Arbitration Agreements as Executory Contracts in Bankruptcy After *Mission Prod. Holdings, Inc. v. Tempnology, LLC*

by

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INTRODUCTION

In 2021, a bankruptcy court refused to enforce an arbitration agreement because, among other reasons, the debtor rejected the contract containing the arbitration agreement under Bankruptcy Code § 365.[1] In concluding that rejection meant the debtor was "no longer bound by the [contract]'s provisions that impose specific performance obligations on it—provisions such as the Arbitration Clause,"[2] the bankruptcy court rightly found "support in" a 2014 federal district court decision refusing to enforce an arbitration agreement against a receiver who had rejected that agreement under receivership law similar to § 365.[3] These two decisions conflict with a long line of cases en-

[1]Highland Cap. Mgmt., L.P. v. Dondero (*In re* Highland Cap. Mgmt., L.P.), Nos. 19-34054-sgj11, 21-03003-sgj, 21-03005-sgj, 21-03006-sgj, 21-03007-sgj, 2021 WL 5769320 (Bankr. N.D. Tex. Dec. 3, 2021).

[2]*Id.* at *5.

[3]*Id.* (*citing* Janvey v. Alguire, Civil Action No. 3:09-CV-0724-N, 2014 U.S. Dist. LEXIS 193394, at *113 (N.D. Tex. Jul. 30, 2014)). *See also* Janvey v. Alguire, 847 F.3d 231, 239 (5th Cir. 2017) ("The district court determined that the Receiver's rejection of the arbitration agreements was permissible, ex-

forcing executory arbitration agreements notwithstanding rejection under § 365. Moreover, the Supreme Court's *Mission Prod. Holdings, Inc. v. Tempnology*[4] decision supports this long line of cases, as another bankruptcy court recognized by citing *Tempnology* in holding that "the bankruptcy code does not render arbitration clauses in rejected executory contracts inoperative."[5]

Bankruptcy Code § 365 gives the trustee or debtor-in-possession representing a bankruptcy estate the power to choose whether the estate will assume or reject many of the executory contracts formed by the pre-bankruptcy debtor. Section 365 instructs courts to treat the estate's rejection of an executory contract as though the pre-petition debtor had breached that contract. This treatment typically means that the non-debtor party to the rejected contract will collect no money from the estate or merely a small portion of the money damages a non-bankruptcy court would have awarded for the debtor's breach of contract had the debtor stayed out of bankruptcy. In this sense, rejection of an executory contract typically weakens enforcement of that contract by the non-debtor party seeking money damages.

In contrast, the rejection of an executory arbitration agreement formed by the pre-bankruptcy debtor does not—except in the two outlier cases noted above—weaken the non-debtor party's enforcement of that arbitration agreement. Notwithstanding rejection under § 365, nearly all courts enforce executory arbitration agreements against the estate with the remedy of specific performance that compels the estate to arbitrate. However, § 365 cases have been uneven in their handling of arbitration law's separability doctrine,[6] which holds that "arbitration clauses as a matter of federal law are 'separable' from the contracts in which they are embedded."[7] The separability doctrine may, at least initially, seem to conflict with § 365 cases stating that an executory contract must be assumed or rejected in its entirety under the "all-or-nothing rule." Difficulties combining the separability doctrine with § 365 have produced erroneous statements by several courts, including the Third Circuit's oft-cited decision in *Hays and Company v. Merrill Lynch, Pierce, Fenner, & Smith, Inc.*[8]

This Article has two main parts. Part I begins with § 365 and the consequences of assumption and rejection, before exploring the implications of the

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plaining that it would be 'unjust and inequitable' to burden and deplete the receivership estate by requiring the Receiver to adopt the arbitration agreements.").

[4]139 S. Ct. 1652, 1662 (2019).

[5]HCB Enters v. Dickey's Barbecue Rests, No. 2:20-CV-407 JCM(VCF), 2020 WL 3643430, at *2 (D. Nev. July 6, 2020).

[6]*See infra* Part II.

[7]Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395, 402 (1967).

[8]885 F.2d 1149 (3d Cir. 1989).

