CAN A LANDLORD'S BANKRUPTCY DESTROY A LEASE? A THIRD LOOK AT THE QUALITECH CASE

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A lien on nothing. That is exactly what a leasehold mortgagee[1] fears it will get when it accepts a ground lease as collateral for a commercial mortgage loan. The lease might terminate prematurely and destroy all of leasehold mortgagee's collateral, leaving the leasehold mortgagee with a lien on precisely nothing.

A long-term tenant shares similar fears, but leasehold mortgagees worry more than tenants. That's because, among other things: (i) leasehold mortgagees have less control over the situation than tenants do; (ii) lenders typically have more money at risk than their borrowers; (iii) lenders' internal procedures (and often regulators) focus on risk identification and mitigation; and (iv) lenders always worry more about everything than do equity investors, even though equity investors know they must look ahead to the worries of lenders if they want to obtain financing, which of course they always do.

Leasehold mortgagees, tenants, and their attorneys thus demand that leases include extensive leasehold mortgagee protections to prevent landlords from terminating leases too easily or too quickly. Leasehold mortgagees do anything they can to eliminate all risk of premature termination of the lease, building in leasehold mortgagee protections that range from the obvious to the arcane.[2]

Many leasehold mortgagees proclaimed the sky was falling in 2003, when the Seventh Circuit issued its decision in Precision Industries v. Qualitech (Qualitech).[3] Qualitech caused an uproar in the leasehold lending community because the decision—the details of which will follow—could be interpreted to give a bankrupt landlord a hitherto unknown way to destroy a lease. Specifically, Qualitech would potentially allow any landlord/debtor to sell the premises to a third party free and clear of the lease and without compensating the tenant for the loss of its lease. Commentators opined rapidly and widely that the potential for such sales would cause a disaster for leasehold mortgagees. The mere possibility of this risk scared at least a few lenders away from accepting leasehold mortgages.

Against this trend, this author (in 2004 and again in 2009) and a few others argued that the Qualitech decision did not justify any panic. As courts issued decisions in the wake of Qualitech, the case appeared to stand for the simple principle that the tenant must pay attention, object early and often, and request protection of its interest when faced with a bankrupt landlord.[4] This is hardly an

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earth-shattering notion. As more fully examined below, this simple principle remained true until some recent cases shifted course. So the sky wasn't falling.

Between 2003 and 2015, a series of bankruptcy cases (discussed later in this article) showed that Qualitech did not open the floodgates to lease terminations in landlord bankruptcy proceedings. Instead of giving Qualitech further credence, bankruptcy judges during that period consistently found reasons to steer clear of, if not actively spurn, the approach suggested by the Qualitech court—a good outcome for leasehold mortgagees everywhere.

A few cases decided after 2015 suggest that the potential opening created by Qualitech merits another look. Tenants must now do more than merely speak up when faced with a landlord bankruptcy; not a particularly novel idea. Tenants also must act quickly and comprehensively to seek protections under all relevant Bankruptcy Code provisions—again, not a particularly novel idea. But the important part is that if a leasehold mortgagee does not take these basic steps, it risks losing everything. The more recent judicial trends may mean that the legal risks that first arose in Qualitech have now become too perilous for a typical risk-averse leasehold mortgagee to stomach.

Section 363 vs Section 365

Before Qualitech, bankruptcy court decisions on landlord/debtors were not very interesting. When a landlord/debtor tried to use Bankruptcy Code section 363 to sell property and extinguish an existing lease, courts consistently protected leasehold estates by invoking Bankruptcy Code section 365(h). A basic check and checkmate.

Section 363 allows any debtor in bankruptcy, with court approval, to raise money by selling its property free and clear of any interest of any other party in the same property (a "landlord's free and clear sale").[5] Section 365(h), in contrast, allows the landlord to reject an unexpired lease, while also giving the tenant the option to remain in possession under most terms of the rejected lease. So, section 365(h) does not give unhappy bankrupt landlords a useful lease termination technique. Before Qualitech, section 365's tenant protections consistently trumped a landlord's free and clear sale. That is no longer so clearly the case given the Qualitech case and later history as described in this article.

New risks of section 363 introduced by Qualitech

The Qualitech case moved away from the historical approach described in the previous paragraph, which allowed tenants to rely on section 365(h) to preserve their leases. The case started from straightforward facts with the burden of some odd procedural history.

Qualitech leased land to Precision Industries, Inc. (Precision) for 10 years at nominal rent. Precision built a warehouse on the land. Qualitech soon filed for Chapter 11 bankruptcy protection. Qualitech (landlord), at that point in bankruptcy, notified Precision (tenant) that landlord proposed a landlord's free and clear sale of the premises. Precision did not object in any way to the proposal. Actually, Precision didn't do or say a single thing about it. This was not exactly an example of circling the wagons to protect a valuable leasehold estate.

Treating Precision's leasehold estate as a property interest,[6] the bankruptcy court authorized landlord's free and clear sale under section 363 free of the property interest arising under Precision's leasehold estate. The buyer (a successful bankruptcy sale bidder—none other than, in effect, the holder of a huge fee mortgage encumbering Qualitech's leasehold estate)[7] locked Precision out of its leased warehouse. Precision finally paid some attention to the landlord's free and clear sale and sued, at last showing signs of life. The buyer argued that the landlord's free and clear sale terminated Precision's leasehold estate. The Seventh Circuit agreed.

If Precision had mortgaged its leasehold estate (it had not), then the landlord's free and clear sale would have destroyed the leasehold mortgagee's entire collateral—a leasehold mortgagee's worst nightmare. If courts interpreted Qualitech to freely allow landlord's free and clear sales, Qualitech would

have introduced a lease destruction technique previously unknown to leasehold mortgagees and their counsel. Things did not play out this way, but the possibility caused a great deal of angst.

As an aside, a typical fee mortgage perhaps would have had priority over Precision's lease, perhaps accompanied by a nondisturbance agreement between the fee mortgagee and Precision. Qualitech says nothing on either point. Would Precision's lease have survived if a nondisturbance agreement existed between Qualitech and Precision, and Precision had paid attention? Not necessarily.

Nondisturbance agreements typically protect a tenant in the case where the fee mortgagee acquires the premises through foreclosure. By their terms, these agreements often do not necessarily protect the tenant if the fee estate is sold through a landlord's free and clear sale to the fee mortgagee or anyone else. Fee mortgagees often hesitate to provide the latter with nondisturbance protection because the fee mortgagee cannot control or prevent the landlord's Insolvency Proceeding or free and clear sale.[8] In practice, this may not matter much because single-asset landlords rarely end up in bankruptcy court. But it could happen. So, fee mortgagees worry about it. They will worry more if it ever actually does happen and receives widespread publicity.

A deeper look at Qualitech

In the years soon after Qualitech, courts handling landlord bankruptcy proceedings did not follow Qualitech to roll out a new lease destruction technique or a flood of lease terminations. Until 2015, as described below, Qualitech had been primarily limited in its application. The decisions sometimes described Qualitech, perhaps tongue-in-cheek, as "the minority view." Most courts readily avoided following Qualitech by emphasizing its unique facts, i.e., the fact that Precision never objected to the landlord's free and clear sale and thus lost its lease. The Seventh Circuit effectively treated Precision's silence as consent or a self-inflicted wound.

