
COVID-19 HIGHLIGHTED FUNDAMENTAL FAILURES IN § 365 OF
THE BANKRUPTCY CODE: UTILIZING OPTION-VALUE THEORY
TO ASSUME OR REJECT EXECUTORY CONTRACTS IN
BANKRUPTCY

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COVID-19 highlighted inherent problems existing within the Bankruptcy Code (the “Code”), namely, the inflexible timelines in §365(d)(4) given to real property tenant-debtors to assume or reject leases. The Consolidated Appropriations Act of 2021 attempted to solve this problem by modifying the treatment of unexpired leases of real property in bankruptcy. This Note argues that the legislation ultimately failed to address underlying issues present in the Code.

Instead, this Note analogizes the debtor’s assumption or rejection power in bankruptcy as a costless option. Understanding § 365 under this option-value paradigm allows us to realize that prolonged waiting periods in the Code cause landlords to lose-out on value of their unexpired leases. Debtors should be allowed more flexibility to extend the period to assume or reject their leases, but in return they should be required to internalize the added costs of waiting.

If we take the perspective that, at the moment of commencement, an unexpired lease converts to a costless option for the tenant-debtor, we can calculate the value of such an option using the Black-Scholes model and allow for the landlord to recover the lease-value amount as an administrative expense in bankruptcy. As such, we can allow the landlord to recoup some of the lost value of the unexpired lease as compensation for letting the tenant-debtor extend their option over time.

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I. INTRODUCTION

On December 27, 2020, President Donald Trump signed into law the Consolidated Appropriations Act of 2021 (“CAA”), one of the largest spending measures ever enacted in the United States.¹ Most notably, the purpose of this legislation was to provide a new round of economic stimulus—over 900 billion dollars—to millions of Americans during the COVID-19 pandemic.² But the whopping five-thousand page bill also included other provisions buried beneath the economic rollout.³ In fact, in response to the number of riders to the bill, some legislators like Alexandria Ocasio-Cortez expressed public frustration

1. See Consolidated Appropriations Act of 2021, Pub. L. No. 116-260 (enrolled bill); Caitlin Emma & Marianne Levine, *Breaking Down the \$900B Stimulus Package and \$1.4T Omnibus Bill*, POLITICO (Dec. 21, 2020, 10:26 PM), <https://www.politico.com/news/2020/12/20/details-stimulus-package-omnibus-bill-449499> [<https://perma.cc/3W7U-JEXC>]; David Guadagnoli, Jacob Lloyd, Jeffrey Morlend & Amy Sheridan, *Key Provisions of the Consolidated Appropriations Act, 2021 for Business and Individuals*, JDSUPRA (Jan. 26, 2021), <https://www.jdsupra.com/legalnews/key-provisions-of-the-consolidated-2031866/> [<https://perma.cc/7UL3-7W5X>].

2. *Senate Passes Virus Relief, Sends Bill to Trump: Congress Update*, BLOOMBERG NEWS (Dec. 21, 2020, 11:34 PM), <https://www.bloomberg.com/news/articles/2020-12-21/relief-bill-set-for-votes-in-house-senate-congress-update> [<https://perma.cc/3WWK-EUPS>] (“The total bill is worth more than \$2.3 trillion, including support for small businesses impacted by the pandemic, \$600 payments for most individuals, supplemental unemployment insurance, regular funding for federal agencies and a bevy of tax breaks for companies.”).

3. Andrew Taylor, *\$900B COVID Relief Bill Passed by Congress, Sent to Trump*, AP NEWS (Dec. 22, 2020), <https://apnews.com/article/congress-900-billion-coronavirus-bill-75389549d3eaf2f3828b16d45c9706e6> [<https://perma.cc/YP63-ZEKE>] (“The 5,593-page legislation—by far the longest bill ever—came together Sunday after months of battling, posturing and postelection negotiating that reined in a number of Democratic demands as the end of the congressional session approached.”); Jennifer Haberkorn, *Congress Approves New Stimulus Plan that Includes Checks for Many Americans*, LA TIMES (Dec. 21, 2020, 8:47 PM), <https://www.latimes.com/politics/story/2020-12-21/congress-includes-historic-measures-in-government-funding-pandemic-relief-bills> [<https://perma.cc/7ZFZ-GNLL>] (“Congress on Monday approved a spending bill providing a new round of economic stimulus to millions of Americans struggling during the coronavirus pandemic, in a massive piece of legislation stuffed with a buffet of unrelated provisions that include halting so-called “surprise medical billing” and creating new Smithsonian museums dedicated to Latinos and women.”); Eriq Gardner, *The COVID-19 Stimulus Bill Would Make Illegal Streaming a Felony*, HOLLYWOOD REP. (Dec. 21, 2020, 11:32 AM), https://www.hollywoodreporter.com/thr-esq/the-covid-19-stimulus-bill-would-make-illegal-streaming-a-felony?utm_source=twitter&utm_medium=social [<https://perma.cc/L2PK-BAMC>].

about the inadequate time to digest the contents of the bill before being required to vote.⁴ Nevertheless, in the late months of 2020, the CAA became the law.⁵

One section of the CAA which has eluded newspaper headlines is a section titled “Bankruptcy Relief,”⁶ which includes significant changes to the United States Bankruptcy Code (“Code”).⁷ Among other changes, the bankruptcy amendments to the CAA allow small business debtors additional time to pay rent, certain preference protections for landlords and suppliers, and provisions for select small business debtors to obtain Paycheck Protection Program (“PPP”) loans.⁸ In short, the changes in the CAA provide temporary relief and flexibility—within the bankruptcy context—to debtors, landlords, tenants, and vendors who have been materially impacted by the COVID-19 pandemic.⁹ This Note discusses one particular CAA amendment to the Code: the modification of the treatment of debtors’ unexpired leases of nonresidential real property in bankruptcy.¹⁰

Prior to the CAA, bankrupt debtors who had nonresidential real property faced two significant challenges regarding their unexpired leases. First, commercial tenant-debtors were required to assume or reject their entire portfolio of unexpired leases before a 120-day deadline set forth in § 365(d)(4).¹¹

For context, the Code typically allows commercial tenants in bankruptcy to either assume a beneficial unexpired lease or reject an above-market lease and pay damages to the landlord.¹² In this way, under normal circumstances, debtors have the advantage of deciding to keep leases that are beneficial to the debtor after bankruptcy—meaning they would choose to “assume” these beneficial leases—and rejecting those unexpired leases which no longer benefit them (usually because rent under these leases are above-market). However, the Code forces tenant-debtors into a time-crunch to perform the assumption-rejection analysis on their entire portfolio before certain deadlines set forth in § 365(d)(4), at which point all unassumed leases are considered “rejected.”¹³

Second, the Code imposes an additional challenge for commercial tenant-debtors: the requirement to perform all obligations under the unexpired lease while the bankruptcy is pending.¹⁴ Under § 365(d)(3)(A) of the Code,

4. Alexandria Ocasio-Cortez (@AOC), TWITTER, (Dec. 21, 2020, 4:15 PM) <https://twitter.com/AOC/status/1341145260014100480> [<https://perma.cc/Q9BP-UWXR>] (“Members of Congress have not read this bill. It’s over 5000 pages, arrived at 2pm today, and we are told to expect a vote on it in 2 hours. This isn’t governance. It’s hostage-taking.”).

5. See Consolidated Appropriations Act of 2021, Pub. L. No. 116-260 (enrolled bill) (accessible via <https://www.congress.gov/bill/116th-congress/house-bill/133/text/enr>) [<https://perma.cc/35FB-UB78>].

6. *Id.* at Div. FF, Title X.

7. 11 U.S.C. § 101 et seq. (as amended in 2020).

8. See Consolidated Appropriations Act of 2021, Pub. L. No. 116-260.

9. Lisa Vandesteeg, Harold Israel, and Sean Williams, *Key Takeaways from CAA Amendments to Bankruptcy Code; No Extension of Cares Act Provision Increasing Eligibility for Subchapter V*, LEVENFELD PEARLSTEIN, LLC (Jan. 7, 2021), <https://www.lplegal.com/content/key-takeaways-caa-amendments-bankruptcy-code-cares-act> [<https://perma.cc/S3RS-Q5RS>].

10. Consolidated Appropriations Act of 2021, Pub. L. No. 116-260, Div. FF, Title X, sec. 1001(f).

11. 11 U.S.C. § 365(d)(4) (pre-CAA).

12. *Id.* at § 365(d)(2).

13. *Id.* at § 365(d)(4).

14. *Id.* at § 365(d)(3)(A) (as amended in 2020).

commercial debtors are required to “timely” perform post-petition obligations arising from unexpired nonresidential leases, including paying rent as soon as it becomes due.¹⁵

As such, before the CAA bankruptcy amendments, debtors faced a one-two punch: First, they had limited time to assume or reject all their leases during the 120-day period (which could be extended to a limited cap of 210 days “for cause”).¹⁶ Additionally, the debtors were required to continue spending valuable resources paying rent and maintaining day-to-day operations.¹⁷

The COVID-19 pandemic exacerbated these challenges faced by tenant-debtors.¹⁸ Specifically, COVID-19 dealt a particularly damaging blow to tenant-debtors in the consumer retail industry in the United States.¹⁹ COVID-19 exposed brick-and-mortar retailers to financial hurdles, accelerating existing trends of e-commerce in an increasingly digitalized society, and limited consumer foot traffic across the United States.²⁰ In 2020 alone, popular brick-and-mortar retailers like J. Crew, True Religion, Modell’s Sporting Goods, Pier 1, and J.C. Penney all sought Chapter 11 protection to stay afloat and stymie their creditors.²¹ In response to the COVID-19 pandemic, many additional consumer retail tenants across the United States have been forced to shutter their doors and file bankruptcy due to unexpected shortages in cash flow.²²

Surprisingly, in response to the unprecedented effects of COVID-19, several bankruptcy courts have allowed retail debtors to either delay the requirement that debtors pay preconfirmation rent or allow a suspension of the deadlines of their cases in seemingly direct contravention of the explicit Code provisions requiring debtors to timely perform their obligations under unexpired leases.²³ Two recent court decisions, *In re Pier 1 Imports, Inc.* and *In re Modell’s Sporting*

15. *Id.* (“The trustee shall timely perform all the obligations of the debtor, except those specified in section 365(b)(2), arising from and after the order for relief under any unexpired lease of nonresidential real property, until such lease is assumed or rejected, notwithstanding section 503(b)(1) of this title.”).

16. *Id.* § 365(d)(4)(B).

17. *Id.* § 365(d)(5).

18. Alicia Adamczyk, *Why Tenants Are Still Struggling to Pay Their Bills, Despite \$46 Billion in Rental Relief Available*, CNBC (Aug 3, 2021, 3:38 PM), <https://www.cnbc.com/2021/08/03/why-tenants-are-still-struggling-despite-46-billion-dollars-in-rental-relief.html> [https://perma.cc/5NMN-N2HH].

19. Silvia Amaro, *How the Coronavirus is Changing the Way We Shop – And What We’re Buying*, CNBC (July 27, 2020, 1:13 AM), <https://www.cnbc.com/2020/07/27/the-future-of-retail-amid-covid-19.html> [https://perma.cc/KX3C-GXSU].

20. Inti Pacheco, *How Coronavirus Changed the Retail Landscape: From Foot Traffic to Profit Margins, the Story of the Retail Reckoning in Charts*, WALL ST. J. (Oct. 6, 2020, 5:30 AM), <https://www.wsj.com/articles/how-coronavirus-changed-the-retail-landscape-11601976600> [https://perma.cc/JGP7-PX76]; *The Retail Evolution’s Great Acceleration: How to Maneuver in the Pandemic-Driven Recession*, DELOITTE, <https://www2.deloitte.com/us/en/pages/consumer-business/articles/retail-recession.html> (last visited Jan. 20, 2022) [https://perma.cc/VCR4-PHML].

21. Rob Walker, *Pier 1 May be the Saddest Story of This Bankruptcy Boom*, MEDIUM: MARKER (July 7, 2020), <https://marker.medium.com/pier-1-may-be-the-saddest-story-of-this-bankruptcy-boom-faf040c2b1b4> [https://perma.cc/64F3-4HYK].