United States Supreme Court's statement in *Mission Prod. Holdings, Inc. v. Tempnology*, that "[a] rejection breaches a contract but does not rescind it. And that means all the rights that would ordinarily survive a contract breach . . . remain in place" after rejection.[9] Consistent with this statement and its likely implications, Part I shows, many courts before, and one after, *Tempnology* have specifically enforced arbitration agreements against the estate, notwithstanding rejection of those arbitration agreements. Part I argues that these many cases are right rather than the two outlier cases identified at the start of this Article.

Part II of this Article explains arbitration law's separability doctrine and integrates it with bankruptcy law. This analysis shows, contrary to the outlier cases and some commentators, that the separability doctrine is compatible with, and even further supports, courts' conclusions that rejection under § 365 does not prevent specific enforcement of an arbitration agreement. The Article concludes that a pre-bankruptcy debtor's arbitration agreement is specifically enforceable by or against the estate, regardless of whether the rest of the contract containing the arbitration agreement is executory. And either party is entitled to specific performance of the arbitration agreement regardless of whether the estate has rejected it and the broader contract containing it or rejected only the arbitration agreement while assuming the broader contract containing it.

I. ARBITRATION AGREEMENTS AS EXECUTORY CONTRACTS IN BANKRUPTCY

A. Basics of Bankruptcy Code § 365

1. *The Bankruptcy Estate May Assume or Reject an Executory Contract*

The commencement of a bankruptcy case creates a new legal person, the bankruptcy estate, represented by a trustee or debtor-in possession (DIP),[10] and automatically transfers much or all the pre-bankruptcy debtor's property to the estate.[11] Largely following earlier bankruptcy law,[12] Bankruptcy Code

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[9]139 S. Ct. at 1657-58.

[10]Charles Jordan Tabb, Law of Bankruptcy 137 (5th ed. 2020) ("[F]iling a bankruptcy petition transfers all of the debtor's property to the newly established bankruptcy estate. The estate is a separate legal entity, and the bankruptcy trustee acts as representative of the estate."); 7 Collier on Bankruptcy ¶ 1101.01 (16th ed. 2020) ("Various courts have found that the bankruptcy estate is a separate legal entity from the chapter 11 debtor or debtor in possession.").

[11]11 U.S.C. § 541.

[12]"A bankruptcy trustee's ability to 'assume or reject' / 'adopt or repudiate' certain contracts and leases predates both the 1978 Bankruptcy Code as well as the Bankruptcy Act of 1898." Janvey v. Alguire, No. 3:09-CV-0724-N, 2014 WL 12654910, at *7 (N.D. Tex. July 30, 2014), *aff'd*, 847 F.3d 231 (5th Cir. 2017). *See also* Vern Countryman, *Executory Contracts in Bankruptcy*, 57 Minn. L. Rev. 439, 444-45

§ 365(a) gives the trustee or DIP the power to choose whether the estate will assume or reject many of the executory contracts formed by the pre-bankruptcy debtor.[13]

While the Bankruptcy Code does not define "executory contract," courts have overwhelmingly adopted the so-called Countryman definition,[14] which defines an executory contract as "a contract under which the obligation of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other."[15]

To see what an executory contract under § 365 is and is not, consider a pre-petition contract obligating Seller to deliver goods and Buyer to pay for those goods. Suppose Seller delivers conforming goods, but Buyer fails to pay, and then enters bankruptcy. This contract is not executory for § 365 purposes because one party (Seller) substantially performed its contractual duties before Buyer's bankruptcy. So, § 365 does not apply, and Buyer's bankruptcy estate has no right to reject this contract. The pre-bankruptcy debtor received Seller's performance under this contract, and Seller has a claim against the debtor's bankruptcy estate for payment.[16]

(1973); Michael T. Andrew, *Executory Contracts in Bankruptcy: Understanding "Rejection,"* 59 U. COLO. L. REV. 845, 932 (1988).

