Economic Shutdown and Commercial Rent In Chapter 11

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I. INTRODUCTION

As we know all too well, the COVID-19 pandemic caught the world off-guard. The virus continues to accumulate a staggering list of victims, but the direct threat to public health also carried with it shock waves that rocked the global economy. At the beginning of the pandemic, commentators in the United States predicted an increase in financially distressed corporations filing for Chapter 11 bankruptcy.[1] Fortunately, the increase in Chapter 11 filings was smaller than initially anticipated.[2] Though the courts did not face a case-volume crisis, the corporate cases filed in the first half of 2020 faced a novel impediment: economic lockdown.[3] Firms generally need a functioning economy

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[1] *See* Khristopher J. Brooks, *Bracing for the Next Phase of the Coronavirus Recession: Bankruptcies*, CBS NEWS: MONEYWATCH (June 9, 2020), https://www.cbsnews.com/news/bankruptcy-coronavirus-recession-2020/ [https://perma.cc/QP7V-8U7R].

[2] *See* Peter Coy, *Bankruptcies Show a Surprising Decline*, BLOOMBERG BUSINESSWEEK (Oct. 9, 2020), https://www.bloomberg.com/news/articles/2020-10-09/bankruptcies-show-a-surprising-decline [https://perma.cc/2V6A-ULPN].

[3] In the United States, the President declared a national emergency, and state governors issued "stay-at-home" orders that had the effect of shutting down the economy. Business leaders had to adapt rapidly to these unprecedented government orders. This was especially true for captains at the helm of distressed corporations in Chapter 11 bankruptcy. Proclamation No. 9994, Fed. Reg. 15,337 (Mar. 13, 2020); *see* Sarah Mervosh et al., *See Which States and Cities Have Told Residents to Stay at Home*, N.Y. TIMES (Apr. 20, 2020), https://www.nytimes.com/interactive/2020/us/coronavirus-stay-at-home-order.html [https://perma.cc/N39U-8ACY]; *see also Status of State COVID-19 Emergency Orders*, NAT'L GOVERNORS ASS'N (last updated July 19, 2021), https://www.nga.org/coronavirus/ [https://perma.cc/FQD5-4HM7]; *see, e.g.*, Order of the Governor of the Commonwealth of Pennsylvania Regarding the Closure of All Businesses That Are Not Life Sustaining (Mar. 19, 2020) (closing non-essential businesses); N.Y. Exec. Order 202.8 (Mar. 20, 2020) (same); Conn. Exec. Order 7H (Mar. 20, 2020) (same).

to proceed regardless of the planned outcome. Whether the trustee liquidates the business piecemeal,[4] sells it at auction as a going concern and distributes cash pro rata to creditors,[5] or parties agree to reorganize the capital structure and distribute ownership pro rata amongst creditors,[6] stay-at-home orders create a significant obstacle for firms in Chapter 11.

In this realm of distressed corporate debtors, this Comment will focus on Judge Papalia's serial suspension orders in the Chapter 11 case of the famous Tri-State sporting goods retailer headquartered in New York City, Modell's Sporting Goods, Inc. In *In re Modell's Sporting Goods, Inc.*[7] (hereinafter "Modell's Case"), Judge Papalia granted successive orders under the authority of §§ 105 and 305 of the Code—an unprecedented combination of two provisions that enable judicial discretion. These orders had the effect of suspending Modell's payment of commercial rent obligations in apparent contravention of § 365(d)(3) of the Code. This Comment examines the use of § 105 and § 305 and the facts of the case to determine whether this combination of provisions should be considered a valid application of the Code going forward.

Overleveraged and out of options, Modell's Sporting Goods, Inc., and its subsidiaries (collectively "Modell's"), like many retailers before it,[8] filed for Chapter 11 bankruptcy on March 11, 2020.[9] Though bankruptcy courts generally respect corporate separateness,[10] complex corporate bankruptcies that involve a parent and various subsidiaries are

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[4] *See* 11 U.S.C. § 363(b)(1).

[5] *See id.*

[6] *See* 11 U.S.C. § 1123.

[7] No. 20-14179 (Bankr. D.N.J. Mar. 11, 2020).

[8] *See* Walter Loeb, *More Than 15,500 Stores Are Closing in 2020 So Far—A Number that Will Surely Rise*, FORBES (July 5, 2020), https://www.forbes.com/sites/walterloeb/2020/07/06/9274-stores-are-closing-in-2020--its-the-pandemic-and-high-debt--more-will-close/?sh=5a896a2d729f [https://perma.cc/9YUE-WDDB] (explaining that the decline of brick-and-mortar retail sales (the "retail apocalypse"), which began in 2010 with the rise of e-commerce competition, accelerated during the pandemic summer of 2020).

[9] Voluntary Petition for Non-Individuals Filing for Bankruptcy, *In re* Modell's Sporting Goods, Inc., No. 20-14179 (Bankr. D.N.J. Mar. 11, 2020), ECF No. 1 [hereinafter "Voluntary Petition"]. The filing included thirteen debtor entities including Modell's Sporting Goods, Inc.; Modell's NJ II, Inc.; Modell's DC II, Inc.; Modell's DE II, Inc.; Modell's II, Inc.; Modell's Maryland II, Inc.; Modell's Massachusetts, Inc.; Modell's NH, Inc.; Modell's NY II, Inc.; Modell's Online, Inc.; Modell's PA II, Inc.; Modell's VA II, Inc.; and MSG Licensing, Inc.

[10] *In re* Owens Corning, 419 F.3d 195, 211 (3d Cir. 2005), *as amended* (Aug. 23, 2005), *as amended* (Sept. 2, 2005), *as amended* (Oct. 12, 2005), *as amended* (Nov. 1, 2007) ("[T]he general expectation of state law and of the Bankruptcy Code, and thus of commercial markets, is that courts respect entity separateness.").

often consolidated into one case.[11] This is known as administrative consolidation. Modell's filed a joint petition requesting administrative consolidation, which was granted.[12]

On the same day, Modell's filed a motion that outlined a straightforward path through Chapter 11.[13] Modell's planned to liquidate its 134 brick-and-mortar stores and its e-commerce assets and wind down the business.[14] Modell's had entered into a consulting agreement on February 14, 2020 with Tiger Capital Group to manage going-out-of-business sales.[15] After liquidating the merchandise, Modell's planned to vacate the storefronts, returning them to their commercial landlords.[16] Tiger Capital Group commenced the sales on February 21, 2020.[17] The goal was to complete the going-out-of-business sales within ninety days in order to minimize the accrual of rent obligations.[18] At the outset of the case, the debtors "anticipated . . . [they] would pay off all of [their lenders] by mid April [sic], be out of most of [their] stores by the end of April, and would promptly wind down all remaining operations."[19]

Modell's original Chapter 11 budget spanned eight weeks: March 11 to May 2.[20] This pre-pandemic budget planned to have net operating cash flow of $2,299,000 after the first week;[21] at close of the second, $11,873,000;[22] at close of the third, $12,607,000.[23] During the fourth

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[11] *See* Fed. R. Bankr. P. 1015.

[12] Order Pursuant to Fed. R. Bankr. P. 1015(b) Directing Joint Administration of Related Chapter 11 Cases at 6, *In re* Modell's Sporting Goods, Inc., No. 20-14179 (Bankr. D.N.J. Mar. 11, 2020), ECF No. 88.

[13] Interim Order (I) Authorizing the Debtors to Assume the Consulting Agreement, (II) Approving Procedures for Store Closing Sales, and (III) Approving the Implementation of Customary Store Bonus Program and Payments to Non-Insiders Thereunder at 6, 39, *In re* Modell's Sporting Goods, Inc., No. 20-14179 (Bankr. D.N.J. Mar. 11, 2020), ECF No. 63 [hereinafter "Mar. 13 Interim Order"].

[14] Debtor's Motion for Entry of Interim and Final Orders (I) Authorizing the Debtors to Assume the Consulting Agreement, (II) Approving Procedures for Store Closing Sales, and (III) Approving the Implementation of Customary Store Bonus Program and Payments to Non-Insiders Thereunder at 3, *In re* Modell's Sporting Goods, Inc., No. 20-14179 (Bankr. D.N.J. Mar. 11, 2020), ECF No. 8 .

[15] *See id.* at 5.

[16] *See id.* at 4.

[17] *See id.*

[18] *See id.* at 5, 20.

[19] Transcript of Motion Hearing Before Honorable Vincent F. Papalia United States Bankruptcy Judge at 5, *In re* Modell's Sporting Goods, Inc., No. 20-14179-VFP (Bankr. D.N.J. Mar. 31, 2020), ECF No. 187 [hereinafter "March Suspension Hearing"].

[20] Interim Order (I) Authorizing Use of Cash Collateral and Affording Adequate Protection; (II) Modifying Automatic Stay; (III) Scheduling A Final Hearing; And (IV) Granting Related Relief at 57, *In re* Modell's Sporting Goods, Inc., No. 20-14179-VFP (Bankr. D.N.J. Mar. 31, 2020), ECF No. 66.