22. Andy Markowitz, *13 Iconic Retailers that Have Fallen into Bankruptcy*, AARP (Mar. 12, 2021), <https://www.aarp.org/money/credit-loans-debt/info-2020/bankrupt-retail-chain-store-list-is-growing.html> [https://perma.cc/5EWB-X74M].

23. 11 U.S.C. § 365(d)(3) (pre-CAA).

Goods, Inc., are examples in which bankruptcy courts utilized their equitable power to grant rent relief to financially distressed companies impacted by COVID-19.²⁴

In this light, the inclusion of bankruptcy language in the CAA can be seen both as a response to the inflexibilities of the Code—juxtaposed against the realities of COVID-19—but also as a direct legislative response to the bankruptcy courts who utilized their powers in contravention of the Code.²⁵ The CAA’s amendments to Title 11 can be viewed, in other words, as highlighting failures within the Code that debilitated retail-debtors with stringent timelines expressed in § 365 regarding the assumption and rejection of unexpired leases, during which period the debtor is still obligated to perform under their unexpired leases.²⁶ This is evidenced, in part, by the fact that the judiciary was forced to intervene on behalf of retail debtors to provide more flexibility.

This Note argues that the CAA does not adequately address the underlying issues regarding the relationship between landlord and tenant-debtors in bankruptcy with respect to assumption and rejection of unexpired leases. The CAA, as evidenced by its explicit language, is meant to provide only temporary relief to debtors in light of a specific external phenomenon—namely, COVID-19—not a permanent fix for an historically complex issue.²⁷ The bankruptcy provisions in the CAA do not appropriately address the tension between tenant-debtors, who require some flexibility in their preconfirmation rent obligations (and the amount of time needed to assume or reject their unexpired leases), and the legitimate concerns of landlord-creditors, who fail to benefit from the value of their unexpired leases held in limbo during period between the commencement of a case and assumption or rejection of their executory contracts.

Part II of this Note offers background on the history of the Code as it pertains to the relationship between commercial landlords and tenant-debtors, both before and after the implementation of the Bankruptcy Abuse Prevention and Consumer Protection Act (“BAPCPA”) imposed strict deadlines to assume and reject unexpired leases.²⁸ It attempts to highlight the tension between landlords and tenants in bankruptcy and how recent changes to the CAA do very little to remedy this historically complex relationship.

Part III attempts to fill in the gaps created by the CAA toward a more permanent solution. In particular, Part III analogizes the debtor’s assumption or

24. *In re Pier 1 Imports, Inc.*, 615 B.R. 196, 197 (Bankr. E.D. Va. 2020); *In re Modell’s Sporting Goods, Inc.*, Case No. 20-14179 (VFP) (Bankr. D.N.J., Mar. 23, 2020), at 3.

25. See Press Release, U.S. Senator Thom Tillis, Tillis Introduces Bill to Provide Landlord-Tenant Bankruptcy Relief in Response to the Coronavirus Pandemic (Aug. 6, 2020), <https://www.tillis.senate.gov/2020/8/tillis-introduces-bill-to-provide-landlord-tenant-bankruptcy-relief-in-response-to-the-coronavirus-pandemic> [<https://perma.cc/423J-AU6L>].

26. *Recent Bankruptcy Amendments of Significance to Commercial Landlords and Tenants*, HONIGMAN (Jan. 12, 2021), <https://www.honigman.com/firm-newsroom-alerts-1644.html> [<https://perma.cc/VC2J-MZY3>].

27. See Paul Laurin, Allison M. Scarlott & Molly N. Sigler, *9 Ways the Recent Stimulus Bill Affects Bankruptcy*, NAT’L L. REV. (Jan. 12, 2021), <https://www.natlawreview.com/article/9-ways-recent-stimulus-bill-affects-bankruptcy> [<https://perma.cc/UW6P-AWGS>] (bankruptcy amendments sunset for bankruptcy cases filed after December 27, 2022).

28. Bankruptcy Abuse Prevention and Consumer Protection Act, Pub. L. No. 109-8, 119 Stat. 23 (2005).

rejection power as a costless option, whereby an unexpired lease has inherent value during the pendency of the bankruptcy which can be realized, or “called,” by assuming the contract with the landlord. While the current bankruptcy rules partially ameliorate the free option problem, primarily by requiring the debtor to pay rent to the landlord under the lease until it is assumed or rejected, the deadlines in § 365(d) are blunt instruments which fail to solve the underlying problems highlighted by COVID-19. Understanding § 365 of the Code under an option-value paradigm allows us to realize that prolonged waiting periods in the Code cause landlords to lose-out on value of their unexpired leases. While debtors should be allowed more flexibility to extend the period to assume or reject their leases, in return they should be required to internalize the added costs of waiting.

Finally, Part IV recommends that, instead of the stringent timeline set forth in BAPCPA, we should return to a pre-BAPCPA world where extensions are granted according to judicial discretion “for cause.” During the period between the commencement of the case and the assumption or rejection date, however, landlords should be able to capture the option value of their leases as an administrative priority expense (similar to the way suppliers are paid in bankruptcy) in addition to the value of the lease once assumed. This Note theorizes that the option-value of the unexpired lease can be calculated using the Black-Scholes method to evaluate option contracts. In this way, debtors-in-possession are incentivized to limit the amount of time between the commencement of the case and the assumption or rejection of their unexpired leases.

II. BACKGROUND

A. *Executory Contracts and Unexpired Leases in Bankruptcy*

Section 365 of the Bankruptcy Code governs the effect of bankruptcy on a debtor’s executory contracts and unexpired leases.²⁹ An executory contract is generally considered a contract on which performance remains due to some extent on both sides.³⁰ In other words, a contract is executory if each side must render performance “on account of an existing legal duty or to fulfill a condition, to obtain the benefit of the other party’s performance.”³¹

Unexpired real property leases both historically and explicitly in the Code have fallen under the umbrella of “executory” contracts.³² The drafters of the Code, as well as the drafters of subsequent amendments thereto, have been

29. 11 U.S.C. § 365 (as amended in 2020).

30. H.R. REP. NO. 95-595, at 122 (1977); S.REP. NO. 95-989, at 59 (1978), U.S.C.C.A.N. (Stat.) Code Cong. & Admin. News 1978, pp. 5787, 5844, 6303; *Accord* NLRB v. Bildisco and Bildisco, 465 U.S. 513, 522 n. 6 (1984); *Eastern Air Lines, Inc. v. Insurance Co. of State of Pennsylvania (In re Ionosphere Clubs, Inc.)*, 85 F.3d 992, 998-99 (2d Cir. 1996).

31. *In re Riodizio, Inc.*, 204 B.R. 417, 424 (Bankr. S.D.N.Y. 1997).

32. JOHN R. KNAPP, JR. & JOHN A. GOSE, THE DEVELOPMENT OF SECTION 365, 2 AM. COLL. OF REAL EST. LAWS., 2001, at 2, <https://cdn.ymaws.com/www.acrel.org/resource/collection/33D33641-7114-4481-A099-3220169F5C8A/a002191.pdf> [<https://perma.cc/F7V2-JEEA>].

sensitive to the needs of different kinds of debtors, including special categories within § 365 treating certain leases (*e.g.*, residential versus nonresidential) differently than others.³³ For example, § 365(d) exempts commercial landlords from the general rule that a debtor may assume or reject an executory contract at any time prior to plan confirmation.³⁴ Instead, § 365(d)(4) imposes strict deadlines to be sensitive to the need for landlords to have some certainty over the status of their premises.³⁵

Under §365(d)(4) a debtor-tenant of commercial property has a strict timeline after the commencement of their case to assume or reject unexpired leases.³⁶ More specifically, before the CAA the debtor-tenant only had 120 days after the petition date to decide whether to assume or reject an unexpired lease of nonresidential real property.³⁷ Failure to assume a nonresidential lease within the 120-day period would result in the lease being deemed rejected by the debtor or trustee; the 120-day period, however, could be extended for 90 days—for a maximum of 210 days after the petition date—upon a showing of “cause.”³⁸

When a lease is “assumed” in bankruptcy, the debtor’s bankruptcy estate is enabled to obtain the continuing benefits, as well as its obligations, arising under the contract or lease.³⁹ The decision to assume a lease merely allows the contract to continue to operate as-is.⁴⁰ The assumption does not change the obligations of the parties, except as otherwise provided explicitly in the Code.⁴¹ If the debtor-tenant is currently in default at the time of the filing, however, the debtor may not assume the lease unless it can cure defaults and provide adequate assurance of future performance under the lease.⁴²

Conversely, rejection of a lease is essentially a decision to terminate or repudiate the obligations of the prepetition contract.⁴³ The decision to reject a contract under § 365(a), according to bankruptcy courts, constitutes of a breach of contract, hypothetically occurring immediately prior to the date of filing the petition.⁴⁴ The practical effect of a rejection is twofold. First, the counterparty to the contract or lease simply becomes an unsecured creditor for state law damages

33. *See, e.g.*, 11 U.S.C. § 365(h)(2)(A) (timeshare leases); 11 U.S.C. § 365(p)(1) (leases of personal property); 11 U.S.C. §§ 365(d)(3), (4) (nonresidential real property leases).

34. *Compare* 11 U.S.C. § 365(d)(2), *with* 11 U.S.C. § 365(d)(4) (as amended in 2020).

35. 11 U.S.C. § 365(d)(4)(A) (as amended in 2020).

36. 11 U.S.C. § 365(d)(4) (2005) (as amended in 2020).

37. *Id.*

38. *Id.* §§ 365(d)(4)(A), (d)(4)(B)(i) (2005) (as amended in 2020).

39. Under Bankruptcy Code § 365(b), assumption requires that the trustee or debtor in possession cure all existing defaults under the contract or lease. 11 U.S.C. § 365(b) (2020). Moreover, if such defaults exist the trustee or debtor in possession must provide “adequate assurance” of future performance under the contract or lease. *Id.* § 365(b)(A). A contract or lease which is assumed may also be assigned to a third party. *Id.* § 365(f).

40. 11 U.S.C. § 365(f) (2020).

41. *See, e.g., In re* Washington Cap. Aviation & Leasing, 156 B.R. 167, 173 (Bankr. E.D. Va. 1993); *In re* Drexel Burnham Lambert Group, Inc., 138 B.R. 687, 706 (Bankr. S.D.N.Y. 1992); *In re* Allen, 135 B.R. 856, 864 (Bankr. N.D. Iowa 1992).

42. 11 U.S.C. 365(b) (2020).

43. *See* Michael T. Andrew, *Executory Contracts Revisited: A Reply to Professor Westbrook*, 62 U. COLO. L. REV. 1, 1–2 (1991).

44. *See, e.g., Aslan v. Sycamore Inv. Co.*, 909 F.2d 367, 369 (9th Cir. 1990); *In re* Cont’l Airlines, Inc., 981 F.2d 1450, 1459 (5th Cir. 1993).

of a breach of contract (deemed to have arisen prepetition); and second, the counterparty has an expense of administration claim for any benefits received by the debtor in possession prior to rejection.⁴⁵ The decision to reject a contract does not extinguish the contract in its entirety, it merely constitutes a breach, and the terms of the contract still control the relationship of the parties.⁴⁶

In this way, § 365(d) gives the debtor an incredible advantage through the choice of assumption or rejection over the counterparty in the unexpired lease. Once a lease becomes property of the bankruptcy estate at the commencement of the case,⁴⁷ § 365 of the Code determines the contractual obligations of the estate, including the rights of the estate to realize contracts' economic value through the

45. See *In re Bridgeport Plumbing Prods., Inc.*, 178 B.R. 563, 565 (Bankr. M.D. Ga. 1994) (holding creditor may file administrative expense claim for the "reasonable value of the use" of the creditor's property prior to rejection.); *In re Hooker Invs*, 145 B.R. 138, 144 (Bankr. S.D.N.Y. 1992); see also *Texaco Inc. v. Louisiana Land & Expl. Co.*, 136 B.R. 658, 663 (M.D. La. 1992) (holding rejection of the prepetition contract does not cancel the contract; it constitutes a breach of the contract and grants the other party a claim against the estate as an unsecured creditor).