[13]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."); 11 U.S.C. § 1107(a) (subject to limitations "a debtor in possession shall have all the rights, other than the right to compensation under section 330 of this title, and powers, and shall perform all the functions and duties, except the duties specified in sections 1106(a)(2), (3), and (4) of this title, of a trustee serving in a case under this chapter").

[14]2 WILLIAM L. NORTON III, NORTON BANKR. L. & PRAC. § 46:6 (3d ed. 2021) ("The prevailing standard employed by courts in determining whether a particular contract is executory and, as a consequence, governed by Code § 365 is that devised by Harvard Law School Professor Vern Countryman in the early 1970s.") *See, e.g.*, Unsecured Creditors' Comm. v. Southmark Corp. (*In re* Robert L. Helms Constr. & Dev. Co.), 139 F.3d 702, 705 n.7 (9th Cir. 1998) (relying on the definition created in 1973 by Professor Countryman, recognizing that this definition is widely used and often referred to as the "Countryman definition"); Olah v. Baird (*In re* Baird), 567 F.3d 1207, 1210 (10th Cir. 2009).

[15]Vern Countryman, *Executory Contracts in Bankruptcy*, 57 MINN. L. REV. 439, 460 (1973); TABB, LAW OF BANKRUPTCY 793 ("Defining 'executory contract' in light of the purposes to be served by the bankruptcy trustee's assumption or rejection of the contract, Professor Countryman excluded contracts that have been substantially performed by either the debtor or the non-debtor party to the contract. This is known as the 'material breach' test.").

[16]3 COLLIER ON BANKRUPTCY ¶ 365.02 (16th ed. 2020) ("[I]f the other party fully performed and only the debtor's performance remained to be done, the estate already has whatever benefit is to be gained from the contract. The other party has a claim against the estate for breach of contract if the debtor or the estate does not perform, but that party cannot deprive the estate of the performance that the estate has already received."); TABB, LAW OF BANKRUPTCY 793 ("Assume that Debtor and Other Party enter into a contract prior to bankruptcy, pursuant to which Debtor agrees to buy and Other Party to sell 1,000 hats at a price of $5 each, with delivery to be made in 30 days. . .. [Suppose] Other Party has delivered the hats to Debtor prior to the bankruptcy filing. The contract between Debtor and Other Party is no longer 'executory' for bankruptcy purposes, because no function would be served by classifying it as such. As-

Now suppose, instead, that before its bankruptcy Buyer paid for the goods but Seller failed to deliver or tender delivery of those goods. This contract is also not executory and § 365 does not apply for the same reason that one party substantially performed its contractual duties before bankruptcy. But because the party that performed (Buyer) is now in bankruptcy, its breach of contract claim against Seller passes (along with Buyer's other property) to the bankruptcy estate.[17]

In contrast, § 365 does apply to a third version of this hypothetical. Suppose before Buyer's bankruptcy neither party performed its contractual duties. That is, Seller did not deliver or tender goods, and Buyer did not pay for them, perhaps because the contractually specified time for each party's performance had not yet occurred when Buyer entered bankruptcy. This is an executory contract for § 365 purposes because each party still owes material duties to the other. So, § 365 empowers the bankruptcy estate (represented by a trustee or DIP) to choose whether to assume or reject this contract formed by the pre-bankruptcy debtor.

2. *Consequences of Assumption and Rejection*

If the estate assumes an executory contract the estate acquires the rights and duties of the pre-bankruptcy debtor with respect to that contract and thus is fully liable if the estate later breaches the contract.[18] In contrast, an estate's rejection of an executory contract constitutes breach of that contract, and Bankruptcy Code § 365(g)(1) treats the non-debtor party's claim for

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sumption of the contract is not necessary for the bankruptcy estate to obtain the benefit of the contract, since the estate already has that benefit (the hats). Nor would rejection do anything, since Other Party already has a claim for the unpaid purchase price. In short, the contract now is only a liability of the estate (and a 'claim' for Other Party).").