If Precision had objected to Qualitech's sale, the Bankruptcy Code might have protected Precision's leasehold estate. At a minimum, it might have required Qualitech to show it had satisfied the statutory requirements for its landlord's free and clear sale. Section 363(f) allows a landlord's free and clear sale (in this case, free and clear of Precision's leasehold estate) only if the landlord meets one of these five tests:

1. State non-bankruptcy law allows the sale free of the interest;
2. The holder of the interest consents;
3. The interest is a lien securing an amount less than the sale price;
4. The interest is in bona fide dispute; or
5. The holder of the interest could legally be compelled to accept payment for and release its lien.

The Seventh Circuit never actually stated which of the five tests Precision's leasehold estate met. Based on the facts, the only possible test that Qualitech could have satisfied was test 2, i.e., Precision consented. Instead, the court slid past the issue in a rather vague, perhaps even glib, footnote:

> [W]e shall assume, as [the new property owner] asserts, that one or more of the statutory criteria were met and that a sale of the property free and clear of Precision's possessory interest as tenant was permissible.[9]

Based on Precision's failure to say anything to the contrary, perhaps the court's assumption was reasonable. If Precision had unambiguously withheld consent to the sale (eliminating any argument for satisfaction of test 2) and asserted that Qualitech satisfied no other test under section 363(f), that would very likely have changed the outcome. Precision might still occupy its warehouse. At a minimum, Precision would have put the evidentiary burden on Qualitech to meet one of the other four tests in section 363(f).

Though the Qualitech result seemed to this author very narrow and fact-specific, in the wake of the decision some writers called it a disaster for leasehold mortgagees.[10] They strongly urged Congress to

enact legislation to protect leasehold estate investments from the new perceived risks arising from Qualitech. For example, one author argued that Qualitech would create problems and risks "severe enough to result in serious problems for the future of leasehold financing and investment unless they are resolved now."[11] A decade and a half later those serious problems have still not yet materialized and Congress still has not gotten around to resolving them. Joe Biden, Nancy Pelosi, and Charles Schumer seem to have their hands full trying to remake the American economy and devalue the dollar. Legislation to protect leasehold mortgagees from Qualitech probably won't sound the bugle call of battle for them.

The commentators' concerns about Qualitech focused on an issue of statutory interpretation that lies at the heart of the Seventh Circuit's decision. In reaching its decision, the Qualitech court considered the tension between the two bankruptcy statutes introduced above. Until Qualitech, no one seemed to care about or consider the proposition that a leasehold estate might constitute an "interest" that a debtor could terminate through a landlord's free and clear sale under section 363. Nowadays, not only does everyone care about it, but some people consider it chiseled in stone.

The second bankruptcy statute, section 365(h), allows a bankrupt landlord to reject a burdensome lease, while also allowing the tenant to remain in possession under most terms of the lease. Section 365(h) once offered the only available technique—though not a very good one—for bankrupt landlords to try to get out from under burdensome leases.

The lower court in Qualitech adopted the then-majority view that sections 363(f) and 365(h) conflicted. It resolved the conflict in favor of section 365(h) and protecting tenants' rights. The district court concluded that a bankrupt landlord could proceed against tenant only by rejecting the lease under section 365(h). This is exactly the result that Qualitech, as landlord, did not want. Qualitech took the obvious next step: It appealed.

The Seventh Circuit reversed, holding that Qualitech need not worry about section 365(h) if it satisfied any section 363(f) test to proceed with a landlord's free and clear sale. The landlord could then treat a leasehold estate as an "interest" capable of being destroyed by a landlord's free and clear sale. And, thus, the Seventh Circuit begat the minority view. The Seventh Circuit saw no conflict between the two statutes, stating that they "apply to two distinct sets of circumstances": (i) section 363(f) applies to sales of property in the bankruptcy estate; and (ii) section 365(h) applies when a debtor chooses to reject a lease.[12] Nice and tidy.

The appellate court further rejected the majority view by declaring that "the plain language" of section 365(h) "says nothing at all about … sales of estate property[.]"[13] For such sales, the court reasoned, the tenant had no need for the protections of section 365 because section 363 builds in other tenant protections. Section 363(e) requires the bankruptcy court to provide "adequate protection" of an interest if the interest holder demands it. But Precision didn't bother to demand section 363(e) protection. As a result the court did not expound further on that provision or how it might apply. So, the Seventh Circuit reversed the district court's, and affirmed the bankruptcy court's, decision that Qualitech's free and clear sale extinguished Precision's leasehold estate.

This author's 2004 article[14] questioned the alarmist reaction to Qualitech. Precision lost because it sat on its rights under section 363(f) and did not demand adequate protection under section 363(e). It did not lose because the Seventh Circuit invented a magic sword that gives any bankrupt landlord a new technique to terminate an unwanted lease. Precision, after receiving notice of the proposed landlord's free and clear sale, simply failed to object to it, failed to ask for adequate protection, essentially failed to do anything at all, and thus lost its rights. Even under the most debtor-oriented reading of Qualitech, the tenant (or more likely the tenant's leasehold mortgagee) could have prevented the landlord's free and clear sale by simply standing up in court, objecting, and demanding adequate protection. This author

thus concluded that leasehold mortgagees' world would not end because of Qualitech. And it didn't. Score one for this author.

The entire problem in Qualitech arose from Precision's failure to do anything to exercise its statutory right to protect itself. As shown in the first three post-Qualitech cases below, bankruptcy courts interpreted Qualitech narrowly and distinguished it based on its facts. Until very recently (see later cases below), bankruptcy courts stuck to the pre-Qualitech approach of asserting the supremacy of section 365(h) over section 363(f), thus protecting tenants. The balance of this article discusses a handful of post-Qualitech cases, followed by a summary conclusion and a response from a prominent commentator who disagrees with the author's view of Qualitech.

In re Haskell L.P.

In In re Haskell L.P.,[15] Haskell owned an assisted living facility, part of which New England Baptist Hospital (NEBH) leased under a 99-year lease to operate a short-term stay facility. NEBH paid no rent, except operating expenses and real estate taxes. Haskell filed for Chapter 11 bankruptcy protection and tried to terminate NEBH's lease through a landlord's free and clear sale. Haskell also filed a motion to reject the lease under section 365. Unlike the procedural history in Qualitech, NEBH took action and vigorously objected to Haskell's proposed landlord's free and clear sale. NEBH tried to protect its leasehold estate. In other words, it did what it was supposed to do under the statute.

Haskell argued that it could sell its fee estate free and clear of the lease because, under section 363(f)(5), NEBH could be compelled to accept money in satisfaction of its claim. Just as the Qualitech court had done, the Haskell bankruptcy court looked at the relationship between sections 363 and 365. The court found that NEBH could "[not] be compelled to accept money for its rejected lease under § 363(f)(5) in view of the provisions of § 365(h),"[16] as doing so would turn the meaning of section 365(h) upside down. The court also held that NEBH's interest could not be adequately protected unless it actually retained possession under its lease.[17] The court thus rejected the proposed landlord's free and clear sale and allowed NEBH to keep its lease.

