encumbrance against the property that is prior to some interests and subordinate to others. The tenant is entitled to treatment in accordance with those priorities. The result urged by this Article is compelled by the text, purposes, and legislative history of the Bankruptcy Code, by Supreme Court precedent that defines property interests in a bankruptcy case on the basis of state law, and by more than 130 years of pre-Code law and practice that Congress has not indicated was changed by enactment of the Bankruptcy Code.

This outcome is not dictated by a harsh bankruptcy law or by the coldness of a debtor-landlord's heart. It is required instead by a bankruptcy law that vindicates bargained-for, prepetition state law property rights while maximizing the value of the debtor's assets for the equitable distribution to creditors, in a manner that is fundamentally fair to the parties.