46. See, e.g., *In re Flagstaff Realty Assocs.*, 60 F.3d 1031, 1034 (3d Cir. 1995) (holding rejection of a lease does not alter the substantive rights of the parties to the lease. Hence, creditor-lessee could rely on lease provision permitting it to make repairs to leased property and deduct the cost of those repairs from its rent payments to the debtor-landlord.); *In re Austin Development Co.*, 19 F.3d 1077, 1082 (5th Cir. 1994) (holding rejection breaches rather than terminates the contract), *cert. denied*, 115 S. Ct. 201 (1994); *In re Continental Airlines*, 981 F.2d 1450, 1459-61 (5th Cir. 1993) (holding rejection does not invalidate or extinguish contract); *In re Printronics, Inc.*, 189 B.R. 995, 1000 (Bankr. N.D. Fla. 1995) (holding rejection of an executory contract does not terminate the contract, it merely breaches the contract.); *In re Yasin*, 179 B.R. 43, 49-50 (Bankr. S.D.N.Y. 1995) (holding rejection constitutes a breach of the contract or lease, it does not terminate it.); *In re Fitch*, 174 B.R. 96, 100 (Bankr. S.D. Ill. 1994) ("[R]ejection . . . neither adds to nor detracts from a claim for payment under the contract or the estate's liability for such payment."); *In re Old Electralloy Corp.*, 167 B.R. 786, 791 (Bankr. W.D. Pa. 1994) ("The Trustee's rejection of the contract . . . does not render the contract non-existent . . . [nor does] the Trustee's rejection extinguish the Debtor's obligations under the . . . provisions of the agreement or render the [contract's] provisions inapplicable as of the date of rejection [Finally], the rejection does not relieve the Trustee of his obligations which arise from the period of time during which the Trustee operated the business [postpetition but prior to rejection]."); *In re South Motor Co. of Dade County*, 161 B.R. 532, 545-46 (Bankr. S.D. Fla. 1993) ("[R]ejection has absolutely no effect upon a contract's continued existence Accordingly, rejection of an executory contract does not ipso facto terminate rights and obligations that arise from rejected contracts."); *In re Walnut Assocs.*, 145 B.R. 489, 494 (Bankr. E.D. Pa. 1992) (holding rejection of contract does not "invalidate, rejudicate, repeal, or avoid" an executory contract; it merely means that contract is not assumed and nondebtor party cannot make an administrative claim against debtor's estate if debtor fails to perform).

47. 11 U.S.C. § 541(a) (2020) When a tenant-debtor files for bankruptcy, an estate is created and § 541(a) brings all of the debtor's property, "wherever located and by whomever held," into the estate, including all "legal or equitable interest of the debtor." The scope of what constitutes property of the estate under § 541 of the Code has been broadly construed by bankruptcy courts as a broad sweep including "every conceivable interest of the debtor, future, nonpossessory, contingent, speculative and derivative" See, e.g., *In re Yonikus*, 996 F.2d 866, 869 (7th Cir. 1993). As such, the estate includes all of the debtor's property, both tangible and intangible, regardless of geographic location or whomever is possessing the property. See, e.g., *In re Simon*, 153 F.3d 991, 996 (9th Cir. 1998), *cert. denied*, 119 S.Ct. 1032 (1999) (holding § 541 sweeps in property of the estate regardless of geographic location); *Shimer v. Fugazy (In re Fugazy Express, Inc.)*, 114 B.R. 865, 869 (Bankr. S.D.N.Y. 1990), *aff'd*, 124 B.R. 426 (S.D.N.Y. 1991) (holding § 541 sweeps in both tangible and intangible property of the debtor in the estate). Generally speaking, the estate inherits all of the rights and obligations of the debtor under contracts as of the commencement of the bankruptcy case, including leases, franchise agreements, and joint venture agreements. See *In re Holywell Corp.*, 913 F.2d 873, 881 (11th Cir. 1990). While the commencement of a bankruptcy case does not increase or decrease a debtor's interest in property, it does change the party who holds the interest from the debtor to being held as property of the estate. See *In re Sanders*, 969 F.2d 591, 593 (7th Cir. 1992).

rules of assumption or rejection.⁴⁸ Assuming a lease in bankruptcy thus enables the debtor's bankruptcy estate to obtain the continuing benefits, as well as its obligations, arising under the lease.⁴⁹ Moreover, the debtor may wait to decide whether to assume or reject during the pendency of the bankruptcy, while the counterparty at all times must be prepared to perform if the debtor chooses to assume.⁵⁰ The advantages are especially prevalent in bankruptcies involving real property, as the landlord must continue to allow the tenant-debtor to occupy the premises and may only be able to retake possession upon debtor's rejection.⁵¹

As this Note discusses in more detail in Part III, this essentially creates a costless option for the debtor. If the debtor's lease is a below-market one, and if the terms of the lease are a "sweet deal" for the debtor, the debtor will "call" the option by paying the landlord and move forward under the terms of the unexpired lease.⁵² If the lease is above-market, however, the tenant-debtor lets the option expire and must give-back the premises to the landlord, who now can assert a pre-petition breach of contract claim (essentially turning the landlord into a general unsecured creditor).⁵³ The insight of seeing the unexpired lease as an option is to recognize that the unexpired lease is valuable to the debtor even if the actual terms of the lease are unfavorable; the debtor in bankruptcy has the option to wait for the market to improve before choosing to assume or reject the lease, even if they are "out of the money."⁵⁴

Additionally, there is a further advantage to the tenant-debtor when deciding to assume or reject an unexpired contract because §§ 365(g) and 502(g) of the Code limit the rejection damage claim occurring immediately before the commencement of the bankruptcy case, regardless of how long the debtor takes to decide to assume or reject.⁵⁵ In bankruptcies involving real property, § 502(b)(6) caps the landlords' damage claim following a rejection of a lease but does not provide the landlord any relief from the duty under state law to mitigate damages

48. ELIZABETH WARREN, JAY LAWRENCE WESTBROOK, KATHERINE PORTER & JOHN A.E. POTTOW, *THE LAW OF DEBTORS AND CREDITORS: TEXT, CASES, AND PROBLEMS* 562 (7th ed., 2014).

49. Assumption requires that the trustee or debtor in possession cure all existing defaults under the contract or lease. 11 U.S.C. § 365(b) (2020). Moreover, if such defaults exist the trustee or debtor in possession must provide "adequate assurance" of future performance under the contract or lease. *Id.* A contract or lease which is assumed may also be assigned to a third party. 11 U.S.C. § 365(f).

50. 11 U.S.C. § 365(f) (2020).

51. See James A. Timko, *Post-Bankruptcy Issues for Commercial Landlords—Assumption and Rejection of Leases in Chapter 11 Cases*, SHUTTS & BOWEN LLP (Sept. 2, 2020), <https://www.shutts.com/news-Post-Bankruptcy-Issues-for-Commercial-Landlords-Assumption-and-Rejection-of-Leases-in-Chapter-11-Cases> [<https://perma.cc/2JWU-KXED>].

52. Daniel R. Swetnam, John C. Cannizzaro, Alyson M. Fiedler & Louis T. DeLucia, *Commercial Landlords' Guide to Navigating a Tenant in Bankruptcy*, ICEMILLER LEGAL COUNS. (June 11, 2020), <https://www.ice-miller.com/ice-on-fire-insights/publications/commercial-landlords-guide-to-navigating-a-tenant/> [<https://perma.cc/5X4Z-Q9A2>].

53. Michael J. Riela, *Lease Defaults and Restructuring: The Impact of Bankruptcy on Commercial Landlords and Tenants*, ABA (Feb. 1, 2021), https://www.americanbar.org/groups/business_law/publications/blt/2021/02/lease-defaults-restructuring/ [<https://perma.cc/AFQ8-ALM8>].

54. See generally Caroline Banton, *The Importance of Time Value in Options Trading*, INVESTOPEDIA (Dec. 11, 2019), <https://www.investopedia.com/articles/optioninvestor/02/021302.asp> [<https://perma.cc/BD9E-CV6M>].

55. WARREN ET AL., *supra* note 48, at 562.

(like re-leasing the premises as soon as possible).⁵⁶ Therefore, depending on the economic circumstances of a particular case, the opportunity to reject leases and limit damages could be a major advantage to a retail debtor.

There are two major exceptions to the advantage given to the tenant-debtor holding an unexpired lease in real property. First, while the debtor is making the vital business decision whether to assume or reject their leases, the commercial landlord is protected under § 365(d)(3), which requires the debtor to perform all obligations arising from the unexpired lease from the petition date until such lease is assumed or rejected.⁵⁷ This includes paying rent in a timely manner. In this way, § 365(d)(3) puts the landlord on the same footing as any other supplier being paid in cash during a bankruptcy.⁵⁸

Second, the time deadlines in § 365(d)(4) do some work to protect the landlord as well.⁵⁹ The timelines limit the length of the debtor's costless option because, all things being equal, shorter options are less valuable than longer options.⁶⁰ A debtor cannot wait indefinitely until the market improves. Instead, debtors must adhere to the strict timelines that only allow for limited extensions under occasional circumstances "for cause."⁶¹ Thus, while the bankruptcy court prior to the CAA could extend the time for performance of post-petition obligations for an additional period "for cause," debtors are provided a much smaller window to assume or reject their leases, a maximum of 210 days.⁶² All-the-while, landlords are given economic protection because debtor-tenants are required to pay post-petition rent until they decide to assume or reject the lease.⁶³

B. Landlord-Tenant Relationship Prior to BAPCPA

Interestingly, prior versions of the federal bankruptcy law struggled immensely with balancing advantages between the landlord and tenant regarding assumption and rejection of unexpired leases in bankruptcy.⁶⁴ Prior to the Code § 365, section 70(b) of the Bankruptcy Act of 1898, as amended in 1938, required that the trustee "assume or reject an executory contract, including unexpired leases of real property, within 60 days after the adjudication or within 30 days after the qualification of a trustee."⁶⁵ In these cases, however, the court could,

56. 11 U.S.C. § 502(b)(6) (2005).

57. *Id.* § 365(d)(3) (2020).

58. See generally Michael J. Viscount, Jr. *Bankruptcy Rights of Suppliers*, SUPPLY & DEMAND CHAIN EXEC. (March 23, 2009), <https://www.sdexec.com/home/article/10269469/bankruptcy-rights-of-suppliers> [<https://perma.cc/EDX2-JSEU>].

59. 11 U.S.C. § 365(d)(4) (2020).

60. For a discussion on this topic, see Caroline Banton, *supra* note 54.

61. 11 U.S.C. § 365(d)(4)(B)(i) (2020).

62. Compare 11 U.S.C. § 365(d)(4) (2005) (amended 2020), with 11 U.S.C. § 365(d)(4) (amended 2020).

63. See 11 U.S.C. § 365(d)(4) (amended 2020).

64. See Ingrid Bagby, Michele C. Maman & Peter F. Tringali, *The Controversy Continues Over Whether the Time for Assumption or Rejection of Integrated Nonresidential Real Property Leases and Other Contracts Should be Governed by Bankruptcy Code Section 365(d)(2) or Section 365 (d)(4)'s Shorter Period*, 23 J. BANKR. L. & PRAC. 1, 2 (2014).

65. Bankruptcy Act of 1898, Pub. L. No. 55-541 (30 Stat. 544) 550, (amended 1938) (repealed by Bankruptcy Reform Act of 1978, Pub. L. 95-598 (92 Stat. 2549) (1978)).

for cause, extend or reduce the timeline.⁶⁶ Haphazard application of the case law, in combination with Bankruptcy Rule 607 which provided virtually no guidance on the procedure of rejection, consequently lead to confusion and uncertainty whenever a bankruptcy proceeding should involve an unexpired lease assumption or rejection.⁶⁷

To modernize the Bankruptcy Code, sweeping changes were made in 1978 to address confusion caused by the former Act.⁶⁸ However, instead of resolving disputes regarding assumption and rejection procedures in the lower courts, the Bankruptcy Code of 1978 was conspicuously silent on the matter.⁶⁹ The 1978 changes to the Code did not prescribe any deadlines for assumption and rejection of unexpired leases.⁷⁰ Instead, the trustee had until confirmation to decide whether to assume or reject leases of nonresidential property.⁷¹ Section 365(a) was added to the Code as a general rule for assumption and rejection of executory contracts but only subjected the decision to court approval.⁷² In fact, in Chapter 9, 11, and 13 cases, the trustee did not have a fixed time limit to assume or reject leases at all.⁷³ In Chapter 7, however, 365(d)(1) provided that if a trustee did not assume or reject an executory contract or unexpired lease within sixty days from the date of the order of relief, the contract was deemed rejected.⁷⁴ The law did provide that if another party to the contract or lease requested that the court fix a time, the court could specify a time within which the trustee must act.⁷⁵ Nevertheless, after the 1978 enactment of the Bankruptcy Code, debtors in Chapter 11 reorganizations had no fixed deadline to assume or reject unexpired leases, and were not even obligated to make payments on those leases pending the debtor's decision to assume or reject the lease.⁷⁶

In 1984, the Bankruptcy Code faced another major revision where, among other sections, § 365 was amended to provide landlords with more certainty when a debtor-tenant entered into bankruptcy.⁷⁷ Lessors of nonresidential property

66. *Id.*

67. See Gregory G. Hesse, *A Return to Confusion and Uncertainty as to the Effective Date of Rejection of Commercial Leases in Bankruptcy: A Critical Analysis of Revco and Joseph C. Spiess Company*, 9 BANKR. DEV. J. 521, 523-24 (1992).