[17]10 WILLIAM L. NORTON, III, NORTON BANKR. L. & PRAC 11 U.S.C. § 541 (3d ed. 2021) (quoting House and Senate Reports (Reform Act of 1978)) ("[T]he estate is comprised of all legal or equitable interest of the debtor in property, wherever located, as of the commencement of the case. The scope of this paragraph is broad. It includes all kinds of property, including tangible or intangible property, *causes of action*, and all other forms of property . . .") (emphasis added); TABB, LAW OF BANKRUPTCY 793-94 ("[A]ssume that Debtor has performed but that Other Party has not performed by the time the Debtor files bankruptcy. In the hypothetical, Debtor therefore has prepaid the purchase price but Other Party has not delivered the hats. Again, the contract would not be considered executory within the meaning of § 365, because again no purpose would be served by dealing with the contract under § 365. Assumption would not give the estate any greater rights than it already has under § 541; the Debtor having paid for the hats, the estate succeeds to Debtor's right either to delivery of the hats or to a remedy for breach against Other Party if Other Party fails to deliver. Rejection, which is treated as a deemed breach by Debtor, § 365(g), would be particularly nonsensical, for the simple reason that Debtor did not breach, but fully performed. It would be absurd to give Other Party a claim against the estate. In this situation, the contract is only an asset of the estate, without an accompanying liability.").

[18]TABB, LAW OF BANKRUPTCY 798 ("'Assumption' means that the estate itself becomes obligated on the contract. It is a decision of the estate representative to perform the contract. By doing so the estate will become entitled to obtain the benefit of the contract; in return, the claim of the non-debtor party will be elevated to priority status as an administrative expense of the estate.").

breach as though it arose before bankruptcy.[19] Consequently, the non-debtor party becomes just another general unsecured creditor in debtor's bankruptcy,[20] and thus is entitled only to its pro rata share of the bankruptcy estate after secured and priority creditors have been paid in full.[21] This nearly always means that the non-debtor party to the rejected contract (the "creditor") collects no money from the estate or merely a small portion of the money damages a non-bankruptcy court would have awarded for the debtor's breach of contract had the debtor stayed out of bankruptcy.[22] The "harsh reality" is that "a contract that had promised to yield a multimillion dollar benefit to the creditor can simply be rejected by the trustee, leaving the creditor to whatever pennies-on-the-dollar-distribution is made to the general unsecured creditors—if any distribution is made at all."[23]

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[19]11 U.S.C. § 365(g)(1); TABB, LAW OF BANKRUPTCY 799 ("'Rejection' is best understood as a decision by the trustee not to assume the contract. By rejecting the contract the trustee has chosen not to obligate the estate on the contract. Rejection is treated as a prepetition breach of the contract . . . ."); 3 COLLIER ON BANKRUPTCY ¶ 365.10 (16th ed. 2020) ("[T]he effect of a rejection is that a breach is deemed to have occurred, which in the ordinary case will give rise to a claim for damages. Contract rejection damages then are measured as of the petition date, not as of the rejection date."); N.L.R.B. v. Bildisco & Bildisco, 465 U.S. 513, 530 (1984) ("The Bankruptcy Code specifies that the rejection of an executory contract which had not been assumed constitutes a breach of the contract which relates back to the date immediately preceding the filing of a petition in bankruptcy. 11 U.S.C. § 365(g)(1). Consequently, claims arising after filing, such as result from the rejection of an executory contract, must also be presented through the normal administration process by which claims are estimated and classified.")

[20]TABB, LAW OF BANKRUPTCY 799 ("Rejection is treated as a prepetition breach of the contract, thus leaving the non-debtor party with only a general unsecured claim for damages.").

[21]TABB, LAW OF BANKRUPTCY 810 ("The third effect of rejection is that the non-debtor party is deemed to have a general unsecured prepetition claim in the bankruptcy case. Section 365(g)(1), just quoted, specifies that rejection constitutes a prepetition breach. The non-debtor party's claim from rejection is allowed as if it arose prior to bankruptcy. § 502(g). Thus, while the non-debtor party is not treated better than any of the debtor's other general creditors (because it does not have a priority claim), neither is it treated worse as a consequence of rejection; it is deemed to have a claim just like all other general creditors"); 2 WILLIAM L. NORTON III, NORTON BANKRUPTCY LAW & PRACTICE § 46:23 (3rd ed. 2022) ("Rejection of an executory contract or unexpired lease, however, constitutes a breach of the contract or lease and results in a claim for resulting damages as an unsecured prepetition claim"); 3 COLLIER ON BANKRUPTCY ¶ 365.10 (16th ed. 2022) ("Section 365(g) provides that rejection of a contract or lease that has not previously been assumed in the case constitutes a breach immediately before the date of the filing of the petition. By placing the time of the breach prepetition, section 365(g) makes any claim that the contract or lease counterparty may have a prepetition claim that is not entitled to priority as an expense of administration of the estate").