In re Samaritan Alliance, LLC

Two years later, in In re Samaritan Alliance, LLC,[18] a Kentucky bankruptcy court similarly recognized a tenant's right to object to a landlord's free and clear sale and preserve its leasehold estate. In Samaritan Alliance, the sublandlord/debtor, Samaritan Alliance, master-leased a hospital from Ventas (the fee estate owner). Samaritan Alliance then entered into various sublease agreements with Cardinal Hill (the subtenant). Soon after, Samaritan Alliance (the sublandlord) filed for Chapter 11 bankruptcy protection. Ventas and Samaritan Alliance (the landlord and sublandlord) undertook various transactions, including terminating their master lease, culminating in Samaritan Alliance's attempt to sell its leasehold estate free and clear of Cardinal Hill's subleases to a third party.

Samaritan Alliance never bothered to tell Cardinal Hill that its sublease had been terminated when the master lease was terminated. Bad idea. When Cardinal Hill got wind of what was happening, it objected. Good idea. The Kentucky bankruptcy court held that the third-party purchaser of Samaritan Alliance's leasehold estate did not acquire it free and clear of Cardinal Hill's subtenancy. The court, explicitly following Haskell, concluded that section 365(h) preserved Cardinal Hill's possessory interests under its sublease and nothing in section 363 allowed termination of those interests. Thus, Cardinal Hill could stay in its subleased space for the remainder of the term—another tenant-friendly result.

MMH

A third decision, MMH (described below), continued the trend of lower courts running as far away as possible from the Qualitech approach. This time the court upheld a landlord's free and clear sale under section 363 (a la Qualitech), while also applying section 363 to protect and value the tenant's (and

consequently any potential leasehold mortgagee's) legitimate interest in the leased premises.

South Motor Co. v. Carter-Pritchett-Hodges, Inc.

In South Motor Co. v. Carter-Pritchett-Hodges, Inc. (In re MMH Auto. Group, LLC),[19] RGA Investment Inc. (RGA) leased a billboard to Carter-Pritchett-Hodges, Inc. (CPH) for 99 years in exchange for a single upfront payment of $15,000. RGA then sold the fee estate to MMH Automotive Group, LLC (MMH) subject to the billboard lease. MMH eventually filed for Chapter 7 bankruptcy protection. MMH did not mention CPH's lease in MMH's schedule of executory contracts and unexpired leases. MMH's trustee never bothered to file a motion to reject it.

MMH ultimately sold the premises to South Motor Company through a landlord's free and clear sale. When South Motor Company discovered the billboard lease, it sought to enforce the sale order and obtain a declaration that CPH had no protected interest in the premises. Fortunately for MMH, the Florida bankruptcy court confirmed the sale, while also providing adequate protection for CPH's leasehold estate.

The court's willingness to protect CPH's leasehold estate implied a belief that section 365(h) did not trump MMH's landlord's free and clear sale, essentially agreeing with Qualitech. The court held that it must consider the application of both section 363(f) and section 365(h) based on the facts before it. The court found that section 365(h) could not protect CPH's interest in its lease because MMH had never rejected (nor assumed) the lease. The court next analyzed whether the landlord's free and clear sale satisfied any of the five tests in section 363(f), concluding that it did. CPH could be compelled to accept a money satisfaction for its leasehold estate because CPH's lease included a liquidated buy-out provision in which tenant had agreed to a $60,000 (plus interest) termination payment. That buy-out provision meant CPH could be compelled to accept a money satisfaction for its leasehold estate.

The court upheld MMH's landlord's free and clear sale. Notably, although CPH did not assert a section 363(e) "adequate protection" claim because it never received notice of the sale, the court assumed CPH would have made that claim. Applying the same reasoning, the court held that, to adequately protect CPH's interest, MMH should pay CPH an amount equal to the value of the leasehold estate from MMH's sale proceeds. The court thus ordered that CPH receive $60,000 plus interest as the value of CPH's leasehold estate, the exact amount in the buy-out clause in the lease.

If leasehold mortgagees fretted over their investments after the Qualitech case, Haskell and Samaritan Alliance perhaps relaxed them. These latter two cases confirmed this author's original view, consistent with the majority of courts since Qualitech, that tenants can protect themselves by simply objecting to landlords' attempts at free and clear sales. The MMH decision bolstered this position and went further by assuming tenants who were not given the opportunity to object would have objected and requested adequate protection. (The Qualitech court had made no similar assumption and instead more or less assumed the opposite.)

Although these early cases should have comforted leasehold mortgagees, more recent case law reveals a growing confusion and complexity—verging on judicial agony—on when and how to apply the Qualitech minority and majority views. In recent years, some courts have interpreted section 363(f) to allow the complete extinguishment of possessory leasehold estates, including tenants' rights typically protected under section 365(h).[20] As seen in the cases discussed below, courts now seem to apply these potentially conflicting statutes by relying on fact-based discretion—also known as goal-oriented jurisprudence—not uncommon in bankruptcy law. Discretionary jurisprudence of this type may "do justice" in a particular case, but it erodes the solid legal foundation necessary to support leasehold financing.

Dishi & Sons v. Bay Condos LLC

The first example of this trend appeared in a 2014 Southern District of New York decision. That

decision, described below, relied on Qualitech to reject the then-majority view that a leasehold estate is absolutely protected under section 365(h) and immune from a landlord's free and clear sale.

In Dishi & Sons v. Bay Condos LLC,[21] Bay Condos owned two commercial condominium units in New York City encumbered by a $13,500,000 fee mortgage. Dishi & Sons LLC (Dishi) acquired the fee mortgage. Dishi proposed a plan of reorganization for Bay Condos and a landlord's free and clear sale of the condo units. Dishi's proposed plan also called for rejection of all nonresidential leases, including one to a bar and restaurant called The Ginger Man (TGM). Dishi asked the bankruptcy court to approve a sale free and clear of TGM's rejected lease. TGM objected and argued for protection of its leasehold estate under section 365(h).

The bankruptcy court sided with the majority view and treated Qualitech as a narrow decision limited to bafflingly lazy tenants. Though the court approved Dishi's sale, the sale would take place subject to TGM's leasehold estate for these two reasons:

1. Section 365(h) took priority over section 363(f) to protect TGM's right to remain in possession; and
2. Even if section 363(f) allows a free and clear sale, a party with a leasehold estate is entitled to require adequate protection under section 363(e). Under the facts of Dishi, adequate protection required continuation of TGM's possession.

The Southern District of New York affirmed the bankruptcy court's decision to protect TGM's continuing possessory rights. But it agreed only with the bankruptcy court's adequate protection reasoning (reason number 2, above). It disagreed with the bankruptcy court's reasoning on conflicting statutes (reason number 1, above).