68. See H.R. Rep. No. 95-595, at 3-4 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 5965.

69. KNAPP & GOSE, *supra* note 32.

70. See Bagby et al., *supra* note 64, at 2 ("The Bankruptcy Code of 1978 did not prescribe any deadlines for the assumption and rejection of leases and contracts[.]").

71. KNAPP & GOSE, *supra* note 32.

72. 11 U.S.C. § 365(a) ("Except as provided in sections 765 and 766 of this title and in subsections (b), (c), and (d) of this section, the trustee, subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor.").

73. KNAPP & GOSE, *supra* note 32.

74. 11 U.S.C. § 365(d)(1) (1988).

75. S. REP. NO. 95-989, at 59 (1978), reprinted in 1978 U.S.C.C.A.N. 5787, 5845. The House Report contained an identical explanation. See H.R. Rep. No. 95-595, at 348 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6304.

76. KNAPP & GOSE, *supra* note 32.

77. 130 Cong. Rec. § 8891 (daily ed. June 29, 1984) ("The bankruptcy code currently provides that when a shopping center lease is assumed . . . assurances must be given that the lease provisions will not be substantially breached and that the tenant mix will not be substantially disrupted. Unfortunately, courts have misapplied these

were displeased with the Bankruptcy Act of 1978, in part because tenant spaces in shopping centers became vacant for long periods of time when a retail debtor went bankrupt and the bankruptcy court—under no time restriction—waited for long periods of time before requiring the trustee to decide whether to assume or reject the lease.⁷⁸ Accordingly, Congress added 11 U.S.C. § 365(d)(4) to lessen the problems caused by extended vacancies, requiring that the trustee decide whether to assume or reject nonresidential real property leases within sixty days after the order for relief in a case under any chapter.⁷⁹ Additionally, Congress added 11 U.S.C. § 365(d)(3) to ensure that trustees and debtors-in-possession were paying rent while deciding whether to assume or reject a lease.⁸⁰ Thus, the 1984 amendments were the first step in a concerted effort to protect landlords by solving the problem of being forced to provide real property space without current payment.

While Congress intended to reduce the uncertainty experienced by commercial landlords, the 1984 version of § 365(d)(4) had the opposite effect. Tenants were given sixty days in which to make decisions on whether to accept or reject executory contract(s), including the time remaining on their unexpired lease(s).⁸¹ The sixty-day limit was burdensome to retailers with large portfolios of stores and leases, and courts often granted multi-year extensions “for cause” up to the date of confirmation of the reorganization plan.⁸² In fact, the practice of bankruptcy judges granting multiple extensions to a debtor in possession beyond the initial decision period effectively gave debtors the ability to avoid making decisions as to its unexpired leases for months, even years, after filing for bankruptcy, to the detriment of the commercial landlord.⁸³

The practical consequences of the 1984 changes to the Code were that courts struggled to find the right balance between the inherent tension of landlord and tenant in bankruptcy. On one hand, the tenant-debtors received bankruptcy protection from their creditors while continuing to operate, pay rent, pay employees and continue their business as a case proceeded through court.⁸⁴ At the same time, while landlords were able to keep rent and benefit from tenant remaining open for business, these landlords had become increasingly concerned that tenant-debtors, protected from litigation by the automatic stay, could prolong the assumption or rejection period of leases until the opportune moment (*e.g.*,

provisions in ways which have deprived shopping centers . . . of the protections which Congress intended to provide them.”) (statement of Sen. Orrin Hatch).

78. *Id.* at 20,088–89.

79. KNAPP & GOSE, *supra* note 32, at 11–12.

80. 130 CONG. REC. 20,088 (1984) (statement of Sen. Orrin Hatch).

81. *Id.* at 20,088–89.

82. *See id.* at 20,088 (discussing burdens); *see, e.g.*, *In re Channel Home Ctrs., Inc.*, 989 F.3d 682, 688 (3d Cir. 1993).

83. Brian Huben, *The Art of Control: Bankruptcy Code Amendments Benefit Shopping Center Landlords*, 25 SHOPPING CTR. LEGAL UPDATE 15, 15 (2005), https://katten.com/files/21686_huben—shopping_center_legal—art_of_control.pdf [<https://perma.cc/822P-AHFP>].

84. Harlan D. Platt, Christopher R. Mirick & Marjorie B. Platt, *Ethics, Bankruptcy & Greed: The Unintended Consequences for Landlords of the 2005 Bankruptcy Amendments* (June 21, 2011) at 5.

favorable market conditions) or even indefinitely.⁸⁵ This amounted to the insertion of uncertainty to the detriment of the anxious landlord waiting to find another tenant for their commercial property (most commonly, retail shopping centers).

C. BAPCPA

Congress changed the Bankruptcy Code with the enactment of Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“BAPCPA”).⁸⁶ The primary aim of BAPCPA was to amend the Code to limit abuses of individual consumers filing high rates of bankruptcies.⁸⁷ The effectiveness of BAPCPA, and whether these steps were appropriate or necessary, are not discussed in this section. Rather, the focus of this section is about how BAPCPA fundamentally altered the power dynamics between commercial landlords and tenant-debtors in bankruptcy by decreasing the amount of time tenant-debtors could assume or reject unexpired leases according to § 365(d)(4) of the Code.

Namely, BAPCPA statutorily reduced the amount of time tenant-debtors could accept or reject unexpired leases of nonresidential property.⁸⁸ As discussed above, before BAPCPA the Code required assumption of nonresidential real property leases within sixty days of the order for relief, unless the court extended the time “for cause.”⁸⁹ This allowed debtors respite from their creditors and courts would routinely allow debtors extensions to find new financing or wait for their assets to improve.⁹⁰

According to the newly minted BAPCPA, § 365(d)(4) was amended to directly address the concerns of the landlord.⁹¹ The revised Code provided a new, definitive timeline within which a debtor-in-possession could assume or reject an unexpired lease, which was the *earlier of* “(i) the date that is 120 days after

85. *Id.*

86. Bankr. Abuse Prevention and Consumer Prot. Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (2005).

87. Kathleen Day, *Bankruptcy Bill Passes; Bush Expected to Sign*, WASH. POST (Apr. 15, 2005), <https://www.washingtonpost.com/wp-dyn/articles/A53688-2005Apr14.html> [<https://perma.cc/CWG7-4N5W>] (“‘This bill will help restore responsibility and integrity to the bankruptcy system by cracking down on fraudulent, abusive, and opportunistic bankruptcy claims,’ said House Judiciary Committee Chairman F. James Sensenbrenner Jr. (R-Wis.)”).

88. Bob Eisenbach, *The Terrible Twos? A Look at BAPCPA’s Impact on Business Bankruptcy Cases at its Second Anniversary*, COOLEY: IN THE RED (Oct. 16, 2007), <https://bankruptcy.cooley.com/2007/10/articles/business-bankruptcy-issues/the-terrible-twos-a-look-at-bapcpas-impact-on-business-bankruptcy-cases-at-its-second-anniversary/> [<https://perma.cc/9G89-GF5H>].

89. See Richard Levin & Alesia Ranney-Marinelli, *The Creeping Repeal of Chapter 11: The Significant Business Provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, 79 AM. BANK. L.J. 603, 623 (2005).

90. Platt et al., *supra* note 84, at 3 (“The 60 day limit was burdensome to retailers with many stores and leases nation-wide; courts often granted multi-year extensions ‘for cause’ up to the confirmation of the reorganization plan at the end of the bankruptcy process.”) (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1520163 [<https://perma.cc/AY4V-6THA>])).

91. Ingrid Bagby, Michele C. Maman & Peter F. Tringali, *The Controversy Continues Over Whether the Time for Assumption or Rejection of Integrated Nonresidential Real Property Leases and Other Contracts Should Be Governed by Bankruptcy Code Section 365(d)(2) or Section 365(d)(4)’s Shorter Period*, 23 NORTON J. BANKR. L. & PRAC. (2014).

the date of the order for relief; or (ii) the date of the entry of an order confirming a plan.”⁹² Although BAPCPA extended the initial sixty-day decision period for assumption or rejection of unexpired leases of nonresidential property, seemingly benefitting the debtor, it allowed only one extension for ninety days, on the request of the debtor-in-possession or lessor “for cause.”⁹³ Whereas extensions were unlimited before BAPCPA, under BAPCPA’s stringent timeline, debtors had a maximum 210-day ceiling to the timeline between the commencement of the case and when they are required to assume or reject their unexpired leases.⁹⁴ Indeed, any subsequent extension past the 210 days was wholly contingent on the landlord’s consent, which could be withheld for any or no reason at all.⁹⁵

On its face, a 210-day time period does not seem like an onerous limitation on tenants, but the BAPCPA’s timeline significantly shifted negotiating leverage to commercial landlords, especially in relation to large, national retailers (with hundreds of store locations) to assume or reject their entire portfolio of leases within the strict deadlines outlined in § 365(d)(4).⁹⁶ For example, tenant-debtors who entered into bankruptcy to realign their financial affairs might have to reject potentially valuable leases prematurely and to the detriment of their creditors and their overall business plan.⁹⁷ Additionally, with less time to make a calculated financial analysis, retail debtors might be pressed to make important decisions regarding which leases to assume, opening the door to miscalculations resulting in administrative claims if their assumption ultimately proved to be imprudent. Tenant-debtors, strapped by deadlines, might also attempt to negotiate with their landlords for more time with costly out-of-court concessions while ultimately remaining beholden to the mercy of their landlord.

The general effect of the BAPCPA amendments, with respect to the time allotted to assume or reject unexpired leases, was to force debtors to make early decisions about their unexpired leases.⁹⁸ These decisions were forced upon the debtor, regardless of the debtor’s reorganization goals. The timeline to assume or reject unexpired leases chilled the effect of finding qualified tenants.⁹⁹ Instead, debtors were incentivized to sell entire portfolios.¹⁰⁰ As such, instead of capturing the value of each individual unexpired lease for the benefit of all creditors, tenant-debtors were nudged to package-and-sell to make their deadlines quickly or negotiate with their landlord for additional extensions.¹⁰¹

92. 11 U.S.C. § 365(d)(4) (amended by CAA in 2020).

93. 11 U.S.C. § 365(d)(4)(B)(i) (2005) (amended by CAA in 2020).

94. *See id.*

95. 11 U.S.C. § 365(d)(4)(B)(ii) (2005) (amended by the CAA in 2020).

96. Levin & Ranney-Marinelli, *supra* note 89, at 624.

97. *Id.*

98. *Id.*

99. *Id.*

100. Platt et al., *supra* note 84, at 5–6.

101. Levin & Ranney-Marinelli, *supra* note 89, at 624.

D. COVID-19 and the Enactment of the CAA

At the end of 2020, Congress enacted the CAA in order to address the widespread economic effects of COVID-19.¹⁰² Interestingly, the bill included, *inter alia*, three provisions affecting landlord-tenant relationships in bankruptcy.¹⁰³ Namely, the CAA amended landlord-tenant relationships in the Bankruptcy Code by adding the following provisions: (1) a preference protection for landlords who provided COVID-19-affected tenants with rent relief, (2) a limited extension of discretionary rent relief windows for Chapter 11 cases proceeding under Subchapter V, and (3), an extension of the deadlines in § 365(d)(4) for the time to assume or reject leases from 120 days to 210 days, which can be extended another 90 days (but no further than 300 days without the landlord's written consent).¹⁰⁴ This Note does not address (1) or (2); rather, it provides an in-depth look at (3): the extensions of deadlines to assume or reject unexpired leases.