[21] *Id.*

[22] *Id.*

[23] *Id.*

week, April rent would come due for Modell's 134 storefronts—an expense of $6,814,000.[24] In sum, the budget depended upon the successful continuation of liquidation sales in order to pay rent. If the sales stopped, the rent could not be paid.

COVID-19 had other plans for Modell's. On March 21, New Jersey Governor Philip Murphy issued a stay-at-home order.[25] On March 22, New York Governor Andrew Cuomo issued a stay-at-home order.[26] States around the country soon followed suit.[27] On March 23, Modell's petitioned the court to grant a "temporary suspension of all deadlines and activities in their Chapter 11 cases, for up to sixty days" using its authority under §§ 105 and 305 of the Bankruptcy Code.[28] Modell's cited the public health emergency and concomitant economic shutdowns across the country.[29] Modell's simply did not have the cash to pay its April lease obligations.[30] Meanwhile, its baseball mitts and basketballs collected dust in shuttered retail stores around the country.

Over the persistent dissent of nearly half of Modell's commercial landlords,[31] Judge Papalia granted Modell's proposed order temporarily suspending the proceedings.[32] As the suspension wore on from March 23 to June 15, the landlords argued repeatedly that § 365(d)(3) prohibited the stay on rent. This section commands "[t]he trustee [to] timely perform all the obligations of the debtor."[33] Though "[t]he court may ex-

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[24] *Id.*

[25] *See* Mervosh et al., *supra* note 3.

[26] *See id.*

[27] *See id.*

[28] 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. §§ 105 and 305 at 2–3, *In re* Modell's Sporting Goods, Inc., No. 20-14179-VFP (Bankr. D.N.J. Mar. 23, 2020), ECF No. 115 [hereinafter "Suspension Motion"].

[29] *See id.* at 6–7.

[30] *See id.* at Ex. A. (Modified Budget); *see also* Transcript of Telephonic Hearing Re: Doc #115 Motion Re: Debtor's Verified Application In Support of Emergency Motion for Entry of an Order Temporarily Suspending Their Chapter 11 Cases Pursuant to 11 U.S.C. Sections 105 and 305 Filed by Michael D. Sirota on Behalf of Modell's Sporting Goods, Inc. and Objections to Debtor's Verified Application in Support of Emergency Motion for Entry of an Order Temporarily Suspending their Chapter 11 Cases Pursuant to 11 U.S.C. Sections 105 and 305 Filed by Michael D. Sirota on Behalf of Modell's Sporting Goods, Inc. at 13, *In re* Modell's Sporting Goods, Inc., No. 20-14179 (Bankr. D.N.J., Apr. 30, 2020), ECF No. 210 [hereinafter "April Suspension Extension Hearing"] (Judge Papalia: "[T]here's not enough cash on hand to pay one month's rent.").

[31] *See* April Suspension Extension Hearing, *supra* note 30, at 95 ("[T]hese landlord objections represent 44 of the debtor's landlords and 53 of the debtor's more than 134 – 130 stores or approximately 39.5 percent, so a significant portion of the stores.").

[32] Order Temporarily Suspending the Debtors' Chapter 11 Cases Pursuant to 11 U.SC. §§ 105 and 305, *In re* Modell's Sporting Goods, Inc., No. 20-14179-VFP (Bankr. D.N.J. Mar. 23, 2020), ECF No. 166.

[33] 11 U.S.C. § 365(d)(3).

tend . . . the time for performance" for cause, "the time for performance . . . shall not be extended beyond such 60-day period."[34] Judge Papalia effectively extended the time of performance beyond sixty days twice: first through May 31[35] and second through June 15.[36] This amounted to forty-seven additional days that Modell's did not pay rent obligations beyond the sixty days for cause permitted under § 365(d)(3). In other words, the series of orders postponed Modell's April, May, and June rent payments, a total of approximately $20.4 million. Judge Papalia's order in *In re Modell's Sporting Goods, Inc.* takes center stage in this Comment.

Though Judge Papalia achieved a desirable outcome in Modell's Case, he used the wrong provision—§ 305(a). Judge Papalia's decision left no binding precedent,[37] and yet it bears comment to caution against an unlawful expansion of judicial discretion in corporate bankruptcies and encourage bankruptcy judges to trust in the resilience of the Code. The Code is designed for crisis. Judge Papalia could have properly alleviated the problem using § 363(b)(1) and § 105.[38] In doing so, Judge Papalia could have conformed with accepted applications of the Code and preserved clarity and confidence in the face of the COVID-19 pandemic. Instead, the incorrect application of §§ 305 and 105 muddied accepted understandings of the Code and invited an unauthorized expansion of judicial discretion in future cases. Of course, we are all generals after the war, but Modell's Case shows that the Code is sufficiently flexible to withstand a pandemic without resorting to orders unmoored from its provisions. If the Code's flexibility fails to meet the needs of the next pandemic, it warrants legislative action rather than judicial departure from statute.

This Comment proceeds in two additional Parts. Part II explains the key provisions and principles that are at play in Modell's Case. This Part will discuss key concepts, including the property of the estate, the automatic stay, claims, the absolute priority rule, nonresidential leases under § 365, equitable discretion under § 105(a), and abstention under § 305(a). Part III argues that Judge Papalia achieved a desirable result for the case but erred in applying § 305(a) and § 105(a) to "partially"

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[34] *Id.*

[35] Order Further Suspending the Debtors' Chapter 11 Cases Pursuant to 11 U.S.C. §§ 105 and 305, *In re* Modell's Sporting Goods, Inc., No. 20-14179 (Bankr. D.N.J. Apr. 30, 2020), ECF No. 294.

[36] Order Further Suspending the Debtors' Chapter 11 Cases Pursuant to 11 U.S.C. §§ 105 and 305 Through and Including June 15, 2020 and Setting Final Hearing on Cash Collateral Motion, *In re* Modell's Sporting Goods, Inc., No. 20-14179 (Bankr. D.N.J. June 5, 2020), ECF No. 371.

[37] *See* 11 U.S.C. § 305(c); *see also* 28 U.S.C.A. § 158(a)(1–3); April Suspension Extension Hearing, *supra* note 30, at 11 (Mr. Sirota for the debtor: "There's no binding Third Circuit or circuit authority under 305(a), and that's for good reason because there's no relief and no ability to appeal a 305 ruling to a circuit or to the United States Supreme Court.").

[38] 11 U.S.C. §§ 105, 363(b)(1).

suspend the case. The Comment concludes that, due to § 365(d)(3)'s lack of remedy, Judge Papalia could have reached the same sensible result by simply approving Modell's proposed limited operating budget under § 363(b)(1) and § 105(a).

II. DYNAMICS AT PLAY: FOUNDATIONAL ELEMENTS OF CHAPTER 11

When a corporation owes more than it can pay, its board of directors may decide to file for bankruptcy.[39] Relevant to Modell's Case, Chapter 11 of the Code provides particular rules for corporations in financial distress[40] with key provisions to facilitate "a day of reckoning."[41] Chapter 11 provides a forum for debtor and creditors to gather and sort through the assets and liabilities of the firm.[42] When a company files for Chapter 11, either the U.S. trustee assumes control of the corporation or the old management retains managerial authority with the duty to maximize the value of the assets.[43] When old management retains control, it is referred to as the debtor-in-possession.[44] The debtor in possession controls the corporation in most Chapter 11 cases, including Modell's Case.[45]

Chapter 11 usually results in one of two outcomes. One possibility is that the firm reorganizes and continues as a going concern[46] under new ownership with a new capital structure.[47] The debtor may seek a plan to issue new equity in a new organization that consists of substantially the same assets.[48] Under a reorganization plan, however, the old equity is generally extinguished.[49] Instead, the trustee distributes the

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[39] *See In re* Integrated Telecom Express, Inc., 384 F.3d 108, 121 (3d Cir. 2004); 11 U.S.C. § 301.

[40] *See* DOUGLAS G. BAIRD, ELEMENTS OF BANKRUPTCY 19 (Foundation Press, 6th ed. 2014).

[41] *Id.* at 59.

[42] *Id.*

[43] 11 U.S.C. § 1107(a); *see also* Official Comm. of Unsecured Creditors of Cybergenics Corp. ex rel. Cybergenics Corp. v. Chinery, 330 F.3d 548, 573 (3d Cir. 2003) ("In Chapter 11 cases where no trustee is appointed, § 1107(a) provides that the debtor-in-possession, *i.e.*, the debtor's management, enjoys the powers that would otherwise vest in the bankruptcy trustee. Along with those powers, of course, comes the trustee's fiduciary duty to maximize the value of the bankruptcy estate.").

[44] *Chinery*, 330 F.3d at 573.

[45] *See* BAIRD, *supra* note 40, at 20.

[46] Will Kenton, *Going Concern*, INVESTOPEDIA (last updated Apr. 20, 2021), https://www.investopedia.com/terms/g/goingconcern.asp [https://perma.cc/M46R-65RA].