In contrast to the bankruptcy court, the district court took the opposing minority position, consistent with Qualitech, concluding that section 365(h) does not absolutely protect leasehold estates. The court distinguished a section 363 sale from a lease rejection, stating that the protection of section 365(h) applies only when a debtor rejects a lease. When a section 363 sale also occurs, however, the court must perform a separate analysis under section 363(f). "In sum, Sections 363(f) and 365(h) should be read harmoniously as addressing distinct issues."[22]

Unlike the procedural history in Qualitech: (i) Dishi's proposed plan consisted of both a lease rejection and a landlord's free and clear sale; and (ii) TGM (tenant) stood up and objected to the sale. The district court therefore bifurcated its analysis, starting with the lease rejection. It upheld TGM's possessory right under section 365(h) but declared ominously, "[t]he majority interpretation proves too much. The purpose of section 365(h) is to clarify that rejection is not an avoidance power—not to give the tenant rights that may never be avoided by some other means."[23]

Breaking away from the majority view, the district court then undertook a separate analysis of whether Dishi could accomplish a landlord's free and clear sale under one of the five tests in section 363(f). Specifically, it analyzed section 363(f)(1) (state law allows the sale free of the interest) and section 363(f)(5) (the holder of the interest could legally be compelled to accept payment), deciding Dishi had satisfied neither test. Under each test, the court narrowly interpreted state law—New York mortgage foreclosure law—to protect tenant's possessory interest. The court opined that mortgage foreclosure law was not akin to a bankruptcy sale because in a foreclosure a debtor does not have enough control to protect its estate. In contrast, bankruptcy laws were designed to empower a trustee to create value and protect the debtor's estate.

Finally, the court affirmed the bankruptcy court's determination that, if faced with a landlord's free and clear sale, the correct way to protect TGM's leasehold estate was by providing adequate protection under section 363(e), not through section 365(h). The district court further concluded that, under section 363(e), TGM should have the right to remain in possession to protect its interest "in light of the Debtor's capital structure and the nature of the interest at stake."[24]

In the end, the district court got it right and protected TGM's leasehold possessory rights. But getting there required a long, intricate, and endlessly fascinating Alice-in-Wonderland legal discussion. It shouldn't be so painful. The holdings of Dishi mean a landlord cannot readily meet any test under section 363(f) to proceed with a landlord's free and clear sale. The court adopted narrow, tenant-friendly interpretations of state law under section 363(f)(1) and section 363(f)(5) and confirmed the importance of protecting tenant's possessory rights under both section 363(e) and section 365(h). The court prioritized a tenant's (and thus presumably any leasehold mortgagee's) rights over a landlord's ability to accomplish a landlord's free and clear sale.

The Dishi decision remains a bit of a concern because it continued to erode the majority view of the absolute nature of the tenant protection delivered by section 365(h). The court's reasoning offered further support for Qualitech's position that section 365(h) does not automatically protect a tenant from a landlord's free and clear sale—only from a rejection. Moreover, the decision left to the next court's discretion when to require adequate protection and what form that might take.

Unfortunately for tenants—and contrary to this author's original view that the sky was not falling for leasehold mortgagees—other recent decisions have relied on Dishi and Qualitech to push the minority view even further. Though doomsday has not yet arrived, courts seem increasingly confused over their discretionary power to use section 363(f) to allow a landlord's free and clear sale to extinguish a tenant's possessory rights or section 365(h) to protect those rights. When courts get confused, results can become unpredictable, especially in bankruptcy. Not a good state of affairs for tenants and leasehold mortgagees trying to rely on settled legal principles to support substantial long-term real estate investments.

In re Revel AC, Inc.

In In re Revel AC, Inc.,[25] a 2015 lower court considered the case of a "catastrophically failed" landlord. There, the landlord wanted to accomplish a landlord's free and clear sale even though numerous tenants both: (i) clearly and vocally objected to the sale; and (ii) asserted their adequate protection rights. On appeal, the Third Circuit troublingly allowed the landlord's free and clear sale to go forward, extinguishing all leasehold estates but one.

In 2012, Revel AC, Inc. (Revel) and its affiliates opened a 47-story, 710-foot-high resort casino in Atlantic City, New Jersey—one of the most expensive hotels ever built anywhere. It cost about $2.4 billion. It housed, among many other things, an array of leased nightclubs, restaurants, spas, and retail shops (the amenity tenants). In 2014, Revel filed for Chapter 11 relief, its second tour through bankruptcy in its short life. The debtor asked the bankruptcy court to authorize bidding procedures, an auction, and a landlord's free and clear sale of the hotel.

In response to the bankruptcy filing, the amenity tenants filed section 365(h) objections to the sale motion, demanding adequate protection for their possessory interests under their leases. Over those objections, the bankruptcy court approved bidding procedures and set an auction date. The first iteration of the asset purchase agreement for the fee estate carved out the amenity tenants' leases as permitted encumbrances, meaning they would survive the sale and any buyer would have to live with them. The debtor struggled for years to find a suitable buyer. Eventually Revel shut its doors during negotiations with what appeared to be its final suitor, Polo North Country Club, Inc. (Polo North).

In the eleventh hour before approval of the sale, Polo North proposed to the bankruptcy court that all existing leases be deemed rejected by Revel and the property be transferred free of any section 365(h) protections. The amenity tenants did not like that idea. They argued that:

- Section 365(h) protected their possessory interests;
- In the alternative, Revel did not (as it had claimed) meet the "bona fide dispute" test of

- section 363(f)(4), because all amenity tenants operated under true leases; and
- Even if the landlord had met the test of section 363(f)(4), the amenity tenants deserved adequate protection—i.e., continued possession—under section 363(e).

Separately, IDEA Boardwalk Inc. (IDEA), operator of the hotel's night clubs, requested a declaratory judgment confirming that it held rights appurtenant to its lease, including an easement for electrical cables that would allow it to operate its night clubs without relying upon the shuttered casino's electrical service.

The bankruptcy court, which had devoted years to presiding over Revel's various failed sales attempts, devoted just two days to a hearing on the Polo North sale motion. The court rejected all three of the amenity tenants' arguments, dismissed IDEA's motion, and approved the sale free and clear of all amenity tenants' leases.

In response to amenity tenants' first argument, the court—relying on Qualitech—concluded that section 365(h) did not absolutely protect leasehold estates from a landlord's free and clear sale.

In response to amenity tenants' second argument, the court found that a "bona fide dispute" existed about the nature of the agreements between Revel and the amenity tenants. Without so much as looking at the leases, the court declared that these agreements were like partnership agreements, not true leases, on the ground that Revel relied on the amenity tenants to provide lifestyle experiences for its hotel and casino guests. The notion that a lease might benefit the landlord's larger project was apparently beyond the court's comprehension.

Having met the section 363(f)(4) test, Revel could extinguish the amenity tenants' interests through the Polo North sale. The amenity tenants' section 363(e) adequate protection arguments simply did not apply.