[22]*See, e.g.*, Mission Prod. Holdings, Inc. v. Tempnology, 139 S. Ct. 1652, 1662 (2019) ("Because the rejection is deemed to occur 'immediately before' bankruptcy, the firm's damages suit is treated as a prepetition claim on the estate, which will likely receive only cents on the dollar."); TABB, LAW OF BANKRUPTCY 718–19 ("[W]ell over 90 percent of all chapter 7 cases are 'no asset' cases, meaning that 'no assets' are available for distribution to general unsecured creditors.").

[23]Note, *Jurisdiction in Bankruptcy Proceedings: A Test Case for Implied Repeal of the Federal Arbitration Act*, 117 HARV. L. REV. 2296, 2313–17 (2004). However, this "dramatic effect" of § 365 rejection is no more dramatic than the effect of what is routine in bankruptcy—a debtor breaching a contract and then filing for bankruptcy and receiving in bankruptcy a discharge of pre-petition debt. In other words, § 365 rejection typically reduces the money creditors recover for breach of contract, much as that recov-

B. *Tempnology* and Rights that Survive a Contract Breach

1. *Rejection is Breach, not Rescission*

As just explained, § 365(g)(1) treats the estate's rejection of an executory contract as though the pre-petition debtor had breached the contract, so bankruptcy-followed-by-rejection may well reduce the money collected by the non-debtor party. However, bankruptcy-followed-by-rejection may not reduce other rights of the contract's non-debtor party compared to the rights that non-debtor party would have had under the breached contract had the debtor stayed out of bankruptcy. As the Supreme Court emphasized in *Mission Prod. Holdings, Inc. v. Tempnology*, "[a] rejection breaches a contract but does not rescind it. And that means all the rights that would ordinarily survive a contract breach . . . remain in place" after rejection.[24]

Tempnology overruled several earlier lower court cases that treated rejection as a rescission of the contract. This enabled trustees and DIPs (debtors in bankruptcy) to use § 365 to strip non-debtor parties of various rights conveyed to those parties by the pre-petition debtor in a contract that otherwise remained executory at the time of bankruptcy. A "notorious" example is *Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc.*[25] In this Fourth Circuit case, Richmond granted Lubrizol a nonexclusive license to use Richmond's technology.[26] A year after granting this license, Richmond filed for chapter 11 bankruptcy.[27] The Fourth Circuit first held that the license agreement was executory because, among other things, Lubrizol owed Richmond a continuing duty to make royalty payments and Richmond owed to Lubrizol a duty to notify Lubrizol of additional licenses Richmond granted and to lower Lubrizol's royalty rate if Richmond gave others lower license rates.[28] More controversially, the Fourth Circuit allowed Richmond, as debtor-in-possession of the bankruptcy estate, not only to reject the executory portions of its contract with Lubrizol but also to rescind the license Richmond, as pre-bankruptcy debtor, had conveyed to Lubrizol.[29] In other words, the Fourth Circuit held that rejection could deprive Lubrizol of rights that had been

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ery would have been reduced had the breach occurred before bankruptcy. And even if the breach and creditor's judgment had both occurred before bankruptcy, a debtor soon enter bankruptcy may be deeply insolvent, so trying to collect a big breach-of-contract judgment against that pre-bankruptcy debtor may similarly yield pennies on the dollar, or no recovery at all.

[24] *Tempnology*, 139 S. Ct. at 1657-58.