While many retailers struggled before the COVID-19 pandemic, after the pandemic stay-at-home orders and decreased consumer foot traffic undoubtedly dealt a particularly damaging blow to the consumer retail industry.¹⁰⁵ Interestingly, bankruptcy courts were complicit with tenant-debtor's requests for relief in light of the pandemic, allowing debtors to either suspend the Chapter 11 case altogether, abate rent obligations, or prolong the § 365(4) lease rejection window.¹⁰⁶ Courts justified such rulings in the name of the bankruptcy court's inherent and equitable powers,¹⁰⁷ in direct contravention to the Bankruptcy Code's explicit language governing the assumption period for non-residential real estate leases.¹⁰⁸

For example, Pier 1 Imports Inc. entered bankruptcy shortly before the COVID-19 pandemic on February 17, 2020, in the U.S. Bankruptcy Court for the Eastern District of Virginia, with plans to be sold as a going concern.¹⁰⁹ Debtors initially expected to confirm their plan in a relatively short period of time after the petition date, but the effects of the nationwide pandemic shuttered their

102. See Consol. Appropriations Act of 2021, Pub. L. No. 116-260, 134 Stat. 1182; see also, *supra* notes 7-9 and accompanying text.

103. See *id.*

104. Consol. Appropriations Act, Pub. L. No. 111-260, 134 Stat. 1182, Div. FF, Title X, sec. 1001(f).

105. See Paul J. Ricotta & Kaitlin R. Walsh, *Mothballing Motions from Retail Debtors to Avoid Rent Payments Due to COVID-19 Pandemic*, 39 AM. BANKR. INST. J. 1, 1 (2020).

106. See Debtors' Emergency Motion for Entry of an Order (I) Approving Relief Related to the Interim Budget, (II) Temporarily Adjourning Certain Motions and Applications for Payments, and (III) Granting Related Relief, *In re Pier 1 Imports Inc.*, Case No. 20-30805-KRH, at *2-3 (Bankr. E.D. Va. March 31, 2020) (Doc. No. 438).

107. 11 U.S.C. § 105(a) ("[the] court may issue any order, process or judgment that is *necessary or appropriate* to carry out the provisions of this title.") (emphasis added); 11 U.S.C. § 305(a)(1). For more information on the bankruptcy court's equitable powers, see, Hon. Michelle M. Harner & Emily A. Bryant-Álvarez, *The Equitable Powers of the Bankruptcy Court*, 93rd Annual National Conference of Bankruptcy Judges October 30 - November 2, 2019, Washington, D.C., available at <https://ncbjmeeting.org/2019/materials/The%20Equitable%20Powers%20of%20the%20Bankruptcy%20Court.pdf> [<https://perma.cc/DAE8-GG89>].

108. See 11 U.S.C. § 365(d)(4) (as amended in 2020); Harner & Bryant-Álvarez, *supra* note 107, at 1 ("[W]hatever . . . sanctions a bankruptcy court may impose on a dishonest debtor, it may not contravene express provisions of the Bankruptcy Code . . .") (quoting *Law v. Siegel*, 571 U.S. 415 (2014)).

109. See *In re Pier 1 Imports Inc.*, 615 B.R. at n. 2.

operations by the end of March of 2020.¹¹⁰ In response, debtors sought court approval to enter into a period of limited operations to preserve liquidity by furloughing employees and seeking the immediate cessation of all rent obligations, regardless of landlord consent, owed pursuant to § 365(d)(3).¹¹¹ Debtors justified seeking the relief under the court's inherent power in § 105 of the Code. Landlords vehemently opposed the motion, arguing that § 105(a) could not be used to suspend rent obligations because it directly conflicted with § 365(d)(3)'s requirement to "timely [or at least within sixty days of the petition date] perform" lease obligations.¹¹² The court overruled the landlord's objections and granted extraordinary relief: suspension of rental obligations lasting through May 31, 2020.¹¹³

Again, in March of 2020, Modell's Sporting Goods sought protection from the bankruptcy court to temporarily suspend their Chapter 11 case pursuant to equitable powers of the bankruptcy courts, namely 11 U.S.C. §§105 and 305.¹¹⁴ Section 305 of the Code provides that, after notice and hearing, the court may suspend all proceedings in the case if "the interests of the creditors and the debtor would be better served by such . . . [a] suspension."¹¹⁵ Section 105(a) allows the court to "issue any order, process or judgment that is necessary or appropriate to carry out the provisions of [Title 11]."¹¹⁶

While nothing in the Code specifically prohibited the use of § 305(a) to suspend bankruptcy cases in light of market factors (like the COVID pandemic), the legislative history of the Code indicates that the provision was originally meant to permit the court to defer to proceedings or negotiations occurring in another forum (*e.g.*, to suspend the bankruptcy case while litigation was ongoing in another court).¹¹⁷ As such, Modell's reliance on § 305 of the Bankruptcy Code was a novel and non-traditional application of the suspension provision in order to cease store operations and "mothball" the bankruptcy case in light of the COVID-19 pandemic.¹¹⁸ Nevertheless, the court opened the door to a novel use

110. See Ricotta & Walsh, *supra* note 105, at 2.

111. Debtors' Emergency Motion for Entry of an Order (I) Approving Relief Related to the Interim Budget, (II) Temporarily Adjourning Certain Motions and Applications for Payments, and (III) Granting Related Relief, *In re Pier 1 Imports, Inc.*, 20-30805-KRH, *3 (Bankr. E.D. Va. March 31, 2020) (Doc. No. 438).

112. See, *e.g.*, Transcript of Hearing Before the Honorable Kevin Huennekens, *In re Pier 1 Imports, Inc.*, 20-30805-KRH, *13 (Bankr. E.D. Va. April 28, 2020) (Doc. No. 610).

113. *Id.* at *12.

114. Debtors' Verified Application in Support of Emergency Motion for Entry of an Order Temporarily Suspending Their Chapter 11 Cases Pursuant to 11 U.S.C.A. §§ 105 and 305, *In re Modell's Sporting Goods, Inc.*, No. 20-14179 (VPF) (Bankr. D.N.J. Mar. 23, 2020) (Doc. No. 166) [hereinafter "Modell's Suspension Motion"].

115. 11 U.S.C. § 305(a)(1).

116. 11 U.S.C. § 105(a).

117. Kara Bruce, *Adjusting Lease Obligations in Pandemic Bankruptcies*, 40 NO. 10 BANKR. L. LETTER 1, 4 (2020); Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, U.S.C.A.N. (92 Stat. 2549) 5787, 5822, 6281 ("This section recognizes that there are cases in which it would be appropriate for the court to decline jurisdiction. . . . [I]f an arrangement is being worked out by creditors and the debtor out of court, there is no prejudice to the rights of creditors in that arrangement, and an involuntary case has been commenced by a few recalcitrant creditors to provide a basis for future threats to extract full payment. The less expensive out-of-court workout may better serve the interests in the case.").

118. Bruce, *supra* note 117, at 1, 4.

of § 305,¹¹⁹ whereby a debtor could suspend their reorganizations indefinitely based on showing that disruptive world events or extraneous circumstances materially affected their business. As one commentator noted, the relief awarded in Modell's was particularly problematic because it did not fully suspend the underlying bankruptcy case, despite § 305's typical application¹²⁰ of temporarily divesting the court of jurisdiction over the case.¹²¹ Instead, the court remained active after the suspension order, allowing Modell's locations to remain open and operating during the suspension period.¹²² In fact, the court was open to hear objections or orders of relief relating to other matters within the bankruptcy case.¹²³ Thus, through somewhat unorthodox court rulings,¹²⁴ we have seen a reversion to the flexibility of a pre-BAPCPA world whereby debtors are given more time to administer their bankruptcy cases.¹²⁵

As such, the inclusion of bankruptcy language in the CAA can be seen not only as a response to the realities of COVID-19, but also as a direct legislative response to the bankruptcy courts' actions helping debtors with the inflexibility of the Code when facing a twofold challenge: (i) assuming or rejecting all leases within a tight timeframe and (ii) paying rent while doing so.¹²⁶ The CAA attempted to remedy these challenges by extending the timeline to assume or reject leases by a mere ninety extra days.¹²⁷ The CAA does not change language in § 365(d)(4), which places a cap on the assumption or rejection period, meaning that under no circumstances will the extension period extend longer than 300 days after the commencement of a case.¹²⁸ Moreover, the CAA does not amend the requirement that debtors timely perform all of the obligations under the lease, including the payment of rent (except in small-bankruptcy subchapter V cases).¹²⁹ Finally, these changes to the Code are temporary, and do not provide for extended relief to the debtor as the provisions are set to expire for bankruptcy cases filed after December 27, 2022.¹³⁰

119. *Id.* at 4.

120. *See, e.g., In re Picacho Hills Utility Company, Inc.*, 77 Collier Bankr. Cas. 2d (MB) 836, 2017 WL 1067754, at *5 (Bankr. D. N.M. Mar. 21, 2017). ("Suspension under § 305(a) divests the bankruptcy court of jurisdiction over the entire case during the suspension period.")

121. Bruce, *supra* note 117, at 4.

122. *See* Transcript of Motion Hearing Before Honorable Judge Vincent F. Papalia United States Bankruptcy Court Judge at 80, *In re Modell's Sporting Goods, Inc.*, No. 20-14179 (VPF) (Bankr. D.N.J. March 31, 2020) (Doc. No. 187).

123. *Id.* ("You'll have access, especially for something like [a potential 363 sale].")

124. *See* *Law v. Siegel*, 571 U.S. 415 (2014) ("We have long held that "whatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of" the Bankruptcy Code." (quoting *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 206 (1988)).

125. *See* discussion *supra* Section II.B.

126. *See* Press Release, U.S. Senator Thom Tillis, *supra* note 25.

127. *Id.*

128. 11 U.S.C. § 365(d)(4)(B)(i).

129. 11 U.S.C. § 365(d)(3)(A).

130. *See infra* note 132 and accompanying text.

III. ANALYSIS

The CAA does not adequately address the underlying issues regarding the relationship between landlord and tenant-debtor in bankruptcy with respect to assumption and rejection of unexpired leases.¹³¹ The CAA, as evidenced by its explicit language, is meant to provide only temporary relief to debtors in light of a specific external phenomenon, namely the COVID-19 pandemic, not a permanent fix for an historically complex issue.¹³² The deadlines in the bankruptcy amendments of the CAA do very little to solve the problems presented to tenant-debtors holding commercial real property in the face of external phenomenon.

In this sense, COVID-19 highlights an inherent problem already present within the Bankruptcy Code: the BAPCPA amendments place too stringent of timelines on a tenant-debtor while simultaneously depleting their assets through the payment of rent.¹³³ While landlords are given some economic protections throughout the pendency of the bankruptcy, they also lose out on the value of the lease being held up in bankruptcy, and are continually burdened with the providing the tenant-debtor access to the premises.¹³⁴ While the CAA provides a solution slightly better than the status quo, it merely prolongs the resolution of the issue, instead of addressing its fundamental, underlying problems.

To better understand the problem between tenant-debtor and landlord, and to provide potential solutions, it is helpful to look at this issue from a very specific paradigm: understanding the unexpired lease as an option contract. In other words, at the commencement of a bankruptcy case, an unexpired lease can be thought of as converting to an option contract until assumed or rejected by the tenant-debtor.

A. Understanding Unexpired Leases in Bankruptcy as Option Contracts

When a tenant-debtor files for bankruptcy, an estate is automatically created.¹³⁵ Section 541(a) of the Code brings all of the debtor's property, "wherever located and by whomever held," into the estate, including all "legal or equitable interest of the debtor."¹³⁶ The scope of what constitutes property of the estate under § 541 of the Code has been construed broadly by bankruptcy courts to include "every conceivable interest of the debtor, future, nonpossessory, contingent, speculative and derivative."¹³⁷ As such, the estate includes all of the

131. See discussion *supra* Section III.B.

132. See Laurin et al., *supra* note 27.

133. *Id.*

134. See Kenneth A. Rosen, *Make the CARES Act Eviction Moratorium Fair to Landlords*, BLOOMBERG L. (July 15, 2021, 3:01 AM), [https://www.bloomberglaw.com/bloomberglawnews/banking-law/XDJMATJC000000?bna_news_filter=banking-law#cite \[https://perma.cc/3CJP-TCMN\]](https://www.bloomberglaw.com/bloomberglawnews/banking-law/XDJMATJC000000?bna_news_filter=banking-law#cite [https://perma.cc/3CJP-TCMN]).