The amenity tenants appealed to the district court for a stay of the sale order, making the same three arguments—all good and persuasive. Though parties are supposed to meet higher standards of proof on a stay motion (i.e., "likelihood of success on the merits" and the lower court's "clear error), the district court made it very easy for Revel to beat the motion. The district court rejected all three of amenity tenants' arguments:

1. Regarding the interplay of sections 363 and 365, it found no "clear error" in the bankruptcy court's decision to follow Qualitech. Instead, "[g]iven the paucity of authority on these issues, and the absence of any controlling precedent,"[26] the lower court did not err by allowing destruction of amenity tenants' leasehold estates.
2. In considering the section 363(f)(4) "bona fide dispute" test, it cut Revel even more slack by concluding that the landlord only needed to articulate "*some* factual or legal dispute" regarding the true nature of the leases.[27] The bankruptcy court did not clearly err, the district court said, because—though the bankruptcy court never bothered to review amenity tenants' leases—it heard "lengthy proffers concerning the disputed agreements."[28] Hence some form of dispute existed, according to the district court, and that was enough.
3. On the issue of adequate protection, it held the amenity tenants would be more adequately protected by pursuing damages for lease rejections than keeping their leases. (Good luck with that in a bankruptcy proceeding!) Given a "catastrophically failed" casino on the property, maintaining the amenity tenants' leases would be catastrophically inadequate protection, according to the court. Notably, the court also opined that "adequate protection would not appear to require full, nor ideal, protection. Rather, adequate protection would appear to include that which suffices under the circumstances." Adequate protection, then, doesn't necessarily need to meet any particular test of adequacy.[29]

The Revel district court thus further chipped away at the tenant protections of section 365(h) and further paved the way for debtors to accomplish landlord's free and clear sales in a way that destroys tenants'

leasehold estates. In this author's view, that was a terrible result. Adding to the confusion, the court refused to acknowledge the strength of the majority view, instead highlighting the uncertain interaction between the two bankruptcy statutes and the lack of clear precedent. Though amenity tenants vocally and repeatedly objected to the landlord's free and clear sale—a winning tactic in previous cases—the court sided with the landlord's interest in selling the property unburdened by the leases.

The story does not end there. IDEA appealed to the Third Circuit. It operated a successful nightclub and asked only for preservation of an electricity easement to run its nightclub. IDEA had invested $16 million in construction, which was unlikely to be recouped by suing the hemorrhaging Revel for damages—the comically inadequate version of "adequate protection" endorsed by the bankruptcy court and approved by the district court.

The Third Circuit reversed the district court's decision on IDEA—and only IDEA—holding that Revel's sale of the hotel was subject to IDEA's lease, protected under section 365(h).[30] The holding was based on Revel's extremely weak proffer of evidence, specifically:

- Revel offered no evidence of any "bona fide dispute" regarding IDEA's lease. On a de novo review of the lease, the Third Circuit found language in the lease that: (i) stated that the lease created no relationship except landlord and tenant; and (ii) required IDEA to pay percentage rent in a manner common for similar tenants.[31]
- Revel failed to prove it faced irreparable harm if the landlord's free and clear sale were subject to IDEA's lease. Revel merely presented statements that IDEA's rent was based on a profit split, testimony that the relationship was more akin to a partnership than a lease, and speculation that Polo North would jump ship if IDEA's lease remained. The Third Circuit concluded that none of these statements would suffice to deny IDEA protection for its leasehold estate under section 365(h).

Taking a step back, the Third Circuit's Revel opinion did not pick sides. Instead, it struck a middle position between Qualitech and the majority view. In a tenant-friendly move, the Third Circuit applied section 365(h) to protect IDEA's rights, but it first undertook the landlord-friendly (Qualitech) analysis of whether any test in section 363(f) would allow the landlord's free and clear sale. The Third Circuit rightly concluded that Revel failed miserably. But the decision gave section 365(h) protection only to IDEA,[32] presumably leaving intact the termination of all other amenity tenants' leases and destruction of their businesses. More troublesome, the Third Circuit did not take the opportunity to clearly state which view it adopted—Qualitech or the majority. Instead, it added to the confusion that the lower court highlighted in its opinion.

In any bankruptcy proceedings subject to the Revel precedent, then, it is unclear what law a bankruptcy court should follow when faced with similar facts. And that risk of uncertainty may very well scare leasehold mortgagees.

The mounting judicial confusion displayed in Revel has spread. As recently as July 2017, other courts have used Qualitech to continue chipping away at the protections of section 365(h). The only other federal appellate court to take a position, the Ninth Circuit, firmly sided with the Qualitech minority. At least in any bankruptcy proceedings subject to that precedent, the tenant can no longer protect its leasehold estate by simply standing up and objecting to the landlord's free and clear sale.

In re Spanish Peaks Holdings II, LLC

In In re Spanish Peaks Holdings II, LLC[33] (Spanish Peaks) the Ninth Circuit affirmed a landlord's free and clear sale of a ski and golf resort in Big Sky, Montana over the objections of two tenants. The landlord's property was encumbered by a $130 million mortgage, eventually assigned to CH SP Acquisitions LLC (CH SP). The landlord filed bankruptcy and asked the court to approve a plan and a landlord's free and clear sale to CH SP free and clear of all interests. The

tenants objected, asserting their possessory rights under section 365(h).

The district court, affirming the bankruptcy court's approval of the sale, relied on some facts unfavorable to tenants, including: (i) the rents were far below market ($1,000 per year for 99 years); (ii) one tenant (a restaurant) had not operated for years; (iii) the mortgage was senior to the leases; (iv) the tenants had no nondisturbance protections; and (v) the tenants and landlord were under common control. The tenants appealed.

Unlike the Third Circuit's silence in Revel, the Ninth Circuit clarified when and how it would apply and harmonize sections 363(f) and 365(h). The court unequivocally adopted Qualitech's minority view—the statutes do not conflict. "In sum, section 363 governs the sale of estate property, while section 365 governs the formal rejection of a lease. Where there is a sale, but no rejection (or a rejection but no sale), there is no conflict."[34] In a footnote, the court distinguished the Dishi facts—rejection before a sale—as irrelevant to its decision. The tenants thus could not rely on section 365 to protect themselves because the trustee never rejected the leases.

The Ninth Circuit did not stop there. It outright rejected the Dishi court's concern that allowing section 363 to override section 365 would effectively repeal the tenant protections of section 365(h).[35] The appellate court pointed to broad language in section 363 as proof that Congress intended the adequate protection requirement of section 363—and not section 365(h)—to protect tenants from potentially abusive landlords' free and clear sales. Because the Spanish Peaks tenants first raised their adequate protection claims on appeal to the district court—and during the bankruptcy case—the Ninth Circuit refused to consider whether the tenants deserved adequate protection under section 363(e). The court mentioned, however, that a possible form of adequate protection in other cases might consist of retaining possession of the leased premises.