[47] *See* 11 U.S.C. §§ 1129, 1141; *see also* BAIRD, *supra* note 40, at 19–20.

[48] 11 U.S.C. § 1129(b).

[49] 11 U.S.C. § 1141; *see also* BAIRD, *supra* note 40, at 20.

new equity in the reorganized corporation pro rata to creditors according to the seniority of their claims.[50] Alternatively, the firm might liquidate.[51] In this case, the trustee might sell the corporation its entirety, or the corporation's assets, to the highest bidder or bidders.[52] The trustee then distributes the cash from liquidating the corporation on a pro rata basis to the creditors.[53] Modell's planned to liquidate.[54]

A. The Property of the Estate and the Automatic Stay

As soon as a bankruptcy petition is filed, the property of the bankruptcy estate is protected by the automatic stay.[55] The stay comes into effect at the moment of filing and prevents creditors from snatching the property of the estate.[56] This protection is essential for the debtor in possession to maximize the value of the assets in the estate.[57] For example, a reorganization that would allow a viable economic enterprise to continue to generate revenue and to pay its creditors in full, albeit on extended payment timelines, would be impossible if secured creditors could seize assets vital to the business.[58] In Chapter 11, what the stay does and does not protect often becomes a crucial question.

Section 541 of the Bankruptcy Code defines what is considered the property of the estate. Among other rights detailed in § 541, property of the estate includes "all legal or equitable interests of the debtor in property as of the commencement of the case."[59] When determining what legal or equitable interest belongs to the debtor or some other party, the court follows what has come to be known as the *Butner* Principle.[60] In *Butner v. United States*,[61] the Supreme Court held that "Congress ha[d]

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[50] *See* BAIRD, *supra* note 40, at 20.

[51] *See id.*

[52] *See id.* at 19, 235–38.

[53] *See id.* at 58, 59.

[54] Mar. 13 Interim Order, *supra* note 13.

[55] 11 U.S.C. § 362; *but see* 11 U.S.C. §§ 544(b), 547, 548 (collectively providing the trustee with avoiding powers that can claw property back into the estate if, for example, the property was improperly snatched on the eve of bankruptcy under § 547 "Preferences" or in the years preceding under § 548 "Fraudulent Transfers and Obligations" along with § 544).

[56] *See id.*

[57] *See* 11 U.S.C. § 1107.

[58] *See* United States v. Whiting Pools, 462 U.S. 198, 203 (1983) (explaining that a "reorganization effort would have small chance of success . . . if property essential to running the business were excluded from the estate"); *see also* Douglas G. Baird et al., *The Bankruptcy Partition*, 166 U. PENN. L. REV. 1675, 1684 (2018).

[59] 11 U.S.C. § 541(a)(1).

[60] *See, e.g.*, *In re* Costas, 555 F.3d 790, 794 (9th Cir. 2009); *In re* Ginn, 186 B.R. 898, 902 (Bankr. D. Md. 1995) (referencing "the *Butner* principle that nonbankruptcy law should apply the same inside as outside of a bankruptcy case").

[61] 440 U.S. 48 (1979).

generally left the determination of property rights in the assets of a bankrupt's estate to state law."[62] Importantly, "all legal and equitable interests of the debtor in property" encompasses the entire array of property rights, including something as minimal as a possessory interest in property—like the occupation of a commercial property. Therefore, for the duration of the Chapter 11 proceedings, parties with competing property interests to the debtor cannot recover their property without judicial permission.[63] This is key to understanding the relationship between the commercial landlords and Modell's.

Parties that have legal title to property in the debtor's possession, and therefore under the stay's protection, must petition the bankruptcy judge to lift the stay if they wish to regain possession.[64] In Modell's Case, the stay prevented the landlords from bringing unlawful detainer actions in state court to evict Modell's without Judge Papalia agreeing to lift the stay. Nevertheless, when a party petitions to have the stay lifted, it is not a foregone conclusion that the debtor may maintain possession. The automatic stay prevents opportunistic extraction that would harm the collective proceeding, but the judge may make exceptions.[65] For example, "the court shall grant relief from the stay . . . such as by terminating, annulling, modifying, or conditioning such stay—(1) for cause."[66] The bankruptcy judge has discretion to determine when there is "cause" to lift the stay.

B. Claims and the Absolute Priority Rule

The debtor is likely in Chapter 11 because of financial distress; it owes more money than it can pay. The debtor's creditors hold claims to the estate, and § 101(5)'s definition of "claims" is broad and includes "right[s] to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured or unsecured."[67] Claims also include "right[s] to . . . equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured."[68] An expansive definition of claims helps the debtor maximize the value of the estate because pre-petition claims are discharged through "free and

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[62] *Id.* at 54.

[63] 11 U.S.C. § 362(d).

[64] *See id.*

[65] *See* 11 U.S.C. §§ 362(d), 362(f), 363(b)(1).

[66] 11 U.S.C § 362(d)(1).

[67] 11 U.S.C. § 101(5).

[68] *Id.*

clear" sales[69] and through confirmation of reorganization plans.[70] Discharge means that, after the sale or reorganization, the claim cannot be brought against the new owners regardless of whether the claim was paid in full or at all. Because the debtor is in bankruptcy, some claims may not be paid in full.

In Chapter 11 liquidations like Modell's Case, the debtor-in-possession converts the property of the estate into cash.[71] However, the debtor first presents a plan that describes how the property will be disposed, and when and in what form the claimholders will receive payment.[72] The plan must also sort the claimholders into classes,[73] and claimholders vote by class to accept or reject the proposed plan.[74] When a plan is confirmed, the debtor-in-possession pays the creditors a pro rata distribution from the bankruptcy estate class by class according to their respective seniority in the absolute priority payment waterfall.[75] First, the highest priority level is paid until creditors at this level receive full payment for the debt owed.[76] If the estate is able to pay the first priority class of claims in full, then the debtor-in-possession pays the remainder to the second highest priority level pro rata.[77] If the estate can satisfy this class of claims in full, then the third highest class receives pro rata shares of what remains, and so on.[78]

The absolute priority rule requires this rigid hierarchy of payment. The principle is central to the negotiation dynamics in Chapter 11—senior lenders have more say.[79] In today's Code, the absolute priority rule is codified in § 1129(b). Section 1129(b) requires that a reorganization be "fair and equitable." While the words "fair and equitable" are

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[69] 11 U.S.C. § 363(f) ("The trustee may sell property . . . free and clear of any interest in such property . . . ."). This Comment will not address these sales beyond this reference. For a discussion and critique of "free and clear" sales under § 363(f), *see generally* Karen Cordry, *Section 363 Sales: Cherry-Picking the Code: Successor Liability and Lessons from Wile E. Coyote*, 28 NORTON J. BANKR. L. & PRAC. 1 (Dec. 2019) (explaining that "free and clear" sales have grown into a sale of parts or the entirety of a business without confirmation of a Chapter 11 plan).

[70] 11 U.S.C. § 1141(c) ("[T]he property dealt with by the plan is free and clear of all claims and interests of creditors, equity security holders, and of general partners in the debtor.").

[71] *See* Mar. 13 Interim Order, *supra* note 13.

[72] 11 U.S.C. § 1121; *see* 11 U.S.C. § 1123.

[73] 11 U.S.C. §§ 1122, 1123(a)(1)–(4).

[74] *See* 11 U.S.C. § 1129; *see also* 11 U.S.C. § 1126.

[75] *See* 11 U.S.C. § 726(a), (b) (requiring pro rata distribution); *see also* Granfinanciera, S.A. v. Nordberg, 492 U.S. 33, 56 (1989) (explaining that creditors hold "hierarchically ordered claims to a pro rata share of the bankruptcy res").

[76] *See* 11 U.S.C. § 726(a).

[77] *See id.*

[78] *See id.*

[79] *See* BAIRD, *supra* note 40, at 75 ("The dynamics of any negotiation are defined by what there is to bargain over and the place of each of the parties in the pecking order.").

codified in 11 U.S.C. § 1129(b) as a requirement for cramdown,[80] due to the absolute priority rule's history and case law, the principle of absolute priority undergirds all Chapter 11 bankruptcy negotiations.[81] Under this rule, in order for a reorganization plan to be effectuated, stakeholder's rights in relation to each other must be respected.[82] Secured claims must be paid in full before any junior claims are paid.[83] Unsecured creditor claims must be paid in full before any junior "claim or interest," such as stock.[84] For example, a vendor that shipped sporting merchandise and holds an unpaid bill (an unsecured claim) holds a claim that must be paid before a Modell's stockholder receives anything.[85] Though there is a new value exception under § 1129(b)(2)(B)(ii) that is the subject of much controversy,[86] as a practical matter, equity is generally wiped out in Chapter 11.[87] A reorganization plan cannot be confirmed over a stakeholder's dissent if absolute priority is violated.[88]

Section 507(a) also creates a hierarchy among other creditors.[89] Importantly for Modell's Case, § 507(a) places administrative expense claims near the top of this waterfall, though they are still below secured claims.[90] Section 503(b) provides that, "[a]fter notice and a hearing, there shall be allowed administrative expense claims, other than claims allowed under § 502(f) of this title, including—(1) the actual necessary costs and expenses of preserving the estate including" assorted expenses a debtor may need to incur during the case, such as wages and

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[80] At a cramdown hearing, the debtor in possession seeks confirmation of a reorganization plan over the dissent of a creditor class. 11 U.S.C. § 1129(b).

