

BILL TO OVERRULE QUALITECH DECISION INTRODUCED IN HOUSE OF REPRESENTATIVES WITH ABA'S SUPPORT

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On July 30, 2010, after a persistent, seven-year effort by the American Bar Association's Real Property Trust and Estate Law Section, United States Representative William Lacy Clay of Missouri introduced a bill to overrule the Seventh Circuit Court of Appeals' decision in *Precision Industries, Inc. v. Qualitech SBQ, LLC*, 327 F.3d 537 (7th Cir. 2003), which permits a lessor that is the subject of a bankruptcy case or his or her bankruptcy trustee to sell real estate free and clear of a leasehold interest under section 363 of the Federal Bankruptcy Code. This development represents the culmination of the Real Property Division's endeavors, begun in 2003, to obtain a congressional sponsor for such a proposed statute.

Section 363(f) of the Bankruptcy Code permits a debtor or its bankruptcy trustee to sell the debtor's real or personal property free and clear of "interests" provided that at least one of five separate conditions is met. Section 365 of the Bankruptcy Code, on the other hand, addresses how "unexpired leases" may be treated in bankruptcy cases. In the situation where a lessor of real estate is the subject of the bankruptcy case, the lessor or its trustee may reject the lease but, upon such rejection, the tenant may choose one of two alternatives. Section 365(h) of the Bankruptcy Code permits the non-debtor lessee either (i) to treat the lease as terminated by the rejection and vacate the premises; or (ii) to remain in possession for the remaining term of the lease (and any renewals or extensions) and offset against the rent otherwise due under the lease certain damages caused by the rejection. Prior to the *Qualitech* decision, bankruptcy courts held that, if a lessor's real estate was sold under section 363 of the Bankruptcy Code, the sale could not be made free and clear of the lessee's interest but that the lessee could, in the context of an asset sale, elect to treat the lease as having been terminated or remain in possession with rent offsets, as permitted in the context of a lease rejection.

All of this was tossed into a cocked hat when the Seventh Circuit published its *Qualitech* decision. In *Qualitech*, the Chapter 11 debtor proposed in the absence of the lessee's consent to sell commercial real estate free and clear of "interests" which included the leasehold interest. On appeal, the Seventh Circuit sustained the sale free and clear, reasoning that a lessee's two choices provided by section 365(h) in the context of a lease rejection did not restrict sales of real estate free and clear of interests. The Court noted that the lessee could have demanded adequate protection of its leasehold interest in connection with the sale but failed to do so. As a consequence, the lessee was dispossessed from the leased premises as a result of the sale. Since the *Qualitech* decision was published, subsequent court decisions have split on this issue. Compare *In re Haskell*, 321 B.R. 1 (Bankr.D.Mass. 2005) (refusing to follow *Qualitech*, the bankruptcy court denied the sale motion) with *In re MMH Automotive Group, LLC*, 385 B.R. 347 (S.D.Fla 2008) (*Qualitech* decision followed to sustain the sale).

In 2003 shortly after the *Qualitech* decision was announced, the Real Property Division established a working group consisting of Michael D. Goler, Raymond J.

Werner and Patrick E. Mears to determine whether and under what circumstances Congress might be approached to adopt legislation overruling the Seventh Circuit's interpretation of section 363. In 2005, Congress enacted the Bankruptcy Abuse Prevention and Consumer Protection Act that amended the Bankruptcy Code in many important respects but did not address this important issue. One year later at the Section's Leadership Meeting in Scottsdale, Arizona, the Section Council approved a proposal for submission of a Recommendation and Report prepared by the working group to the ABA House of Delegates at its meeting during the 2007 Midyear Meeting in Miami, Florida. The language of this Report and Recommendation, which urged Congress to adopt legislation overruling *Qualitech*, was thereafter negotiated with representatives of the Business Law, Legislation and other ABA Sections. Although the Report and Recommendation was withdrawn from consideration at this meeting for further consideration, it was nevertheless resubmitted to the ABA House of Delegates at the ABA's Annual Meeting in August, 2007 and adopted at that time.

On January 11, 2010, Patrick E. Mears on behalf of the Section visited with counsel to both the House and Senate Judiciary Committees in Washington, D.C. in the company of representatives of the ABA Governmental Affairs Office to discuss proposed legislation overruling *Qualitech* in accordance with the Report and Recommendation. These visits were productive and resulted in the submission by Representative Clay of H.R. 6020 entitled "The Tenant Rights Restoration Act of 2010." This bill is short and to the point. It proposes to amend section 363 of the Bankruptcy Code by adding a new subsection "(r)" that grants to a non-debtor lessee in the context of a proposed sale of a debtor/lessor's real estate the two choices that are available to a lessee where its lease is rejected by the lessor in its bankruptcy case. This legislation, if adopted, would consign *Qualitech*, like the *Mensheviks* in 1917, to the "dustbin of history" and preserve a non-debtor's leasehold interest notwithstanding the sale of the underlying real estate.

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