[25] TABB, LAW OF BANKRUPTCY 806-07 (*citing* Lubrizol Enters., Inc. v. Richmond Metal Finishers, Inc., 756 F.2d 1043 (4th Cir. 1985), *cert. denied*, 475 U.S. 1057 (1986)).

[26] *Lubrizol*, 756 F.2d at 1045.

[27] *Id.*

[28] *Id.*

[29] *Id.* at 1046.

conveyed to it by Richmond.[30] *Lubrizol* said, "[e]ven though § 365(g) treats rejection as a breach, the legislative history of § 365(g) makes clear that the purpose of the provision is to provide only a damages remedy for the non-bankrupt party."[31] So, Lubrizol "could not seek to retain its contract rights in the technology by specific performance even if that remedy would ordinarily be available upon breach of this type of contract."[32] "Allowing specific performance would," *Lubrizol* said, "undercut the core purpose of rejection under § 365(a)."[33]

This *Lubrizol* approach to rejection denied non-debtor parties equitable remedies, such as specific performance, and confined non-debtor parties to money damages which, as noted above, may well be less collectible after bankruptcy-followed-by-rejection than had the debtor stayed outside of bankruptcy. The *Lubrizol* approach allowed trustees and debtors in bankruptcy to use § 365, in some important respects, to rescind, rather than merely breach a contract, which resulted in stripping non-debtor parties of various rights that had been conveyed to those parties by the pre-petition debtor in the contract.

However, *Lubrizol*'s approach was, as noted above, overturned by the Supreme Court in *Tempnology*, which held that "[r]ejection of a contract—any contract—in bankruptcy operates not as a rescission but as a breach."[34] Tempnology manufactured clothing which it marketed under the brand name Coolcore.[35] Tempnology granted to Mission an exclusive license to distribute certain Coolcore products in the United States and granted Mission a non-exclusive license to use the Coolcore trademarks, both in the United States and around the world.[36] Before this licensing agreement expired, Tempnology filed for bankruptcy and moved to reject the licensing agreement.[37] The First Circuit agreed with Tempnology's argument that its "rejection of the contract also terminated the rights it had granted Mission to use the Coolcore trademarks."[38] But the Supreme Court reversed and held that "[a] rejection breaches a contract but does not rescind it. And that means all the rights that would ordinarily survive a contract breach, including those conveyed here,

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[30] *Id.* at 1048 ("the district court was under a misapprehension of controlling law in thinking that by rejecting the agreement the debtor could not deprive Lubrizol of all rights to the [technology].")

[31] *Id.*

[32] *Id.*

[33] *Id.*

[34] Mission Prod. Holdings, Inc. v. Tempnology, 139 S. Ct. 1652, 1661 (2019). "*Lubrizol* adopted the same rule for patent licenses that the First Circuit announced for trademark licenses here." *Id.* at 1664 (reversing First Circuit).

[35] *Tempnology*, 139 S. Ct. at 1658.

[36] *Id.*

[37] *Id.*

[38] *Id.* at 1659.

remain in place."[39]

2. *Money Damages v. Equitable Remedies*

After *Tempnology*, courts may now need to decide which rights would and would not "ordinarily survive a contract breach" to determine which rights survive the estate's rejection of an executory contract.[40] Perhaps *Tempnology*'s distinction is between property rights and mere promissory rights—with only property rights being "rights that would ordinarily survive a contract breach." This interpretation of *Tempnology* is supported by Justice Kagan's opinion for the Court using the property words "conveyed" and "granted," rather than the contract word "promised," to describe the pre-bankruptcy debtor's license to Mission, which the *Tempnology* court found survived the bankruptcy estate's breach (rejection) of the contract containing that license.[41] In contrast, while one might loosely say, pre-breach, that a contractual promisee has a right to whatever the promisor promised (e.g., goods or services), upon breach any such right typically vanishes and is replaced by a mere claim for money damages, the usual remedy for breach of contract.[42] So, *Tempnology* may stand for the proposition that a contract's

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[39]*Id.* at 1657-58.