[81] *See* BAIRD, *supra* note 40, at 74 ("The absolute priority rule is central to the law of corporate reorganizations because it is a source of substantive rights as well as the procedural protections that each participant in a reorganization enjoys."). For a cogent discussion of the absolute priority rule's history and evolution see generally BAIRD, *supra* note 40.

[82] *Id.* at 69 ("*Case* [a Supreme Court decision] . . . forged a link between the phrases 'fair and equitable' and 'absolute priority,' a link that lawyers, judges, and Congress have accepted ever since.").

[83] *See* 11 U.S.C. § 1129(b)(2)(A).

[84] 11 U.S.C. § 1129(b)(2)(B)(ii).

[85] *See id.*

[86] *See* Bruce A. Markell, *Owners, Auctions, and Absolute Priority in Bankruptcy Reorganizations*, 44 STAN. L. REV. 69, 72 (1991).

[87] *See, e.g.*, *In re* Toy & Sports Warehouse, Inc., 37 B.R. 141, 150 (Bankr. S.D.N.Y. 1984) (explaining that "[t]he debtors' equity shareholders in [the lowest class within the Absolute Priority Rule] are impaired under the plan because they will be wiped out and all of the stock of [the company] will be cancelled").

[88] *See* 11 U.S.C. § 1129(b)(1) ("[T]he court . . . shall confirm the plan . . . if the plan . . . is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted the plan.").

[89] 11 U.S.C. § 507(a).

[90] *Id.*

salaries of key employees, taxes, and professional services.[91] Pragmatically, this makes sense. Debtor firms may have essential expenses that arise after filing for bankruptcy that must be paid to keep the lights on. For example, firms need their employees to continue generating revenues to stay in business or maximize the value in assets of the firm as the firm liquidates. These employees would not continue to work for the firm if they thought it probable that they would only get cents on the dollar for their labors during the bankruptcy. Generally, rational creditors want to grant administrative expense priority for the "actual, necessary costs and expenses of preserving the estate."[92] These payments inure to the benefit of the other claimholders.

Of course, the debtor in bankruptcy has finite resources, so administrative expenses are still at risk of partial or non-payment. Administrative insolvency occurs in Chapter 11 cases where the debtor cannot afford to pay the allowed administrative expenses in full.[93] Debtors that mismanage their resources—or encounter public health crises like COVID-19—in Chapter 11 may face administrative insolvency.[94] The longer the Chapter 11 case drags on, the more administrative expenses it will accumulate through operating expenses—even if these are reduced due to an economic lockdown—and legal fees. Additionally, the firm still must compete in the market. Chapter 11 does not protect a firm from losing money due to mismanagement.

As a firm approaches administrative insolvency, parties holding administrative expense claims begin to sweat. Administrative expense claims do not receive equal treatment. The clearest—and most relevant—example of this is the Code's preferential treatment of professional services expenses.[95] Professionals can extract payment for their services during the proceedings, protecting themselves from the risk of administrative insolvency.[96] Conversely, the Code is silent about interim payment of other administrative expenses.[97] It is only clear that administrative expense claims must be paid before junior claims when the property of the estate is distributed at the end of the case.[98]

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[91] 11 U.S.C. § 503(b)(1)–(9).

[92] 11 U.S.C. § 503(b).

[93] Alec P. Ostrow, *The Animal Farm of Administrative Insolvency*, 11 AM. BANKR. INST. L. REV. 339, 340 (2003) (noting that unsuccessful Chapter 11 cases can result in the debtor being unable to pay in full the bills it accumulated during the proceedings—a nightmare scenario for professionals and lenders who risked their time and resources in the endeavor).

[94] *See id.* at 345.

[95] *See* 11 U.S.C. § 331.

[96] *Id.*

[97] Ostrow, *supra* note 93, at 346–48.

[98] 11 U.S.C. § 726(b).

C. Nonresidential Leases Under Section 365

Commercial leases are one potentially large "actual, necessary cost[ ] and expense[ ]" for retail businesses in Chapter 11.[99] Unlike the wages, taxes, and fees noted above, however, lease obligations are not necessarily a new expense incurred. Indeed, the unexpired leases in Modell's Case were subject to the debtor's privilege in § 365 that enables the trustee to assume or reject unexpired nonresidential leases and executory contracts.[100] If the trustee assumes a lease, the estate will be liable for the obligations under the agreement, and the debtor can retain the benefit of the lease agreement—occupancy.[101] The debtor must fulfill any obligations of assumed leases or executory contracts when they arise during the proceedings;[102] they must pay when rent is due. On the other hand, if the trustee rejects a lease, the rejection is considered a pre-petition breach.[103] The landlord then has an unsecured claim—"a right to payment"[104]— for expectation damages.[105] The debtor must vacate the premises.[106] The landlord then must get in line with all of the other claimholders to await the pro rata waterfall pursuant to absolute priority rule.

In cases like Modell's, however, the trustee may not immediately assume or reject upon filing petition for Chapter 11. Instead, the trustee can take the time permitted by the Code to determine which unexpired leases (and executory contracts) would benefit the estate and which should be rejected. The trustee has 120 days to decide whether to assume or reject unexpired leases, subject to court granted extensions.[107] During the interim period while the debtor occupies premises under an unexpired lease, § 365(d)(3) requires the debtor to "timely perform all the obligations of the debtor . . . arising from and after the order for relief under any unexpired lease of nonresidential real property, until such lease is assumed or rejected." While it is possible to receive a sixty-day extension on rent payment if the debtor shows "cause," the statute explicitly commands that "the time for performance shall not be extended beyond such sixty-day period."[108]

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[99] 11 U.S.C. § 503(b).

[100] *See* 11 U.S.C. § 365(a), (d)(4)(A)(i–ii).

[101] *See* BAIRD, *supra* note 40, at 134.

[102] *See In re* Airlift Int'l, Inc., 761 F.2d 1503, 1508 (11th Cir. 1985).

[103] 11 U.S.C. § 365(g).

[104] 11 U.S.C. § 101(5).

[105] 11 U.S.C. § 365(g) ("[T]he rejection of an executory contract or unexpired lease of the debtor constitutes a breach of such . . . lease.").

[106] *See id.*

[107] *See* 11 U.S.C. § 365(d)(4)(A)(i–ii), (B)(i–ii).

[108] *Id.*

Despite lobbying efforts from commercial landlords, this special landlord protection under § 365(d)(3) has more bark than bite. Congress added this provision to the Code in the Bankruptcy Amendments and Federal Judgeship Act of 1984.[109] Senator Orrin Hatch, one of the proponents of the amendment, outlined the purpose of the provision. First, it would "insure [sic] that the debtor-tenants pay their rent, common area and other charges on time," meaning "at the time required in the lease."[110] Second, after a sixty-day extension on these payments for cause, "the amounts due during the first 60 days would be required to be paid." Third, once the sixty-day grace period expired, the debtor would have to pay "all obligations" "on time."[111] Despite Senator Hatch's clear intention that the provision require payment at the time obligations are due under the lease, neither the 1984 amendment nor the present-day Code includes a remedy in the event of § 365(d)(3) default.[112]

Because the Code is silent on the remedy for default,[113] judges decide: they use their discretion. First, the judge must determine whether the default of "timely payment" under § 365(d)(3) requires a penalty. If the judge decides a penalty is appropriate, they then decide what it will be. For example, in *In re Southwest Aircraft Services, Inc.*,[114] the Ninth Circuit indicated it would take a discretionary approach to handling violations of § 365(d)(3).[115] The judge may determine whether the lease is rejected by nonpayment, some other penalty, or no penalty at all.[116] A bankruptcy court in the Southern District of New York also opted for this discretionary approach.[117] One Delaware Bankruptcy court suggested in dicta that failure to pay could cause the lease to be rejected.[118]

After deciding whether to apply a more extreme remedy to enforce § 365(d)(3), the judge must determine the priority level of the landlord's

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[109] Pub. L. No. 98-353, 98 Stat. 333.

[110] *In re* Mr. Gatti's, 164 B.R. 929, 932 (Bankr. W.D. Tex. 1994) (quoting 130 Cong. Rec. S8891, 599 (1984) (statement by Sen. Hatch)).

[111] *Id.*

[112] *Id.* at 933 ("As straightforward as newly added Section 365(d)(3) was regarding the obligation of the debtor-tenant to fully and timely perform, it was wholly lacking with regard to any expression of the remedies available to the lessor in the event of a default."); *see also* 11 U.S.C. § 365.