135. See, e.g., *In re Burgess* 438 F.3d 493, 496 (5th Cir. 2006) ("[P]roperty of the estate is determined at '[t]he commencement of the case.' The case is commenced, and the estate created, when the bankruptcy petition is filed." (quoting *In re Swift*, 129 F.3d 792, 795 (5th Cir. 1997) and 5 Collier on Bankruptcy 541.02 (15th ed. rev. 2005)).

136. 11 U.S.C. 541(a).

137. See, e.g., *In re Yonikus*, 996 F.2d 866, 869 (7th Cir. 1993).

debtor's property, both tangible and intangible, regardless of geographic location or whomever is possessing the property.¹³⁸ Generally speaking, this includes all rights and obligations of the debtor under contracts as of the commencement of the bankruptcy case including franchise agreements, joint venture agreements, and lease agreements.¹³⁹

The conventional way to think about the property rights of the unexpired lease within the bankruptcy estate is to think of the lease as succeeding to the estate as of the date of commencement and continuing unaltered until the tenant-debtor decides to either assign or reject the document under § 365.¹⁴⁰ While the commencement of a bankruptcy case does not necessarily increase or decrease a debtor's interest in property, it does change the party who holds the interest, namely, from the debtor to property held by the bankruptcy estate.¹⁴¹ Once a lease becomes property of the estate, § 365 of the Code determines the contractual obligations of the estate, including the rights of the estate to realize a contract's economic value through the rules of assumption or rejection.¹⁴² Without the benefit of § 365, the unexpired lease would succeed from the debtor to the debtor's estate, and the estate would be automatically bound to the obligations under that contract after the bankruptcy filing (allowing the estate to enjoy the benefits and burdens of the contract).¹⁴³ However, the Code, through § 365, allows the debtor or trustee to reject contracts that are executory in nature.¹⁴⁴ This includes unexpired leases.¹⁴⁵

This conventional viewpoint has conceptual merit. Indeed, the document's terms, obligations, and rights under the unexpired lease have not changed from the time the debtor commences their case until the time chosen to assign or reject.¹⁴⁶

For purposes of this Note, however, it is helpful to think about the unexpired lease viewed through a different lens. Namely, a costless option for the debtor. Although substantively, the lease-document does not change and its substantive terms, obligations, and rights remain unaltered, the document does fluctuate in value during the pendency of bankruptcy. During this period of time, the debtor no longer has the obligation to be bound by the entirety of the agreement (through the act of rejection).¹⁴⁷ In this sense, it is helpful to think of the

138. See, e.g., *In re Simon*, 153 F.3d 991, 996 (9th Cir. 1998), cert. denied, 119 S.Ct. 1032 (1999) (§ 541 sweeps in property of the estate regardless of geographic location); *Shimer v. Fugazy (In re Fugazy Express, Inc.)*, 114 B.R. 865, 869 (Bankr. S.D.N.Y. 1990), aff'd, 124 B.R. 426 (S.D.N.Y. 1991) (§541 sweeps in both tangible and intangible property of the debtor in the estate).

139. See *In re Holywell Corp.*, 913 F.2d 873, 881 (11th Cir. 1990).

140. See *id.*

141. See *In re Sanders*, 969 F.2d 591, 593 (7th Cir. 1992).

142. WARREN ET AL., *supra* note 48, at 562.

143. See, e.g., *In re Superior Air Parts, Inc.*, 486 B.R. 728, 738 (Bankr. N.D. Tex. 2012) ("[W]hen a contract is non-executory, the debtor remains bound to its obligations under that contract after the bankruptcy filing"), *aff'd sub nom*, *Lycoming Engines v. Superior Air Parts, Inc.*, No. 3:13-CV-1162-L, 2014 WL 1976757 (N.D. Tex. May 15, 2014).

144. 11 U.S.C. § 365(d).

145. *Id.*

146. 11 U.S.C. § 365(d).

147. *Id.*

commencement of a bankruptcy case as triggering an option for the debtor, whose strike price is the amount paid to the landlord under the lease under its terms.¹⁴⁸

Were the debtor to be required to assume the lease at the time of the case commencement, the estate would gain title to the property immediately and be required to perform under the lease, irrespective of its terms.¹⁴⁹ However, because the tenant-debtor can choose to assume or reject the lease under § 365, the tenant-debtor can “execute” the option at the agreed-upon terms *or* they can choose to wait and test the market.¹⁵⁰ In other words, the Code allows the tenant-debtor to occupy the premises under the lease according to a certain price, and wait until the economy improves, at which point the tenant has the option to assume below-market leases or reject their above-market ones.¹⁵¹

This creates a costless option for the debtor.¹⁵² This option gives the current (bankrupt) tenant the right, but not the obligation, to assign the lease to another tenant or assume the lease for its (the debtor-lessee’s) own use.¹⁵³ Moreover, to whatever extent a debtor can prolong their stay in bankruptcy, the debtor could expand the value of their newly acquired costless option at a direct disadvantage to the landlord.¹⁵⁴

To show how an option-value approach can advance understanding the incentive structure of § 365(d)(4) of the Code, I analyze a simple hypothetical model by way of example. The hypothetical demonstrates a basic case in which a tenant-debtor could reap the benefit of a prolonged period of time to assume or reject unexpired leases.

1. *A Hypothetical Case*

Consider a situation where tenant-debtor *T* holds a 1,000 square foot leasehold in a shopping center held by landlord *L*. In this hypothetical, also assume that *T* and *L* are both parties to a lease agreement for \$1 per square foot, with \$1 per square foot increases each year. Also assume that the lease agreement was entered into five years ago but has a ten-year term. Thus, at year one (Y_1), *T* paid \$1,000; in Y_2 , *T* paid \$2,000 . . . and now, in Y_5 , *T* pays \$5,000. Also, for purposes

148. Platt et al., *supra* note 84, at 4. For a similar conversation regarding option-preservation in Chapter 11, see generally Anthony J. Casey, *The Creditors’ Bargain and Option-Preservation Priority in Chapter 11*, 78 U. CHI. L. REV. 759 (2011).

149. See, e.g., *In re Superior Air Parts, Inc.*, 486 B.R. 728, 738 (Bankr. N.D. Tex. 2012), *aff’d sub nom*, *Lycoming Engines v. Superior Air Parts, Inc.*, No. 3:13-CV-1162-L, 2014 WL 1976757 (N.D. Tex. May 15, 2014).

150. See 11 U.S.C. § 365(d)(1).

151. Platt et al., *supra* note 84, at 4.

152. For more information about options, see Marshall Hargrave, *Options Contract*, INVESTOPEDIA (Sept. 3, 2021), <https://www.investopedia.com/terms/o/optionscontract.asp> [<https://perma.cc/JBE9-NKAB>].

153. *Id.*

154. See Fischer Black & Myron Scholes, *The Pricing of Options and Corporate Liabilities*, 81 J. POL. ECON. 637, 649–53 (1973); Robert C. Merton, *Theory of Rational Option Pricing*, 4 BELL J. ECON. & MGMT. SCI. 141, 141–42 (1973). (“Normally the value of an option declines as its maturity date approaches, if the value of the stock does not change.”)

of this hypothetical, assume in year five T files for bankruptcy and the unexpired lease falls under § 365 of the Code.

T is presented with a few options depending on the market for a 1,000 square foot lease in L 's shopping mall. If T determines that the lease agreement is above-market (in other words, if property values in the market are less than \$1 per square foot; *i.e.*, lower than their value at the time the lease was signed), T is paying “too much” for rent at the contracted price. T can reject the lease according to § 365 and the effect on the bankruptcy estate is that L has a prepetition breach of contract claim which will be paid out an unsecured creditor through the administration of the case (likely for pennies on the dollar).¹⁵⁵

If T determines that the lease agreement is below-market (in other words, if property values in the market rise above \$1 per square foot; *i.e.*, higher than their value at the time the lease was signed), T will opt to assume the lease at the contracted price under its present terms. According to §541(a) the assumed lease will be property of the estate, and the debtor in possession (T) would be able to assign the lease to a third party at the current market rate (above \$1 per square foot) to realize a gain of the difference between the lease values.

If T is strategically minded—and there are no limitations on the time T has to assume or reject their lease— T can wait as long as possible to wait until the market improves to get the best price and realize the highest amount of money for the estate.

Thus, imagine a volatile market for the lease in the next few years: the market in Y_5 is \$5, but the market in Y_6 falls to \$1 per square foot and then increases dramatically to \$20 per square foot in Y_7 . Assuming T foresees a market uptick, T is incentivized to wait until Y_7 before assuming the lease. In this case, T will “execute” the strike price of their option (the unexpired lease with L) by assuming the lease at a contract price of \$7 per square foot (\$7,000) according to the terms of the agreement, and then assigning the lease to a third party for the market rate of \$20 per square foot (\$20,000), realizing the capitalized gain of \$13 per square foot (\$13,000). This calculation assumes that the transaction has zero costs.

Unfortunately, under the realities of the Code under both BAPCPA and the CAA, T would not be able to capitalize on this gain; T would be forced to assume or reject the lease within the strict time periods set forth in § 365(d)(4).¹⁵⁶ Under the CAA, T only has 210 days after the order of relief (here, in Y_5 —the date of the commencement of his bankruptcy case) to assume or reject their lease agreement with L . Thus, if the deadline under § 365(d)(4) falls within Y_5 , T will only be able to realize the market price of \$5 per square foot (in this case, T will likely

155. See *NLRB v. Bildisco and Bildisco*, 465 U.S. 513, 530–31 (1984). The nondebtor party has (1) a claim against the debtor for damages for breach of contract, which claim is deemed to have arisen immediately before the filing of the petition and is a prepetition claim, and (2) an expense of administration claim for any benefits received by the debtor in possession prior to rejection. *In re Bridgeport Plumbing Prods., Inc.*, 178 B.R. 563, 565 (Bankr. M.D. Ga. 1994) (creditor may file administrative expense claim for the “reasonable value of the use” of the creditor’s property prior to rejection); *In re Hooker Investments*, 145 B.R. 138, 144 (Bankr. S.D.N.Y. 1992); see also *Texaco Inc. v. Louisiana Land and Exploration Co.*, 136 B.R. 658, 663–64 (M.D. La. 1992).

156. See 11 U.S.C. § 365(6)(4) (2005), (2020).

reject the lease if the price is too burdensome). Under the present circumstances, *T* would never have the option to assume the contract in *Y*₇ to capture the increased value of their unexpired lease.

2. *Limitations to the Hypothetical Case and the Option Paradigm*

While the above hypothetical case is useful for a high-level understanding of unexpired leases in bankruptcy as option contracts, there are a few limitations which must be recognized. First, the above hypothetical assumes that *T* has perfect knowledge of the market (and future markets) when determining whether to assume or reject their unexpired lease. In reality, the market is much more uncertain and imperfectly recognized by both the debtor and landlord. Thus, it must be noted that in practice there are costs associated with determining the market price and overall decision-making involved.¹⁵⁷ It must be stressed that assumption and rejection is never as simplistic as the above hypothetical suggests.

Secondly, and more broadly, the above hypothetical suggests that *T*'s lease agreement with *L* is somewhat fungible insofar as *T*'s lease can be assigned to a willing and able third party. Additionally, the hypothetical assumes that the market is considerably less liquid with respect to lease agreements, in comparison to, say, stocks or securities. It must be noted that, in practice, *T*'s lease agreement with *L* is a specialized agreement between two specialized parties: leaseholders in a shopping center. This, however, is a matter of degree and not kind.¹⁵⁸ All that is required for a practical assumption and assignment is that the third party is sufficiently similar as to satisfy the obligations under the lease agreement to be able to perform.¹⁵⁹

Nevertheless, despite its limitations, the option-value paradigm is useful for a nuanced understanding of unexpired leases in bankruptcy as option contracts. The market is certainly not as frictionless as the hypothetical suggests, but, as this Note discusses in Part IV, options-pricing techniques can proceed from these generalized observations.