The court then focused on section 363(f)(1), which allows a landlord's free and clear sale to destroy an interest if that interest could be extinguished under applicable non-bankruptcy law. The court found that the section 363(f)(1) test was satisfied (and the CH SP sale could proceed) because Montana foreclosure law would have allowed CH SP to terminate the leases in a foreclosure sale. It rejected the tenant-favorable Dishi holding that mortgage foreclosure law could not be used to satisfy section 363(f)(1), declaring instead that the Dishi court went too far by enhancing the tenants' rights instead of just protecting them.[36]

The Ninth Circuit pounded one more nail into the coffin of the majority view. It stated sinisterly that, although section 365(h) embodies congressional intent to protect tenants, "[t]hat intent is not absolute; it exists alongside other purposes and sometimes conflicts with them." The court reasoned that a fee estate burdened by a lease will presumably sell for a lower price. Giving tenants a section 365(h) trump card would thus violate "another core purpose of bankruptcy law, namely maximizing creditor recovery." The Ninth Circuit's words are just what a leasehold mortgagee does not want to hear.

Before leasehold mortgagees or their counsel conclude that the sky is finally falling as a result of Qualitech, they should note that Spanish Peaks included some noteworthy distinguishing facts. First, the landlord's trustee never rejected the disputed leases. The Spanish Peaks holding thus doesn't affect a landlord's free and clear sale after lease rejection. In that circumstance (rejection then sale), courts probably have discretion to protect a tenant's leasehold estate by either applying the broad protection of section 365(h) (the majority view) or the adequate protection requirement of section 363(e) (the Dishi approach).

Also noteworthy: the Spanish Peaks tenants held favorable below-market leases, did not obtain subordination or nondisturbance agreements from fee mortgagees, and did not record their leases. In contrast to Revel's nightclub operator that needed only an electricity easement to continue its successful operations, the Spanish Peaks restaurant had been closed for six years. These facts could limit

the Spanish Peaks holding to the occasional case where the tenant's leasehold estate is so trivial that it should not burden landlord's free and clear sale. The Ninth Circuit did not, however, specifically limit its decision to the facts before it.

Spanish Peaks indicates that this author was overly optimistic in thinking Qualitech would apply only to cases where the tenant fails to object to the landlord's free and clear sale. Though it is too soon to gauge the impact of Spanish Peaks outside the Ninth Circuit, a real risk exists that courts will no longer automatically protect tenants when bankrupt landlords try to wipe out leases through landlord's free and clear sales. The facts of individual cases and bankruptcy courts' discretionary views on adequate protection will likely determine the outcome—not an appealing state of the law for leasehold mortgagees.

Lessons learned

These recent landlord-friendly decisions shine the spotlight again on Qualitech and can teach tenants and leasehold mortgagees some important lessons:

- Qualitech is not dead! Nor is it limited to the lazy tenant who fails to object to a landlord's free and clear sale. To the contrary, through judicial expansion and creativity, the Qualitech principles have opened the door to dangerous new lease termination techniques in bankruptcy proceedings.
- Tenants should obtain clear, comprehensive subordinations by fee mortgagees. Recording a lease may provide additional protection, though normal principles of real estate law say recordation shouldn't matter if the tenant is in possession. (Ground leases typically cover all three bases: subordination, recordation, and possession.)
- If the landlord enters bankruptcy, the tenant should understand and immediately assert all its rights under the Bankruptcy Code—both section 365(h) and section 363(e). Do not assume section 365(h) will provide protection. Be ready to demand adequate protection under section 363(e).
- The "majority" view may no longer be followed by a majority of courts. What law applies will depend on where the property is located and which precedent discussed in this article applies.
- Courts may still strive to protect the possessory rights of successfully operating tenants. But the protection is not automatic. It may be random. Maximizing creditor recovery in the landlord's bankruptcy may be valued as or more highly.
- Pay attention to leases and landlords. This is no great new insight, but worth mentioning. If the tenant or leasehold mortgagee receives notice, or catches wind, of the landlord's bankruptcy or a proposal for a landlord's free and clear sale, act immediately.

Based on these lessons, leasehold mortgagees may want to make sure their loan documents cover at least these points:

- The tenant/borrower should agree to object vociferously if the landlord attempts to terminate the lease through a landlord's free and clear sale. Requiring the tenant/borrower to "protect" the leasehold estate may not be enough.
- The leasehold mortgagee should have the right to take any steps necessary to protect its collateral, including trying to block a landlord's free and clear sale. The loan documents should clearly give the leasehold mortgagee that authority. It may require some form of agency appointment.[37]
- The tenant/borrower should agree not to allow the landlord to terminate the lease through a landlord's free and clear sale. Both the loan documents and the lease should give the leasehold mortgagee the right to stand up and object to such a sale.
- A tenant/borrower should be prohibited from agreeing to accept a monetary payment in exchange for its leasehold estate. This language creates a preemptive defense against the landlord's use of section 363(f)(5) to extinguish the lease (attempted and rejected in Haskell). Given

the recent focus on section 363(e)'s adequate protection clause, this language may help.

- The leasehold mortgagee may want to seek nonrecourse carveout guaranties to backstop some or all of these suggested covenants.

One final thought. This author previously believed the push for legislation, urged by some commentators and supported by the ABA, to unscramble the Qualitech morass had proven unnecessary.[38] Those legislative efforts stalled. Leasehold mortgagees are now left with the decisions discussed above, some problematic and confusing. Without clear guidance, courts will likely remain confused and follow the trends and judicial goals of the moment. Early cases trended towards applying section 363 in a sensible way to protect leasehold estates consistent with tenants' and leasehold mortgagees' expectations. Recent cases trend elsewhere: ambiguity, discretion, and sympathy for landlord's free and clear sales.

After Spanish Peaks and the continuing inconsistency in decisions, the time may have come to revisit earlier calls for legislative clarity. Congress can alleviate the mounting anxiety of leasehold mortgagees (or what should be the mounting anxiety of leasehold mortgagees) by confirming that a landlord's free and clear sale simply cannot extinguish a tenant's leasehold estate.[39] That should not be a difficult or controversial proposition if considered outside the heat of a particular bankruptcy dispute.

AFTERWORD FROM PROFESSOR ZINMAN

Note: Professor Robert M. Zinman, whose article on the Qualitech case is mentioned extensively in the discussion above, was invited to add his own comments, which follow. They include the specific statutory changes that Professor Zinman recommends.

Congress should act now on Qualitech

In the height of the excitement over the implications of the Qualitech decision for leasehold investments, an excitement described by Joshua Stein above, I found myself as a keynote speaker at the John Marshall Law School symposium on real estate. My assignment was to try to make some sense of, and make suggestions for dealing with the effects of, that decision. After much thought and study, my conclusions were incorporated in an article, Precision in Statutory Drafting: The Qualitech Quagmire and the Sad History of section 365(h) of the Bankruptcy Code, 38 John Marshall L. Rev. 97 (2001) (referred to as the 2001 Article) as follows:

1. The Seventh Circuit was probably correct in concluding that: (i) section 363(f) of the Bankruptcy Code (dealing with the ability of a landlord in bankruptcy to sell its property free and clear of another entity's interest in that property) and section 365(h) (where a landlord in bankruptcy remains as owner of property but can reject a tenant's lease of the property) are two distinct provisions that deal with two entirely different circumstances; and (ii) both sections contain separate requirements designed to protect parties injured by any such sale or rejection. See 2001 Article, Part D, pp. 128-149 on protections for parties injured by a free and clear sale, and 2001 Article, Part I, pp. 102-119 on protections for the lessee or parties with interests in the lease injured by its rejection.
2. Although Congress has indicated its intent to protect a tenant when a landlord rejects a lease, there appears to be no statutory basis to find that the protections afforded the lessee or persons with interests in a lease rejected under section 365 would protect, or were designed to afford protection to, a person with an interest adversely affected by a free and clear sale of property under section 363(f).
3. Section 365(h) was amended many times over the years, to strengthen protection for the lessee against innumerable attempts to frustrate that protection. See 2001 Article, Part I, pp. 102-119.
4. On the other hand, section 363(f) and section 363(e), while intended to provide protection to a party whose interest is adversely affected by a free and clear sale, were not given enough attention in the drafting stage. They consequently fail to provide for that protection. See 2001 Article, Part D, pp. 128-149.