[113] *See* CIT Comm. Fin. Corp. v. Midway Airlines Corp. (*In re* Midway Airlines Corp.), 406 F.3d 229, 235 (4th Cir. 2005) ("While it is clear that § 365(d)(10) and § 365(d)(5) impose on [the debtor-in-possession] the duty to perform all lease obligations in a timely manner, these sections do not specify a lessor's remedy should the [debtor-in-possession] fail to perform.").

[114] 831 F.2d 848 (9th Cir. 1987).

[115] *Id.* at 854.

[116] *Id.*

[117] *In re* Westview 74th St. Drug Corp., 59 B.R. 747, 754 (Bankr. S.D.N.Y. 1986) ("[T]he appropriate remedy for such a failure is one which should be formulated by the court after a review of the facts of the particular case.").

[118] *In re* DBSI, Inc., 407 B.R. 159, 164 (Bankr. D. Del. 2009).

claim. Courts fall into three groups at this point: (1) courts that "do not automatically grant administrative status to the lessor's claim"[119] (the minority); (2) courts "that do automatically grant administrative status"[120] to the landlord's claim (the majority); and (3) courts that have determined the claim is entitled to both administrative status and "some form of special or superpriority treatment"[121] (a minority within the majority).[122] Superpriority places the administrative expense claim above other administrative expenses.[123]

In summary, the language of § 365(d)(3) presents a bright line requirement. The debtor must "timely" pay their lease obligations, and they cannot receive an extension to pay beyond sixty days. Nonetheless, the bankruptcy judge may exercise considerable discretion due to the Code's lack of remedy—especially in the Third Circuit where there is no binding precedent on this issue.

D. Equitable Discretion Under § 105(a)

Section 105(a) of the Code grants the bankruptcy judge residual equitable power that enables judges to craft discretionary orders.[124] Judges "may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the Code]."[125] Judges have turned to this seemingly broad provision for the authority to make many different kinds of orders they deem "necessary" for a particular case.[126] However, because of the diversity of these orders, accepted § 105(a) usage varies by jurisdiction.[127] Courts often cabin their use of

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[119] *See, e.g.*, *In re* Mr. Gatti's, 164 B.R. 929, 935–38, 946 (Bankr. W.D. Tex. 1994) (citing other courts that follow the minority approach and adopting the minority approach).

[120] *See, e.g.*, *In re* Worths Stores Corp., 135 B.R. 112, 116 (Bankr. E.D. Mo. 1991) (holding that the lessor need not meet the requirements under § 503(b)(1)(A)); *see also In re* Mr. Gatti's, 164 B.R. at 937–40 (identifying courts that follow the majority approach).

[121] *See, e.g.*, *In re* Telesphere Communications, Inc., 148 B.R. 525, 531 (Bankr. N.D. Ill. 1992) ("Pursuant to the plain language of Section 365(d)(3), the trustee or debtor in possession has a duty, prior to assumption or rejection of a lease of nonresidential real property, to make timely payment of the full rent due, from any available funds (subject to Section 363(c)(2) of the Code), regardless of the administrative solvency of the estate.").

[122] *In re* Mr. Gatti's, 164 B.R. at 940–42.

[123] Ostrow, *supra* note 93, at 347–48.

[124] *See* United States v. Energy Res. Co., 495 U.S. 545, 549 (1990) ("[Section 105(a)] [is] consistent with the traditional understanding that bankruptcy courts, as courts of equity, have broad authority to modify creditor-debtor relationships.").

[125] 11 U.S.C. § 105(a).

[126] *See, e.g.*, Knupfer v. Lindblade (*In re* Dyer), 322 F.3d 1178, 1189–90 (9th Cir. 2003) (recognizing the bankruptcy court's authority to sanction a party for civil contempt under § 105(a)); Bayer Corp. v. MascoTech, Inc. (*In re* Autostyle Plastics, Inc.), 269 F.3d 726, 748 (6th Cir. 2001) (explaining that "a bankruptcy court can consider whether to recharacterize a claim of debt as equity" using its authority under section 105(a)).

[127] *Bayer Corp.*, 269 F.3d at 749 (allowing recharacterization of insider debt as equity). *But see* Unsecured Creditors Comm. Of Pac. Express, Inc. et al. v. Pioneer Com. Funding Corp. (*In re*

§ 105(a) in a particular case to the facts at hand and so limit uniformity of § 105(a) usage.[128]

Despite the variety of orders that use § 105(a), there are "two general schools of thought regarding the breadth of section [sic] 105."[129] One school views § 105(a) as a gap-filler that should be used by judges to vindicate implicit goals of the Code.[130] Courts frequently cite the treatise Collier on Bankruptcy,[131] which contends that this is the dominant view.[132] The gap-filler view does not include administration of rough justice.[133] The other school of thought views § 105(a) as one provision among many that should be used only to implement what is expressly covered by the statute.[134] Courts take both views when applying § 105(a).[135]

Pacific Express, Inc.), 69 B.R. 112, 115 (B.A.P. 9th Cir. 1986) (explaining that because "there is a specific provision governing [recharacterization]," (Equitable Subordination under 11 U.S.C. § 510(c)) "it is inconsistent with the interpretation of the Bankruptcy Code to allow such determinations to be made under different standards through the use of a court's equitable powers" under section 105(a)); *In re* CoServ, L.L.C., 273 B.R. 487, 497 (Bankr. N.D. Tex. 2002) (explaining that "it is only logical that the bankruptcy court be able to use Section 105(a) of the Code to authorize satisfaction of the prepetition claim in aid of preservation or enhancement of the estate"); *In re* Kmart Corp., 359 F.3d 866, 874 (7th Cir. 2004) (ruling that § 105(a) without another provision of the Code does not grant the court authority to issue payment of prepetition claims in what have become known as critical vendor orders).

[128] *See* Palmer v. United States (*In re* Palmer), 219 F.3d 580, 586 (6th Cir. 2000) (explaining that though "these equitable powers [under section 105(a)] are sufficient to toll the § 507(a)(8)(A)(i) look-back period if the facts of a given case require such an action," they do not create an "automatic tolling provision that Congress expressly failed to include"); *In re* Lehigh & N. E. Ry. Co., 657 F.2d 570, 582 (3d Cir. 1981) (explaining that the court's use of 105(a) to order payment of prepetition creditors "is neither an expansive nor a broad [holding]" but is particular to "the general principles . . . in the Trust Fund cases" and "cannot control a situation where all funds have been dissipated").

[129] 2 COLLIER ON BANKRUPTCY ¶ 105.01 (16th ed. 2020).

[130] *See id.*

[131] *See* Law v. Siegel, 571 U.S. 415, 421 (2014).

[132] 2 COLLIER ON BANKRUPTCY ¶ 105.01 (16th ed. 2020) ("The broad view currently prevails, and this tracks the power of district courts in equity receiverships.").

[133] *But see id.* ¶ 105.01, n. 6 ("Section 105 of the Bankruptcy Code bestows on bankruptcy courts a specific equitable power to act in accordance with principles of justice and fairness. Bankruptcy courts have broad latitude in exercising this power.") (quoting Sears, Roebuck & Co. v. Spivey, 265 B.R. 357, 371 (E.D.N.Y. 2001)).

[134] *See id.* ¶ 105.01.

[135] *See In re* Oi Brasil Holdings Cooperatief U.A., 578 B.R. 169, 201 (Bankr. S.D.N.Y. 2017), *reconsideration denied*, 582 B.R. 358 (Bankr. S.D.N.Y. 2018) ("Section 105(a) is understood as providing courts with discretion to accommodate the unique facts of a case consistent with the policies or directives set by the other applicable substantive provisions of the Bankruptcy Code."); *see also* New England Dairies, Inc. v. Dairy Mart Convenience Stores, Inc. (*In re* Dairy Mart Convenience Stores, Inc.), 351 F.3d 86, 91–92 (2d Cir. 2003) ("The equitable power conferred . . . by section 105(a) is the power to exercise equity in carrying out the *provisions* of the Bankruptcy Code, rather than to further the purposes of the Code generally, or otherwise to do the right thing. This language suggests that an exercise of section 105 power be tied to another Bankruptcy Code section and not merely to a general bankruptcy concept or objective.") (internal citations omitted); Jamo v. Katahdin Fed. Credit Union (*In re* Jamo), 283 F.3d 392, 403 (1st Cir. 2002) ("The authority bestowed [by section 105(a)] may be invoked only if, and to the extent that, the equitable remedy

Occasionally, even judges on the same court may disagree about which approach should be applied. For example, in *In re Kmart Corp.*,[136] Seventh Circuit Judge Frank Easterbrook rejected a request for using § 105 to depart from the absolute priority scheme.[137] He explained that "[a] 'doctrine of necessity' is just a fancy name for a power to depart from the Code."[138] In contrast, Judge Richard Posner, also writing for the Seventh Circuit, accepted the solitary use of § 105 to enjoin a third party lawsuit in *In re Caesars Entertainment Operating Co.*[139] There, Judge Posner criticized the bankruptcy judge's "cramped interpretation of section 105(a)" and suggested it should be used as needed to "enhance the prospects of successful resolution of the disputes attending [the] bankruptcy."[140]

Despite the diverse issues that § 105(a) could apply to, there has been a trend in circuit court opinions restricting bankruptcy judges' use of § 105(a).[141] It has become common practice to tie § 105(a) to another provision of the Code.[142] It is also widely accepted that § 105(a) "does not authorize the bankruptcy courts to create substantive rights that are otherwise unavailable under applicable law or constitute a roving commission to do equity."[143] And whatever controversy may exist about § 105(a), the Supreme Court has noted that "[i]t is hornbook law that § 105(a) 'does not allow the bankruptcy court to override explicit mandates of other sections of the Bankruptcy Code.'"[144]

E. Section 305 Abstention

Though a norm has developed that tying § 105 to another provision of the Code can justify all sorts of creative orders so long as they don't contravene another section, Modell's Case presents an odd challenge to this proposition. In Modell's Case the order in question used § 105 with § 305—another discretionary provision that is viewed as an extraordinary remedy.