B. *More on the Loss of Lease Value During Bankruptcy*

As discussed in Part II, the primary reason for BPCPA's creation of a deadline to assume or reject unexpired leases was to appease commercial landlords.¹⁶⁰ In the expansionary economic period preceding BAPCPA (pre-2005), most tenants held below-market leases with a face value below current-market due to increased demand pressure on lease rates at that time.¹⁶¹ Therefore, in a strong economy, leaseholders, and therefore tenant-debtors attempting to reorganize, had an incentive to hold the lease during bankruptcy and continue to operate, hoping their economic condition improved or to assign the lease to another

157. *See id.*

158. *See id.*

159. 11 U.S.C. § 365(b)(3) (2020).

160. *See supra* Section II.C.

161. *See* Platt et al., *supra* note 84, at 13.

retailer who would pay them something to take over the valuable below-market lease.¹⁶² Where above-market leases could be rejected, the below-market leases could be assumed or assigned for a profit.¹⁶³

While the prevalence of this phenomenon is tacitly approved of by the plain language of the Code, there is reason to doubt that the current procedures for assumption and rejection of executory leases achieve the fundamental goals of an appropriate system of reorganization.¹⁶⁴ Indeed, the efficiency of the Code's provisions on the assumption and rejection of leases is called into question and distorted by the diverging incentives of landlord and debtor-tenant. On one hand, the stringent timeline of the Code incentivizes tenant-debtors to make uninformed decisions about individual leases, or at a minimum, simply to sell an entire lease portfolio instead of making financial analyses for each individual lease.¹⁶⁵ The rushed timelines set forth in the Code result in an inefficient sale of the debtors' valuable assets, namely, their unexpired leases which could be sold or retained for a profit to the direct benefits of creditors.¹⁶⁶

On the other hand, if leases were extended indefinitely, landlords would be losing out on the value of the unexpired lease because it is locked into a below-market agreement with a bankrupt debtor, in a seemingly perpetual holding pattern to perform under obligations of the lease until the market increases, at which point the tenant-debtor realizes 100% of the lease's value.¹⁶⁷ To add insult to injury, while the tenant-debtor waits indefinitely to assume the lease, the landlord also loses the "opportunity cost" of leasing to a new, solvent tenant. Moreover, while the bankruptcy proceeding is delayed (waiting for the tenant-debtor to assume or reject), all the debtor's creditors lose out on being repaid in a timely and efficient manner.¹⁶⁸

Such inefficiencies caused by the deadlines set forth in both BAPCPA and the CAA mean the assets of the tenant-debtor are not maximized for the benefit of the estate. For example, when the tenant-debtor is in full control, the length of the reorganization is extended to maximize the unexpired lease value (waiting for the market), and all creditors lose value in terms of not being able to collect their repaid debt. Conversely, when the landlord is in full control, the unexpired leases are sold at less than their highest value. In either case—where a definitive deadline exists *or* where there are no time limitations on debtor's assumption and rejection right—the full potential value of the unexpired lease is not fully realized. Therefore, in any circumstance without significant change to the Code, the bankruptcy will be suboptimal.¹⁶⁹

162. *Id.* at 14.

163. *Id.* at 4.

164. For a similar discussion on options-theory being useful conceptually for capturing lost value in bankruptcy, see generally Casey, *supra* note 148.

165. *See supra* Section II.C.

166. *See supra* Section II.C.

167. *See supra* Section II.B.

168. *See supra* Section II.C.

169. Moreover, there is a low chance that this problem could be mitigated by negotiations between landlord and tenant due to the transaction costs associated with prolonged negotiations. *See* Thomas H. Jackson, *Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain*, 91 YALE L.J. 857, 866–67 (1982).

The CAA attempts to find a middle ground by arbitrarily fixing a deadline so that the length of the reorganization will not be affected by the tenant-debtor's choice to wait before assuming or rejecting the lease.¹⁷⁰ However, the deadlines set forth in the CAA say nothing about the lost value of an unexpired lease from the landlord providing an option to their tenant-debtor during bankruptcy.¹⁷¹

According to the law and economics account of bankruptcy, the loss of the unexpired lease value is a failure of the system.¹⁷² The optimal system of reorganization should be designed to maximize the value of the debtor's assets for the benefit of all creditors.¹⁷³ By increasing the pool of assets in bankruptcy, all creditors benefit by enlarging the "pie" they are dividing amongst themselves.¹⁷⁴

Indeed, the landlord, in theory, should also want to enlarge the pie for all parties as well. When the expected value of assets in bankruptcy is not maximized, the costs of a suboptimal bankruptcy outcome are borne by all creditors (landlord included), as a reduced expected value.¹⁷⁵ Therefore, if mechanisms exist to realize a more efficient procedure, they should be adopted by all parties.¹⁷⁶

However, the current law under the CAA does not realize the most efficient procedure, at least with reference to the timeline given to tenant-debtors to assume or reject their unexpired leases. In practice, *both* BAPCPA and CAA *per*versely require strict timelines for assumption and rejection to curb the tenant-debtor's realization of value from the costless option.¹⁷⁷ Moreover, by extending these deadlines arbitrarily for an additional 90 days,¹⁷⁸ the CAA does little to remedy this inherent flaw in the Code.

IV. RECOMMENDATION

One of the fundamental goals of bankruptcy is the principle that struggling debtors entering bankruptcy are afforded a "breathing spell" from creditors to effectuate a return from indebtedness to economic productivity.¹⁷⁹ During this time, debtors are relieved from financial pressures and are given enough time to create a repayment or reorganization plan.¹⁸⁰ However, as this Note suggests, these maxims of bankruptcy are in direct conflict with Code language placing stringent time limitations on tenant-debtors for assumption or rejection of

170. See Consolidated Appropriations Act of 2021, Pub. L. No. 116-260, Div. FF, Title X, § 1001(f).

171. See *id.*

172. See Jackson, *supra* note 169, at 880.

173. *Id.* at 860.

174. *Id.* at 864-65.

175. See *id.* at 861-62.

176. See *id.*

177. 11 U.S.C. § 365(d)(4)(B)(i) (2005) (amended in 2020).

178. See *id.*

179. H.R. REP. NO. 595, 95th Cong., 1st Sess. 340 (1977), reprinted in 1978 U.S.C.A.N. 5787, at 6296-97 (1978) (The "breathing spell" is important as it gives the bankruptcy trustee the opportunity to inventory the debtor's position before proceeding with the administration of the case).

180. William Bassin, *Why Courts Should Refuse to Enforce Pre-Petition Agreements That Waive Bankruptcy's Automatic Stay Provision*, 28 IND. L. REV. 1, 4 (1994).

unexpired leases. While it is true that bankruptcy courts have been historically characterized as “courts of equity,” in recent years there has been a continual contraction of the bankruptcy courts’ equitable powers.¹⁸¹ Namely, there has been pervasive case law to suggest that, despite the need for judicial discretion to accommodate inevitably changing legal environments, bankruptcy judges are fundamentally bound to the language of the Bankruptcy Code.¹⁸² This tension is highlighted in recent retail bankruptcies during the COVID-19 pandemic, where bankruptcy courts are stuck between a rock and a hard place: being flexible to struggling debtors during a pandemic or violate the strict timelines set forth in the Code.¹⁸³

In 2020, the CAA was passed, in part, to respond to such concerns. The discussion in Part III indicates, however, that a mere 90-day extension of the code does not allow much for tenant-debtors or commercial landlord to realize the full potential value of unexpired leases.¹⁸⁴ Instead, the debtor’s estate should be allowed some more flexibility, but also be required to internalize the cost of waiting to assume or reject their unexpired leases. This Note provides two recommendations, working in tandem to remedy this apparent suboptimal realization of unexpired lease value, with particular emphasis on the need to curb the stringent deadlines set forth in the Code.

First, this Note recommends a return to the pre-BAPCPA world by repealing the maximum 210-day period (300-day period under the CAA) for debtors to assume or reject non-residential real property leases. Instead of the current 210-day initial period, up to a 90-day extension, the statute would revert back to a 60-day period to assume or reject. But, more importantly, the statute would allow the bankruptcy court to grant further extensions without any limit, “for cause.”¹⁸⁵ In this way, bankruptcy courts are placed in a position to evaluate the benefits and burdens of the present situation and to make an informed decision on whether the market is viable for assumption or rejection.

While this is a potentially viable option, it must be recognized that this recommendation standing alone lacks sufficient protection for commercial landlords. In essence, the same issues presented pre-BAPCPA would emerge: debtors could hold a lease for long periods of time—essentially holding an unlimited and costless option—and only assume or reject their lease when economically convenient, to the direct detriment of their landlords.

Therefore, as an additional protection for landlords, this Note proposes that there should also be changes to the Code to allow commercial landlords to capture the lost extrinsic value (time-value) of the tenant-debtor’s unexpired lease. In other words, commercial landlords should be allowed to recoup some of the

181. See, e.g., *Law v. Siegel*, 571 U.S. 415, 422–23 (2014).

182. See *id.*

183. See, e.g., Ricotta & Walsh, *supra* note 105.

184. See *supra* Part III.

185. Bob Eisenbach, *Legislation Introduced to Repeal Certain Business Bankruptcy Changes Made by BAPCPA’s 2005 Amendments*, COOLEY: IN THE RED: BUS BANKR. BLOG (Apr. 5, 2009), <https://bankruptcy.cooley.com/2009/04/articles/business-bankruptcy-issues/legislation-introduced-to-repeal-certain-business-bankruptcy-changes-made-by-bapcpas-2005-amendments/> [https://perma.cc/Q48K-HTN4].

value of the unexpired contract as an administrative expense. By making this change to the Code, debtors could have a flexible timeframe to assume or reject leases, but would be disincentivized to extend their leases indefinitely during bankruptcy because they would also be required to provide the landlord adequate compensation during the pendency of the prolonged bankruptcy.¹⁸⁶ Moreover, bankruptcy courts would monitor the process, only extending the deadline to assume or reject upon a showing by the tenant-debtor that such extension would be beneficial to the estate.

A. Valuing Unexpired Leases in Bankruptcy as Options

When a lease is rejected under § 365 of the Code, commercial landlords are limited to a prepetition breach of contract recovery for statutory damages as set forth in § 502(b)(6).¹⁸⁷ That section of the Code limits recovery to claims pursuant to a statutory formula, calculated as “the [non-accelerated] rent reserved by [the] lease . . . for the greater of one year, or 15 percent, not to exceed three years, of the remaining term of such lease”¹⁸⁸ Although courts apply this language differently across jurisdictions,¹⁸⁹ in all cases, landlord damages are capped at a percentage over the remaining term to compensate the landlord for the tenant-debtor rejecting the lease. Currently, however, there is no statutory calculation for compensating the landlord for capturing lost *value* of an assumed lease in bankruptcy.

If we take the perspective that, at the moment of commencement, an unexpired lease converts to a costless option for the tenant-debtor, we can calculate the value of an option and allow for the landlord to recover that amount as an administrative expense in bankruptcy. As such, we can allow the landlord to recoup some of the lost value of the unexpired lease as compensation for letting the tenant-debtor extend their option over time.

A common method to determine the exact value of a particular option contract is the Black-Scholes model.¹⁹⁰ The Black-Scholes model is a relatively complex formula which derives the price of an option from five factors: (1) the time until the option expires, (2) the strike price, (3) the value of the underlying stock, (4) the volatility of the price of the underlying stock, and (5) the risk free

186. See *infra* Section IV.A.

187. 11 U.S.C. § 506(b)(6) (2020).

188. *Id.*

189. These courts calculate the amount of rent due over the remaining term of the lease and multiply that amount times 15%. See, e.g., *In re USInternetworking, Inc.*, 291 B.R. 378, 380 (Bankr. D. Md. 2003) (citing *In re Today's Woman of Florida, Inc.*, 195 B.R. 506 (Bankr. M.D. Fl. 1996)); *In re Gantos*, 176 B.R. 793 (Bankr. W.D. Mich. 1995); *In re Financial News Network, Inc.*, 149 B.R. 348 (Bankr. S.D.N.Y. 1993); *In re Communicall Cent., Inc.*, 106 B.R. 540 (Bankr. N.D. Ill. 1989); *In re McLean Enter., Inc.*, 105 B.R. 928 (Bank. W.D. Mo. 1989). Other courts calculate lease rejection damages based on 15% of the “remaining term” of the lease. See, e.g., *In re Iron-Oak Supply Corp.*, 169 B.R. 414, 419 n. 8 (Bankr. E.D. Cal. 1994); *In re Allegheny Intern., Inc.*, 145 B.R. 823 (W.D. Pa. 1992); *In re PPI Enterprises, Inc.*, 324 F.3d 197, 207 (3rd Cir. 2003).