5. To correct this situation: (i) detailed proposed amendments to sections 363(e), (f) and (k) were suggested in the 2001 Article Appendix, designed to make those sections effective in accomplishing the purpose for which they were written; and (ii) a quick-fix optional additional amendment was proposed that would simply make section 365(h) superior to section 363 in protecting the rights of a party adversely affected by a free and clear sale. The American Bar Association proposed the quick-fix amendment to Congress but it stalled. Congress never adopted it.

As Joshua Stein points out, the majority of courts dealing with the Qualitech issues seem to support the argument that the protections in section 365 should be applied to free and clear sales under section 363. My research does not support the conclusions of those courts. Recent decisions, as analyzed by Joshua Stein, take a more cautious approach and are more consistent with the Qualitech approach. The real estate community should promote adoption of either the comprehensive amendments proposed in the Zinman Appendix that would clear up the drafting ambiguities in section 363, or promote the quick-fix approach to deal solely with Qualitech before a really bad decision brings leasehold investments to a halt.

Professor Zinman's statutory proposals

Note: The Appendix to the 2001 Article proposed two possible statutory changes. The first proposal, as mentioned above, consisted of detailed proposed amendments to several subsections of section 363. The second, a "quick fix," would merely add a new subsection 363(g) after subsection 363(f), with suitable re-labelling of the remaining subsections. Both proposals are reprinted here, without the accompanying commentary that appeared in the 2001 Article. Additions are underscored. Deletions are ~~crossed out~~. *Minor changes in format are not marked.*

Detailed proposed amendments

(e) Notwithstanding any other provision of this section, at any time, on request of an entity that has an interest in property used, sold, or leased, or proposed to be used, sold, or leased, by the trustee, the court, with or without a hearing, shall prohibit or condition such use, sale, or lease as is necessary to provide adequate protection of such interest. This subsection also applies to property that is subject to any unexpired lease of personal property (to the exclusion of such property being subject to an order to grant relief from the stay under section 362). As used in this subsection, an entity that has an interest in property used, sold, or leased, or proposed to be used, sold or leased, includes a leasehold mortgagee, sublessee or other entity with an interest in such entity's interest.

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

(1) applicable nonbankruptcy law permits sale of such property by the debtor free and clear of such interest;

(2) such entity and any entity holding a leasehold mortgage, sublease or other interest in such entity's interest consents....

(4) the validity of such interest is in bona fide dispute; or

…

(5) such entity could be compelled by the debtor, in a legal or equitable proceeding under nonbankruptcy law, to accept a money satisfaction of such interest.

Subject to the foregoing, a court may order a property sold free and clear of an interest in the property of an entity other than the estate only at a fair upset price that will produce moneys sufficient to compensate fully the holder of such interest after paving prior administrative expenses chargeable to the sale and other prior claims or interests.

(k) Unless the court for cause orders otherwise, at ~~At~~ a sale under subsection (b) of this section, an

entity that has an interest in, or a claim secured by a lien on the property proposed to be sold, ~~of property that is subject to a lien that secures an allowed claim, unless the court for cause orders otherwise~~ the holder of such interest or claim may, bid at such sale, and, if such ~~the~~ holder ~~of such claim~~ purchases such property, such holder may offset such claim or the value of such interest against the purchase price of such property~~.~~ after payment of prior administrative expenses chargeable to the sale and other prior claims or interests. Prior to the sale, the court shall determine the value of any interest in order to carry out the purpose of this subsection.

Possible addition after section 363(f) — Professor Zinman's quick fix described above:

(g) Any sale of real property pursuant to subsection (f) shall be subiect to the provisions of § 365 that govern the assumption, assignment and rejection of leases.

Notes

1 This article will appear, in different form, as part of the author's upcoming multivolume New Guide to Ground Leases, successor to a book published in 2005 by ALI CLE's predecessor organization. Toward that end, comments on this article will be appreciated. All references to "sections" are to the United States Bankruptcy Code.

2 For a summary of typical leasehold mortgagee protections, see Joshua Stein, Model Ground Lease Criteria for CMBS and Other Lenders, 37 Prac. Real Est. Law. 11 (May 2021).

3 Precision Industries, Inc. v. Qualitech Steel SBQ, LLC (In re Qualitech Steel Corp. & Qualitech Steel Holdings Corp.), 327 F.3d 537 (7th Cir. 2003).

4 See, e.g., John C. Murray, Bankruptcy Court Holds Tenant's Rights Must be Protected When Landlord-Debtor Attempts to Sell Property Free and Clear of Lease (2005), http://files.ali-cle.org/thumbs/datastorage/skoobesruoc/pdf/CL004-CH114_thumb.pdf/; John C. Murray, Precision Industries Part I: Debtor-Lessor's Property May Be Sold "Free and Clear" of Unexpired Lease, 18 Prob. & Prop. 10, 14-15 (Mar./Apr. 2004). In the latter article, Murray concluded:

[T]he [Qualitech] opinion is perhaps not as devastating to tenants as it might appear. Indeed, given the limited circumstances in which a section 363(f) sale is allowed, [Qualitech] seems to be an anomalous case … [It] is not the end of Western Civilization as we know it, as some commentators seem to believe.

5 The statute does not define "interest." The courts have not reliably filled that gap. See John A. Nasr, Selling Assets Free and Clear of an Interest in Property under Sec. 363(f): An Examination of the TWA and Chrysler Bankruptcies and Successor Liability Issues, 11 DePaul Bus. & Com. L.J. 237 (2013).

6 The court's willingness to treat Precision's leasehold estate as an "interest" in real estate raised some eyebrows in the bankruptcy community, unjustifiably in the opinion of the author, who is not a bankruptcy lawyer. The definition of "interest" lies outside the present discussion. The author considers it intuitively obvious that a leasehold estate constitutes an interest in real property. Of course, intuition is not always the best guide to bankruptcy or any other law.

7 Qualitech, supra note 3, 327 F.3d at 541.

8 In a typical nondisturbance agreement, a fee mortgagee also would not have agreed to protect the tenant's possessory rights if: (i) the landlord/debtor rejected the lease; (ii) the tenant accepted the rejection (intentionally or not); (iii) and after that, the fee mortgagee or its designee acquired the fee estate through any bankruptcy transfer, not limited to a landlord's free and clear sale. This hypothetical seems rather unlikely. But it is at least as conceivable as many other unlikely hypothetical eventualities that spawn significant verbiage in real estate documents, such as temporary partial condemnation.