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dispensed by the court is necessary to preserve an identifiable right conferred elsewhere in the Bankruptcy Code.").

[136] 359 F.3d 866 (7th Cir. 2004).

[137] *Id.* at 871.

[138] *Id.*

[139] 808 F.3d 1186, 1188 (7th Cir. 2015).

[140] *Id.* at 1188.

[141] Lawrence Ponoroff, *Whither Recharacterization*, 68 RUTGERS L. REV. 1217, 1222 (2016).

[142] *See In re* Dairy Mart Convenience Stores, Inc., 351 F.3d 86, 92 (2d Cir. 2003); *see also* Ponoroff, *supra* note 141, at 1222.

[143] United States v. Sutton, 786 F.2d 1305, 1308 (5th Cir. 1986); *see also In re* Dairy Mart Convenience Stores, Inc., 351 F.3d at 92; S. Ry. Co. v. Johnson Bronze Co., 758 F.2d 137, 141 (3d Cir. 1985).

[144] Law v. Siegel, 571 U.S. 415, 421 (2014) (citing 2 COLLIER ON BANKRUPTCY ¶ 105.01 (16th ed. 2020)).

Under § 305(a)(1), a judge "may dismiss a case . . . or may suspend all proceedings in a case . . . at any time if—(1) the interests of creditors and the debtor would be better served by such dismissal or suspension."[145] Because orders under § 305(a) are unappealable,[146] courts have emphasized that the section provides an extraordinary remedy.[147] The § 305(a) remedy comes in two forms: dismissal and suspension.[148] In order for the judge to use her discretion under § 305, she must be convinced that such dismissal or suspension will be in the best interest of the creditors and the debtor.[149] This generally requires a case-by-case analysis.[150]

Though there are two different remedies under § 305, according to the limited legislative history, the legislature focused more on dismissal than suspension at the time of enactment. The House Judiciary Committee Report ("Committee Report") noted that § 305(a) is designed to enable a bankruptcy court to decline jurisdiction.[151] Furthermore, the legislature contemplated two examples for application of § 305(a). First, if the debtor and its creditors are working toward an agreement out of court and "a few recalcitrant creditors [commence an involuntary case] to provide a basis for future threats to extract full payment," § 305(a)

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[145] 11 U.S.C. § 305(a)(1).

[146] 11 U.S.C. § 305(c) ("An order under subsection (a) of this section dismissing a case or suspending all proceedings in a case . . . is not reviewable by appeal or otherwise by the court of appeals . . . .").

[147] *In re* RAI Mktg. Servs., Inc., 20 B.R. 943, 945 (Bankr. D. Kan. 1982) ("[G]iven that an abstention order is not appealable, this Court finds that § 305 should be strictly construed."); *In re* Artists' Outlet, Inc., 25 B.R. 231, 232 (Bankr. D. Mass. 1982) ("As a dismissal under § 305 is not appealable, application of § 305 is not to be made indiscriminately."); *In re* 82 Milbar Boulevard, Inc., 91 B.R. 213, 216 (Bankr. E.D.N.Y. 1988) ("[Section 305] should be used sparingly . . . .").

[148] *See In re* Colonial Ford, Inc., 24 B.R. 1014, 1023 (Bankr. D. Utah 1982) ("Section 305(a)(1) permits 'suspension' as well as dismissal of a case, suggesting the possibility that efforts toward settlement may proceed on more than one front at the same time.").

[149] *See, e.g.*, Pennino v. Evergreen Presbyterian Ministries (*In re* Pennino), 299 B.R. 536, 538 (B.A.P. 8th Cir. 2003) ("The Code . . . permits a court to abstain and dismiss a case only when the best interests of both the debtor and his or her creditors are better served."); GMAM Inv. Funds Tr. I v. Globo Comunicacoes E Participacoes S.A. (*In re* Globo Comunicacoes E Participacoes S.A.), 317 B.R. 235, 255 (S.D.N.Y. 2004) ("Courts that have construed Section 305(a)(1) are in general agreement that abstention in a properly filed bankruptcy case is an extraordinary remedy, and that dismissal is appropriate under that provision only where the court finds that both 'creditors and the debtor' would be 'better served' by a dismissal."); *In re* Iowa Coal Mining Co., 242 B.R. 661, 671 (Bankr. S.D. Iowa 1999) ("[T]he statute requires only that the best interests of both the debtors and the creditors be served.").

[150] *See In re* Trina Assocs., 128 B.R. 858, 867 (Bankr. E.D.N.Y. 1991) ("Although the tests are useful, in determining whether dismissal under § 305(a) is appropriate, courts must look to the facts of the individual cases."); *In re* Birchall, 381 B.R. 13, 19 (Bankr. D. Mass. 2008) (considering "the particular facts of th[e] case" though they were "[n]ot included in the [ ] listed factors"); Farmer v. First Va. Bank, 22 B.R. 488, 491 (E.D. Va. 1982) ("[A]bstention is appropriate only if it will not impair the interests of any of the parties involved.").

[151] *See* H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 325 (1977).

could be used to dismiss the involuntary filing.[152] Second, "if there is a pending proceeding concerning the debtor and the factors specified in proposed 11 U.S.C. [§] 304(c) warrant dismissal or suspension the court may so act."[153] There is nothing more in the Congressional Record for § 305(a). It is noteworthy that the Committee Report identified these two scenarios as "examples" where § 305 could be applicable.[154] The legislature likely knew the provision would be applicable in additional unimagined situations.[155] Indeed, the majority of courts now consider § 305(a) applicable beyond the Committee Report's examples.[156]

Courts have applied § 305(a) in a wide range of cases. They have ordered § 305(a) dismissal when creditors file involuntary petitions to hinder out-of-court workouts.[157] They have used § 305 to dismiss bad faith filings[158] and cases that were simply two party disputes.[159] When novel issues of law arise or there is external litigation with significant bearing on a bankruptcy case, courts have used § 305 to suspend cases.[160] Courts have abstained from administering proceedings so that

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[152] *Id.*

[153] *Id.*; *see also* 11 U.S.C. § 304(c) (repealed) ("[T]he court shall be guided by what will best assure an economical and expeditious administration of such estate, consistent with—(1) just treatment of all holders of claims against or interests in such estate; (2) protection of claimholders in the United States against prejudice and inconvenience in the processing of claims in such foreign proceeding; (3) prevention of preferential or fraudulent dispositions of property of such estate; (4) distribution of proceeds of such estate substantially in accordance with the order prescribed by this title; (5) comity; and (6) if appropriate, the provision of an opportunity for a fresh start for the individual that such foreign proceeding concerns.").

[154] H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 325 (1977).

[155] *See In re* 801 S. Wells St. Ltd. Pshp., 192 B.R. 718, 723 (Bankr. N.D. Ill. 1996) ("Had Congress intended the illustrative example in the legislative history to limit the factual scenarios under which abstention is authorized, it would have included such language in § 305(a) itself.").

[156] *See In re* Spade, 258 B.R. 221, 230 (Bankr. D. Colo. 2001) (collecting cases) ("[T]he vast majority of cases applying § 305 . . . [v]iew[ ] their [the court's] discretion to be . . . broad under § 305, these courts routinely use a wide variety of factors to evaluate the question of whether dismissal would better serve the interests of the creditors and the debtor.").

[157] *See In re* Wine & Spirits Specialties, Inc., 142 B.R. 345, 347 (Bankr. W.D. Mo. 1992) (dismissing an involuntary petition filed by a single creditor where bankruptcy proceedings would disrupt an ongoing and profitable liquidation sale).

[158] *See, e.g.*, First Conn. Consulting Group, Inc. v. Mocco (*In re* First Conn. Consulting Group, Inc.), 340 B.R. 210 (D. Vt. 2006), *aff'd*, 254 Fed. App'x 64 (2d Cir. 2007) (affirming the bankruptcy judges use of equitable discretion under § 1112(b) and § 305(a) to dismiss Chapter 11 case for bad faith filing); *In re* Long Bay Dunes Homeowners Ass'n, 246 B.R. 801, 806 (Bankr. D.S.C. 1999) (dismissing the case under § 305 "[b]ecause the issues . . . appear[ed] to be primarily between two parties with a long history of litigation in the state court and numerous orders ha[d] already been entered by the state court dealing with the issues").