190. See Fischer Black & Myron Scholes, *The Pricing of Options and Corporate Liabilities*, 81 J. POL. ECON. 637 (1973).

interest rate.¹⁹¹ The model makes several assumptions, including that price changes of the underlying stock are lognormally distributed, and if such assumptions hold, Black-Scholes can offer “a precise theoretical value for [an] option.”¹⁹²

In its terms, the Black-Scholes call option formula is calculated by multiplying the stock price by the cumulative standard normal probability distribution function.¹⁹³ Thereafter, the net present value (“NPV”) of the strike price multiplied by the cumulative standard normal distribution is subtracted from the resulting value of the previous calculation.¹⁹⁴

Typically, this well-known pricing model is implemented in a setting which pertains to financial options trading on the open market.¹⁹⁵ Because the formula is simple to use and is closed-form, insofar as the inputs and computations are finite in nature and well-defined in valuation theory, it can be used in other contexts as well.¹⁹⁶ Thus, although the Black-Scholes model was a major development in the valuation of financial options,¹⁹⁷ today the model can be extended and employed to value real estate leases pending in bankruptcy.¹⁹⁸

In fact, Mark Pomykacz and Chris Olmstead utilized the Black-Scholes model in their 2013 paper, *Options in Real Estate Valuation*, to assist real estate appraisers valuing purchase options.¹⁹⁹ In the paper, they usefully translate classic financial terminology and market measurements into terms and measurements that can be inserted into the real estate context.²⁰⁰

For example, they indicate that market value would be equivalent to the stock price in the traditional model.²⁰¹ Market value can be estimated as the value of the unexpired lease, assuming the use and rights of the property at the option expiration date.²⁰² Similarly, the strike price and term would be the contract price at a future date when the option is called, and the amount of time taken to assume or reject the lease (the “term” of the option).²⁰³ For the purposes of this Note, the bankruptcy court could estimate the strike price as the current market value grown at the appropriate inflation rate for the “term,” or the time period between the commencement of a case and the decision to assume or reject the lease.²⁰⁴ If

191. David F. Babbel, Vincent James Strickler & Ricki Sears Dolan, *Statistical String Theory for Courts: If the Data Don't Fit . . .*, SU024 AM. L. INST. ALI-CLE COURSE MATERIALS 83 (Sep. 20–21, 2012).

192. See Charles T. Perry, *Option Pricing Theory and the Economic Incentive Analysis of Nonrecourse Acquisition Liabilities*, 12 AM. J. TAX POL'Y 273, 339 (1995).

193. Adam Hayes & Gordon Scott, *Black Scholes Model*, INVESTOPEDIA (Mar. 8, 2021), <https://www.investopedia.com/terms/b/blackscholes.asp> [<https://perma.cc/B6F7-ENWB>].

194. *Id.*

195. Mark Pomykacz & Chris Olmstead, *Options in Real Estate Valuation*, APPRAISAL J. 227, 235 (2013).

196. *Id.*

197. *Id.*

198. *Id.*

199. *Id.*

200. *Id.*

201. *Id.*

202. *Id.*

203. *Id.*

204. *Id.*

these assumptions about value are made, then subsequent assumptions about risk, volatility, and dividends must also be made as well.

Typically, volatility in the closed-form model describes the potential range of the change in the future price of a stock.²⁰⁵ According to Pomykacz and Olmstead, this is analogous to an appraiser's time adjustment, or the expected change in market value over the term.²⁰⁶ They note that, although in the financial context volatility is derived by analyzing historical changes in stock markets, valuation in the real estate context may be limited to the data available on hand.²⁰⁷ Thus, an analogous real estate model of volatility might depend on *past* valuations. Nevertheless, there are good foundations for probabilistic value change forecasts on which to compute a basic model. For example, a bankruptcy court can calculate volatility by looking to substantially similar leases, finding a meaningful range of potential change in value over time—and then calculating the variance during the period between the commencement of the case and the assumption/rejection date.

Finally, the risk-free interest rate is a type of yield rate employed in the Black-Scholes Model.²⁰⁸ Pomykacz and Olmstead note that the Black-Scholes model uses the low-risk alternative rate, or the yield rate from the low-risk category of alternative investments.²⁰⁹ In the financial context, this would be the low rate for government bonds or AAA corporate bonds, but the real estate rate would be higher than what would be used for stock and options valuation, in part, due to “illiquidity, maturity risk premium, lack of diversification, management intensity, and other risks associated with real estate investment.”²¹⁰

As such, if we want to provide value to the landlord while an unexpired lease stays open for assumption or rejection, one logical resolution is to pay the landlord an approximation of the “option value” of the unexpired lease which can be calculated using the Black-Scholes method.

B. Example Calculation of Bankruptcy Lease Option Value

The role of the components of the Black-Scholes model can be illustrated in the following example of an unexpired lease in bankruptcy. For the purposes of this Note, consider a bankruptcy court making an *ex-post* determination of the option value of the unexpired lease, in order to add that value as an administrative priority expense for the landlord after the trustee's (or debtor-in-possession's) decision to assume or reject. This model is based off Pomykacz and Olmstead's similar calculations in the context of real estate appraisal option pricing.²¹¹

In this example, assume an unexpired lease had a value of \$1,000,000 and was able to assign the lease to another tenant for \$1,050,000 during a period of

205. *Id.* at 236.

206. *Id.*

207. *Id.*

208. *Id.* at 237.

209. *Id.*

210. *Id.*

211. *Id.*

six months (0.5) between the commencement of the case and the decision to assume or reject the lease. Additionally, assume a riskless rate of 5.0% and a volatility estimate of 7.5%. Using this information, a bankruptcy court can estimate the value of the option that was given to the debtor during the assumption/rejection period and charge the debtor this administrative expense according to the calculations in Table 1. Note that dividend yields are usually not expected in real estate purchase options and therefore are included in the model at 0.0%.

TABLE 1

Table 1 – Option Valuation		
Inputs		
Lease value (t_0)	V	\$1,000,000
Strike Price (t_1)	K	\$1,050,000
Volatility	σ	7.5%
Riskless Rate	r	5.0%
Term	T	0.25
Annual Dividend	q	0.0%
Intermediate Steps		
NPV of K, at r , $T = K_0$	K_0	\$1,024.08
$= V/(1+r)^t$		
$d1 = (\text{Natural Log}(V/K) + (r - q + \sigma^2/2) \times T) / (\sigma \times \text{Square Root}(T))$	d1	(0.422075)
$d2 = d1 - (\sigma \times \text{Square Root}(T))$	d2	(0.475108)
Final Step		
Option Value =	c	\$11,490.00
$V \times \text{Standard Normal Cumulative Distribution}(d1) - K_0 \times \text{Standard Normal Cumulative Distribution}(d2)$		

C. Limitations to this Recommendation

One significant limitation to the recommendation is that some retail debtors are administratively insolvent, meaning the debtor in possession cannot pay for even *post-petition* costs associated with administration of the estate.²¹² As such, a tenant-debtor who knows they will be administratively insolvent in bankruptcy—disincentivized to care about costs associated with extending the time to assume or reject leases indefinitely—will almost certainly extend the bankruptcy case to their advantage. In these cases, bankruptcy courts should operate as a failsafe to weigh the benefits and burdens of the creditors and tenant-debtors,

212. Nicholas J. Zluticky, *Managing Risks in Doing Business with Administratively Insolvent Retail Debtors*, J. CORP. RENEWAL, April 2020, at 25, available at <https://www.stinson.com/assets/htmldocuments/Managing%20Risks%20in%20Doing%20Business%20with%20Administratively%20Insolvent%20Retail%20Debtors.pdf> [<https://perma.cc/5LWX-QYT6>].

only granting extensions when value can be viably created for the bankruptcy estate.

V. CONCLUSION

In 2020, the CAA amendments to the Code modified the treatment of unexpired leases of nonresidential real property in bankruptcy, but ultimately failed to address underlying issues in the Code.²¹³ Specifically, the CAA sought to extend bankruptcy deadlines for tenant-debtors to assume or reject unexpired leases of nonresidential real estate.²¹⁴ Prior versions of the federal bankruptcy law struggled immensely with the question of assumption and rejection of unexpired leases. Prior to the modern Code, bankruptcy courts often extended the 60-day timeline, for months or years, to assume or reject unexpired leases, often to the detriment of commercial landlords.

Sweeping changes to the code in 1978 eliminated the timeline altogether.²¹⁵ In 1984, landlords lobbied Congress to explicate strict guidelines and timetables for assumption and rejection.²¹⁶ The practical consequences of the 1984 changes to the Code struggled to find the right balance between the inherent tension of landlord and tenant in bankruptcy. Changes in 2005 reduced timelines further to limit tenant-debtors from prolonged periods of time between the commencement of a case and assumption or rejection.²¹⁷ The inclusion of bankruptcy language in the CAA can be seen not only as a response to the harsh timelines of the Code juxtaposed against the realities of COVID-19, but also as a direct legislative response to the bankruptcy courts across the United States which provided equity power to alleviate the stressors of the Code.²¹⁸

COVID-19 highlighted inherent problems already existing within the Bankruptcy Code: the inflexible timeline given to tenant-debtors to assume or reject unexpired leases, and landlords losing out on the value of those leases during that period of time. Today, the Code allows the tenant-debtor to occupy a leasehold premises under a certain set price and wait until the economy improves, at which point the tenant has the option to reject their above-market leases, or assume below-market leases.²¹⁹ This creates a costless option for the debtor.²²⁰ Moreover, the stringent timelines to assume or reject unexpired leases chill the effect of finding qualified tenants to sell unexpired leases in favor of selling the entire portfolio as a whole. As such, instead of capturing the value of each

213. *Supra* Part II, III.

214. 11 U.S.C. 365(d)(4)(A)(i), (B)(i) (as amended in 2020 by the CAA).

215. *Id.*

216. *Id.*

217. *Supra* Part II, III.

218. See Press Release, U.S. Senator Thom Tillis, Tillis Introduces Bill to Provide Landlord-Tenant Bankruptcy Relief in Response to the Coronavirus Pandemic, *supra* note 25.

219. Platt et al., *supra* note 84.

220. Marshall Hargrave, *What is an Options Contract?*, INVESTOPEDIA (Dec. 22, 2020), <https://www.investopedia.com/terms/o/optionscontract.asp> [<https://perma.cc/JBE9-NKAB>]; Fischer Black & Myron Scholes, *The Pricing of Options and Corporate Liabilities*, 81 J. POL. ECON. 637, 649–54 (1973); Robert C. Merton, *Theory of Rational Option Pricing*, 4 BELL J. ECON. & MGMT. SCI. 141, 141–42 (1973).

individual unexpired lease for the benefit of creditors, tenant-debtors are incentivized to package-and-sell to make deadlines or negotiate with their landlord for additional extensions where a definitive deadline exists *or* if there were no time limitations on debtor's assumption and rejection right—the full potential value of the unexpired lease is not being fully realized. In any circumstance, without significant change to the Code, the bankruptcy will be suboptimal.²²¹

Instead, this Note recommends a two-pronged approach. First, this Note calls for a return to the pre-BAPCPA world by repealing the maximum 210-day period (300-day period under the CAA) for debtors to assume or reject non-residential real property leases. Instead, the statute would revert to a simple sixty-day period to assume or reject but, more importantly, would allow the bankruptcy court, for cause, to grant further extensions without any limit.²²² This timeline better captures the need for flexibility in a bankruptcy case, keeping in mind that a fundamental goal of bankruptcy is to allow the debtor a “breathing spell” to reorganize.

Secondly, as an additional protection for landlords against debtors' indefinite extension of the term during bankruptcy, this Note proposes that there should also be changes to the Code to allow commercial landlords to capture the lost option-value of the tenant-debtor's unexpired lease. In other words, commercial landlords should be allowed to recoup some of the value of the unexpired contract as an administrative priority expense. A modified approach could use the Black-Scholes model to capture such an option-value for the lease during the pendency of the case.

221. See Thomas H. Jackson, *Bankruptcy, Non-bankruptcy Entitlements, and the Creditors' Bargain*, 91 *YALE L.J.* 857, 866–67 (1982).

222. Eisenbach, *supra* note 185.