The issue seems more likely to arise in the context of a nondisturbance agreement protecting a hotel manager. There, the landlord/debtor can reject the management agreement and the hotel manager has no tenant-like rights to remain in possession under 11 U.S.C. § 365(h). Hence, a careful hotel manager should insist, in any nondisturbance agreement with a fee mortgagee, that if the landlord rejects the management agreement and then consummates any transfer of the fee estate under the Bankruptcy Code, the hotel manager will receive nondisturbance protection. The fee mortgagee may agree to that concept, but very likely only in the limited case where the transferee is a fee mortgagee or its affiliate or designee. And then the hotel manager will be left with a potential gap in its nondisturbance protection. The bankruptcy-related gaps in nondisturbance agreements described in this footnote and the accompanying text have not elicited as much concern as perhaps they should. Maybe that's because so far no one has suffered a loss. If that changes, Tenants may worry more about these weaknesses in nondisturbance agreements.

9 Qualitech, supra note 3, 327 F.3d at 546 n.3.

10 Qualitech joined a distinguished series of left-field bankruptcy decisions that temporarily struck terror into the hearts of lenders but were ultimately corrected. Others in that series:

(i) Durrett v. Washington Nat'l Ins. Co., 621 F.2d 201 (5th Cir. 1980) (setting aside as a preferential transfer a prop-

erly conducted foreclosure sale because the successful bid was less than 70 percent of the property's value), overruled, BFP v. Resolution Trust Corp., 511 U.S. 531 (1994);

(ii) In Re Carlton Restaurant, Inc., 151 B.R. 353 (Bankr. E.D. Pa. 1993) (the tenant cannot assign its rights after the landlord rejects the lease), later repaired by statute;

and (iii) United States v. Fleet Factors Corp., 901 F.2d 1550 (11th Cir. 1990) (secured creditor potentially liable if its participation in management could influence treatment of hazardous waste), later repaired by statute. The author welcomes additions to this august list.

11 Robert M. Zinman in Precision in Statutory Drafting: The Qualitech Quagmire and the Sad History of section 365(h) of the Bankruptcy Code, 38 J. Marshall L. Rev. 97, 101 (2005) (2001 Article).

See also Michael St. Patrick Baxter, landlord's free and clear sales Free and Clear of Interests: Why the Seventh Circuit Erred in Precision Industries v. Qualitech Steel, 59 Bus. Law 475, 475 (2004) (arguing that "[t]he Seventh Circuit's decision in Precision Industries will have profound implications not only on bankruptcy sales but on real estate leasing and real estate lease financing");

Harris Ominsky, Bankrupt Landlord Sale Terminates Leases (July 2003), https://www.blankrome.com/siteFiles/publications//35C5EC85C5EF59BE1483AF54AC9D7CB7.pdf (the decision "can be viewed as a bankruptcy bombshell that will reverberate in legal circles around the country");

posting of Patrick A. Randolph, randolphp@umkc.edu, to dirt@umkc.edu (Apr. 29, 2003) (on file with author) (describing Qualitech as "a bombshell on the order of magnitude of Durrett and Fleet Factors" and arguing that "interested parties should seek to muster support for a petition for en banc rehearing and, if necessary, a Supreme Court appeal. It puts virtually all long term leases and leasehold mortgages in mortal danger when the landlord files for bankruptcy.");

letter from ABA to Congress regarding Proposed Technical Amendment to Bankruptcy Code Regarding Certain Sales of Real Property (Nov. 15, 2007) (on file with author) (urging Congress to enact legislation related to sections 363(f) and 365(h) to rectify the "problematic" holding in Qualitech that could "eviscerate the special provisions of section 365(h)") (the ABA Letter).

12 Qualitech, supra note 3, 327 F.3d 548.

13 Id. at 547.

14 Joshua Stein, Is the Sky Falling on leasehold mortgagees?—Ground Lease Financing after Qualitech, 20 Prac. Real Est. Law. 6 (July 2004.)

15 In re Haskell L.P., 321 B.R. 1 (Bankr. D. Mass. 2005).

16 Id. at 9.

17 Id. at 10-11.

18 In re Samaritan Alliance, LLC, 58 Collier Bankr. Cas. 2d (MB) 1635 (Bankr. E.D. Ky. Nov. 21, 2007).

19 South Motor Co. v. Carter-Pritchett-Hodges, Inc. (In re MMH Auto. Group, LLC), 385 B.R. 347 (Bankr. S.D. Fla. 2008).

20 As early as 2007, bankruptcy courts showed some inclination to follow Qualitech. See In re Sophie H. Ng, No. 06-30904, 2007 Bankr. LEXIS 4212 (Bankr. N.D. Cal. Dec. 13, 2007). The case includes no factual history to shed any light on the context or the court's conclusion. The case does seem to suggest that, as in Qualitech, Tenant never objected or sought to have her interests protected.

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

22 Id. at 13.

23 Id. at 12.

24 Id. at 14.

25 In re Revel AC, Inc., 525 B.R. 12 (D.N.J. 2015).

26 Id. at 11.

27 Id. at 12 (emphasis in original).

28 Id.

29 Id. at 14.

30 In re Revel AC, Inc., 802 F.3d 558 (3rd Cir. 2015).

31 Id. at 574

32 Id. at 575

33 Pinnacle Rest. at Big Sky LLC v. CH SP Acquisitions LLC (In re Spanish Peaks Holdings II, LLC), No. 15-35572, 2017 U.S. App. LEXIS 12526, 2017 WL 2979660 (9th Cir. 2017).

34 Id. at 15.

35 Id.

36 Id. at 17. The court did not comment on what would have happened if the tenants had obtained subordination or nondisturbance agreements from the fee mortgagee. Presumably, the hypothetical fee mortgagee foreclosure sale would not have terminated their rights. So, in that case, the court probably could not have relied on Montana's mortgage foreclosure laws to allow a landlord's free and clear sale under section 363(f)(1). This gives tenants another good (but very arcane) reason to demand such agreements.

37 Before exercising any such authority, of course, a leasehold mortgagee should consider any potential claims or defenses it might give the borrower. Perhaps a prescient leasehold mortgagee will have already negated any such claims or defenses in its loan documents.

38 See Christopher C. Genovese, Precision Industries v. Qualitech Steel: Easing the Tension Between Sections 363 and 365 of the Bankruptcy Code?, 39 Real Prop. Prob. & Trust. J. 627, 649 (2004) ("This clear division among authorities [on the proper application of sections 363 and 365] demonstrates the need for Congress to intervene and provide guidance about what it desires as a result."); 2001 Article; ABA Letter.

39 In the rare case where a lease gives the landlord a right to terminate by paying money, the landlord/debtor in bankruptcy could certainly exercise that right as a business decision, with or without help from section 363. No reason exists to take away in bankruptcy any such freely negotiated right.