[159] *See In re* Spade, 258 B.R. 221, 235 (Bankr. D. Colo. 2001) ("There is no need for a federal court to resolve this two-party dispute that implicates purely state law issues.").

[160] *See In re* Milestone Educ. Inst., 167 B.R. 716, 724 (Bankr. D. Mass. 1994) (ordering "relief from stay for cause and concomitant suspension of all activity in th[e] case pursuant to 11 U.S.C. § 305" to preserve the case and enable "the Massachusetts Appeals Court to review the Superior Court's order and address novel and unsettled issues of receivership law"); *In re* Duratech Indus.,

external litigation with significant bearing on the case could be resolved.[161] Finally, courts have also dismissed proceedings on a comity rationale when aware of another proceeding in a foreign jurisdiction.[162]

Despite the variety of applications, § 305(a) should only be applied to a case in its entirety. The Committee Report emphasizes that "[a]bstention under this section . . . is of jurisdiction over the entire case."[163] Case law generally reflects this intent.[164] In Modell's Case, the court departed from this accepted limitation of § 305.

III. MODELL'S MISCONCEIVED SUSPENSION ORDER

Judge Papalia granted Modell's proposed suspension order.[165] The authority to do so purportedly derived from § 305(a)(1) and § 105(a).[166] Under § 305(a)(1), "[t]he court after notice and a hearing, may dismiss a case . . . , or may suspend *all* proceedings in a case . . . at any time if—(1) the interests of the creditors and the debtor would be better served by such dismissal or suspension."[167] Under § 105(a), "[t]he court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title."[168] However, because the automatic stay remained in effect, this order effectively used § 105(a) to transmogrify § 305(a)(1)'s "*all proceedings*" into "some proceedings."[169]

The order allowed the debtor to institute a new Limited Operating Budget[170] and temporarily suspend the proceedings.[171] Judge Papalia explained at the hearing on the emergency motion that the COVID-19

241 B.R. 283, 287 (E.D.N.Y. 1999) (affirming the bankruptcy court's decision "to abstain from administering Duratech's Chapter 11 case" because the outcome of ongoing litigation the debtor and one of its creditors "could substantially bear upon Duratech's ability to confirm a plan of reorganization").

[161] *In re* Duratech Indus., 241 B.R. 283, 287 (E.D.N.Y. 1999) (affirming the bankruptcy court's decision "to abstain from administering Duratech's Chapter 11 case" because the outcome of ongoing litigation the debtor and one of its creditors "could substantially bear upon Duratech's ability to confirm a plan of reorganization").

[162] *In re* Northshore Mainland Servs., Inc., 537 B.R. 192, 208 (Bankr. D. Del. 2015) ("Here, considerations of comity support abstention pursuant to § 305(a).").

[163] H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 325 (1977).

[164] *See, e.g.*, Andrus v. Ajemian (*In re* Andrus), 338 B.R. 746, 750 (Bankr. E.D. Mich. 2006) ("By its terms, § 305(a) applies to entire cases or all proceedings in a case, not particular proceedings in a case, such as this adversary proceeding."); *In re* Bellucci, 119 B.R. 763, 771 (Bankr. E.D. Cal. 1990) ("[Section 305(a)] is applicable on an all-or-nothing basis to the bankruptcy 'case,' . . . . The court cannot rely on section 305 abstention to pick and choose proceedings within the case.").

[165] March Suspension Hearing, *supra* note 19, at 62–63.

[166] *Id.* at 8.

[167] 11 U.S.C. § 305(a)(1) (emphasis added).

[168] 11 U.S.C. § 105(a).

[169] *See* March Suspension Hearing, *supra* note 19, at 60–65.

[170] Suspension Motion, *supra* note 28, at Ex. 1.

[171] March Suspension Hearing, *supra* note 19, at 39–40.

pandemic was sufficient cause to permit extension for up to sixty days under § 365(d)(3).[172] The sixty-day timer started the date of filing March 11 and would expire on May 11.[173] The order, however, provided that "[a]ll deadlines that would otherwise occur during the Bankruptcy Suspension are hereby extended until further notice."[174] This order theoretically stopped the clock on the sixty-day lease obligation extension under § 365(d)(3). Judge Papalia then granted successive orders extending the suspension order well beyond the expiration of the sixty-day clock in apparent contravention of § 365(d)(3).[175] Under the order, the landlords retained their claim—a right to payment of accrued rent subject to the absolute priority rule—that they could pursue when the stores reopened.[176] This did little to reassure them of payment in full because limited operating costs continued to melt the Modell's ice cube as the COVID-19 lockdown continued.

The landlords' objected that Modell's was "run[ning] [the] case[ ] on the backs of the landlords."[177] They wanted a guarantee of payment ahead of all other claims, including the lender bank, Wells Fargo, which provided the cash to fund the going-out-of-business sales originally and permitted its use for the essential costs in the suspension budget—which did not include rent payments.[178] The Debtor's counsel assured the landlords that the debtor intended to pay the rent when the liquidation sales resumed.[179] Modell's had leverage because the specifics of the landlords' right to "timely payment" under § 365(d)(3) remained an open question that required litigation.

The landlords protested that Judge Papalia was inappropriately altering their substantive right to "timely payment" under the unexpired lease agreements.[180] The landlords had legitimate concerns. Modell's

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[172] *Id.* (Judge Papalia: "When in my long life . . . have there been more extraordinary circumstances or would there be a better reason to at least put it off for the 60 days, the 365(d)(3)?").

[173] *See* Fed. R. Bankr. P. 9006.

[174] Order Temporarily Suspending the Debtors' Chapter 11 Cases Pursuant to 11 U.SC. §§ 105 and 305 at 3, *In re* Modell's Sporting Goods, Inc., No. 20-14179-VFP (Bankr. D.N.J. Mar. 23, 2020), ECF No. 166.

[175] Order Further Suspending the Debtor's Chapter 11 Cases Pursuant to 11 U.S.C. §§ 105 and 305, *In re* Modell's Sporting Goods, Inc., No. 20-14179-VFP (Bankr. D.N.J. April 30, 2020), ECF No. 294 (scheduling status conference for May 20); Order Further Suspending the Debtors' Chapter 11 Cases Pursuant to 11 U.S.C. §§ 105 and 305 Through and Including June 15, 2020 and Setting Final Hearing on Cash Collateral Motion, *In re* Modell's Sporting Goods, Inc., No. 20-14179-VFP (Bankr. D.N.J. June 5, 2020), ECF No. 371 (scheduling status conference for June 11).

[176] *See* Order Temporarily Suspending the Debtors' Chapter 11 Cases Pursuant to 11 U.SC. §§ 105 and 305 at 4, *In re* Modell's Sporting Goods, Inc., No. 20-14179-VFP (Bankr. D.N.J. Mar. 23, 2020), ECF No. 166.

[177] March Suspension Hearing, *supra* note 19, at 40.

[178] April Suspension Extension Hearing, *supra* note 30, at 100.

[179] *Id.* at 13.

[180] *See id.* at 37.

was so strapped for cash that the case faced a genuine risk of administrative insolvency.[181] The landlords protested that the repeated and seemingly indefinite suspension of the case—and more importantly the rent payments—effectively made the landlords bear the risk of administrative insolvency to benefit the other creditors.[182] The landlords cited the Supreme Court case *Law v. Siegel*,[183] arguing this order was an unlawful use of § 105(a) in direct contravention of another provision of the Code.[184]

Judge Papalia did not use § 105(a) in a way that altered the landlords' substantive rights. Indeed, it is true that § 105(a) should not be used to alter parties' substantive rights.[185] However, the lack of remedy for § 365(d)(3) complicates the nature of the landlords' rights. No one denied the landlords' right to payment. The order did not alter the fact that the definition of "timely" remained an open question regardless of what one senator intended. Therefore, the uncertainty of the landlords' recovery arose due to a remedial gap in the Code and the ensuing diversity of case law rather than a straightforward abuse of judicial discretion through an unlawful use of § 105(a).

Judge Papalia also did not use § 105(a) in a way that contravened § 365(d)(3), which would have been unlawful under *Seigel*. Because of the diversity of decisions about the § 365(d)(3) rent obligations, the question of exactly when and whether Modell's had to pay this rent remained an open issue that could have required litigation. Judge Papalia simply postponed the determination of this issue.

It is also a good thing that Judge Papalia did not ask the parties to litigate the issue at that juncture. Consider the following counterfactual: If Judge Papalia had asked the landlords to litigate the issue with so much of Modell's value still tied up in merchandise, legal fees might have depleted the dwindling supply of cash earmarked to pay essential expenses until the economy reopened. If the landlords had prevailed and received administrative expense priority, they would have a claim to be paid at the end of the case, not immediately. After expending resources litigating the issue, they would be in close to the same place—holding a claim to be paid sometime in the future *if* Modell's had enough money to pay. Alternatively, assuming the court granted immediate

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[181] *Id.* at 46–47.

[182] *See id.* at 33.

[183] 571 U.S. 415 (2014).

[184] *Id.* at 37. *See also* Limited Objection of 498 Seventh LLC to Extension of Temporary Suspension of Debtors' Chapter 11 Cases at 7, *In re* Modell's Sporting Goods, Inc., No. 20-14179-VFP (Bankr. D.N.J. April 30, 2020), ECF No. 254.

[185] United States v. Sutton, 786 F.2d 1305, 1308 (5th Cir. 1986); *see also In re* Dairy Mart Convenience Stores, Inc., 351 F.3d 86, 92 (2d Cir. 2003); S. Ry. Co. v. Johnson Bronze Co., 758 F.2d 137, 141 (3d Cir. 1985).

payment, the landlords would be awarded their rent payments from a pool of money insufficient to pay them in full.[186] Upon depleting this cash, Modell's would have nothing left to pay employees needed to liquidate the remaining merchandise when the stores reopened, making it impossible for the landlords to recover any more than about half what they were owed.[187]

From a practical perspective, Judge Papalia probably made the best decision for the case by delaying the rent issue and allowing the debtors to run on the Limited Operating Budget. If debtor's counsel kept his word and Modell's eventually paid the rent in full when stores reopened, the § 365(d)(3) issue might not even require litigation—saving an unnecessary legal expense.

At the hearing, Judge Papalia reassured the landlords that he took their concerns seriously. The landlords still had access to the court.[188] Nothing in the suspension order prevented them from seeking relief for any issues that arose during the suspension.[189] The landlords complained that they would not be allowed to find new tenants and generate income from the properties.[190] After all, they had debts of their own. However, it seems unlikely that the landlords would have found new commercial tenants during the economic lockdown. Indeed, the debtor's counsel also pointed out that New York, one of Modell's major operating states, had a moratorium on rent.[191] Nonetheless, Judge Papalia assured the landlords that if they came to him and asked to lease their property to a new tenant, he would be willing to lift the automatic stay so they could evict Modell's.[192] The landlords reiterated that a promise to lift the stay was not the same as an order guaranteeing they would be paid what they were owed.[193]

However, as outlined by the discussion concerning the ambiguity of the landlords' right to payment under § 365(d)(3), this argument is comparing apples to oranges. The landlords did not have a guaranteed right to payment that could overpower the absolute priority rule. The banks that provided cash to run the sales had a security interest in

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[186] *See* April Suspension Extension Hearing, *supra* note 30, at 38–39 (Judge Papalia: "[T]hey have three million which is not even a - - as I see it, not even a half a month. But they need a million anyway to get started.").

[187] *See id.*

[188] *Id.* at 57 (Judge Papalia: "[T]he order that we have in place says you can ask for relief . . . .").

[189] *Id.*

[190] *Id.* at 56.

[191] *Id.* at 14.

[192] *Id.* at 56.

[193] *See id.* at 57–59.

Modell's assets.[194] No claim is guaranteed payment in bankruptcy—that is why the rigorous application of absolute priority has important ex ante effects for lenders. Interestingly, the sum of Judge Papalia's reassurances draws into question whether anything was actually suspended by the Suspension Order. We will return to this after discussing the inapplicability of § 305(a) to effectuate the desired limited operations effect.

Practically, Judge Papalia's anomalous use of § 305(a) was unappealable under § 305(c). Judge Papalia reasoned soundly that the COVID-19 pandemic presented extraordinary circumstances. He appropriately attempted to mitigate any persuasive effect of his ruling on future cases by highlighting the extraordinary circumstances justifying an extraordinary order.[195] While the pandemic facts of the case will likely be distinguishable from many future Chapter 11 cases, it is widely accepted in U.S. commercial law that clear legal rules enable efficient corporate planning.[196] No matter how distinguishable the facts of Modell's Case are, parties should be able to rely on the intended limitations of § 305(a) in Chapter 11 especially because § 305(c) prevents appeal.

Legally, however, Judge Papalia did not have the authority to grant this order. Both § 105 and § 305 are extraordinary remedies. Section 305(a) does not permit a partial suspension. The temporary order enabled Modell's to continue to receive the benefits of the automatic stay under § 362 while using some property of the estate to pay essential expenses on a limited operating budget.[197] The plain language of the statute allows the judge to "suspend all proceedings," not some proceedings. Case law applying § 305(a) also reflects this straightforward interpretation of the language. Courts have noted that the remedy under § 305(a) is "all-or-nothing."[198]

Furthermore, the prohibition against appeal under § 305(c) should inform the usage of § 305(a). Bankruptcy judges should not be able to

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[194] *See* Interim Order (I) Authorizing Use of Cash Collateral and Affording Adequate Protection; (II) Modifying Automatic Stay; (III) Scheduling a Final Hearing; and (IV) Granting Related Relief at 8, *In re* Modell's Sporting Goods, Inc., No. 20-14179-VFP (Bankr. D.N.J. Mar. 13, 2020), ECF No. 66.

[195] March Suspension Hearing, *supra* note 19, at 39–40; April Suspension Extension Hearing, *supra* note 30, at 100 (Judge Papalia: "There's no question that it's an extraordinary remedy, just as I said at the other hearing — at the previous hearing. There is no question that these are extraordinary times").

[196] *See, e.g.*, *In re* My Type, Inc., 407 B.R. 329, 337 (Bankr. C.D. Ill. 2009) ("Uncertainty, while it may be a boon to bankruptcy trustees, is the bane of commercial laws, whose primary purpose is to promote certainty in commercial transactions.").

[197] Order Temporarily Suspending the Debtors' Chapter 11 Cases Pursuant to 11 U.SC. §§ 105 and 305 at 4, *In re* Modell's Sporting Goods, Inc., No. 20-14179-VFP (Bankr. D.N.J. Mar. 23, 2020), ECF No. 166.

[198] *See, e.g.*, *In re* Bellucci, 119 B.R. 763, 771 (Bankr. E.D. Cal. 1990).

use § 105(a) to enable a bespoke, piecemeal application of § 305(a) that alters the rights of the parties simply because their decision cannot be appealed. The § 305(c) prevention of appeal of a decision to dismiss or suspend all proceedings indicates Congress must have intended a narrow and simple application for § 305(a) that bankruptcy judges could apply with little or no error. A bespoke tailoring of "suspension" using § 105(a) increases judicial discretion and necessarily increases the likelihood of error. This is especially true in light the Supreme Court's comments in *Siegel*: "Section 105(a) confers authority to 'carry out' the provisions of the Code, but it is quite impossible to do that by taking action that the Code prohibits."[199] A party is not entirely without remedy; they could petition for a writ of mandamus from a higher court that ordered a bankruptcy judge to take a particular action. "The traditional use of the writ in aid of appellate jurisdiction both at common law and in the federal courts has been to confine an inferior court to a lawful exercise of its prescribed jurisdiction or to compel it to exercise its authority when it is its duty to do so."[200] However, the mere possibility of using writ of mandamus to correct § 305(a) abuses under innumerable bespoke arrangements using § 105(a) does not defeat the inference that can be drawn from § 305(c). Courts prefer formal appeal to the use of the extraordinary writ of mandamus.[201]

Interestingly, by the end of the suspension extension hearing on April 30, the understanding between the parties more closely resembled an order modifying the budget than a partial suspension of the proceedings. In short, the same effect could have and should have been legally achieved using § 105(a) paired with § 363(b)(1). Section 363(b)(1) permits "[t]he trustee . . . [to] use, sell, or lease, other than in the ordinary course of business, property of the estate." Instead of granting the Suspension Order under § 105(a) and § 305(a), Judge Papalia should have clarified the applicable uses of § 305(a) and encouraged the debtor to refile using § 105(a) and § 363(b)(1). While the outcome would have been the same, the order would have avoided opening up an avenue for possible abuse of § 305(a).

IV. CONCLUSION

In moments of crisis, lawyers make novel requests to solve novel problems. Though extraordinary relief may be warranted in rare cases,

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[199] Law v. Siegel, 571 U.S. 415, 421 (2014).

[200] Roche v. Evaporated Milk Ass'n, 319 U.S. 21, 26 (1943).

[201] *See* Mallard v. U.S. Dist. Court for the S. Dist. of Iowa, 490 U.S. 296, 309 (1989) ("To ensure that mandamus remains an extraordinary remedy, petitioners must show that they lack adequate alternative means to obtain the relief they seek.").

bankruptcy judges should resist problem-solving that contradicts accepted understandings of the Code. Bankruptcy judges may still be able to reach the practical solutions under legitimate legal authority even in the face of catastrophic unforeseen circumstances like a pandemic. Modell's Case illustrates the resilience of the bankruptcy Code and of the bankruptcy courts. Though the economic shutdown posed a significant obstacle for the success of the proceedings, upon closer examination, two run-of-the-mill provisions—§ 363(b)(1) and § 105(a)—could have resolved seemingly extraordinary COVID-19 problems.