[40]*See, e.g.*, Fraunhofer-Gesellschaft zur Förderung der Angewandten Forschung E.V. v. Sirius XM Radio Inc., 940 F.3d 1372, 1378 (Fed. Cir. 2019) (sublicensee's rights to continue to use technology licensed to it by pre-bankruptcy debtor did not "vaporize" when debtor in bankruptcy rejected Master Agreement granting that sublicense); FERC v. Ultra Res., Inc. (*In re* Ultra Petro. Corp.), 28 F.4th 629, 637-39 (5th Cir. 2022) (The Federal Energy Regulatory Commission's (FERC) exclusive right to modify and approve filed-rate contracts between private parties was not affected by debtor's rejection of a contract to use a natural gas pipeline because the "rejection of [the] contract is not a collateral attack on the filed-rate because that rate is given full effect when determining the breach of contract damages resulting from the rejection"); Gulfport Energy Corp. v. FERC, 41 F.4th 667, 685 (5th Cir. 2022) (affirming Court's holding in *In re Ultra* that FERC's exclusive right to modify and approve filed-rate contracts was not affected by debtor's rejection of the contract because the "contract itself does not change; nor does the filed rate"); EPLET, LLC v. DTE Pontiac N., LLC, 984 F.3d 493, 506 (6th Cir. 2021) (creditor-lessee's right to continue the lease under 11 U.S.C. § 365(h) after debtor's rejection of an integrated lease and utility services agreement also meant that a parental guaranty "including its obligations regarding maintenance, environmental costs, and remediation" survived debtor's rejection because of creditor-lessee's § 365(h) election).

[41] Mission Prod. Holdings, Inc. v. Tempnology, 139 S. Ct. 1652, 1662-63 ("The licensor not only grants a license, but provides associated goods or services during its terms; the licensee pays continuing royalties or fees. If the licensor breaches the agreement outside of bankruptcy (again, barring any special contract term or state law), everything said above goes. In particular, the breach does not revoke the license or stop the licensee from doing what it allows. . . And because rejection 'constitutes a breach,' § 365(g), the same consequences follow in bankruptcy. The debtor can stop performing its remaining obligations under the agreement. But the debtor cannot rescind the license already conveyed. So the licensee can continue to do whatever the license authorizes").

[42]PHILIP T. LACY & RALPH C. ANZIVINO, UNIFORM COMMERCIAL CODE TRANSACTION GUIDE § 10:4 (2020) ("The usual remedy for breach of a contract is a recovery of money damages."); Tess Wilkinson-Ryan, *Justifying Bad Deals*, 169 U. PA. L. REV. 193, 231 (2020) ("Any student of contract law is familiar with the remedies for breach of contract: expectation damages, reliance damages, maybe specific performance if you're very lucky and/or transferring land.").

executory promises do not provide "rights that would ordinarily survive a contract breach," while pre-breach conveyances (a/k/a grants or transfers) of property interests effectuated by the same contract do.

This reading of *Tempnology*—distinguishing between breach of contract *claims* and property *interests*—fits with fundamentals of bankruptcy law. As noted above, bankruptcy's effect on claims typically discharges creditors' claims while paying them no more than a small portion of the money damages a non-bankruptcy court would have awarded for the debtor's breach of contract had the debtor stayed outside of bankruptcy. In contrast, bankruptcy law has long enforced creditors' interests in property.[43] For example, bankruptcy law protects creditors' pre-petition security interests in the debtor's property which becomes property of the estate.[44] Other creditor property interests protected in bankruptcy include leaseholds,[45] co-tenancy,[46] and

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[43]TABB, LAW OF BANKRUPTCY 502 ("[T]he practical effect of finding that another entity has a property right that is superior to that of the debtor (and thus the estate) is to accord that entity priority over creditors of the debtor in the bankruptcy distribution. That property claimant is entitled to recover its property in full before any distribution is made to creditors").

[44]Security interests generally survive bankruptcy unless the secured creditor receives in bankruptcy the value of its lien, typically the value of its collateral, the property in which it has a lien. *See* 1 COLLIER ON BANKRUPTCY ¶ 1.02 (16th ed. 2022) ("The discharge injunction does not apply . . . to any act taken to enforce a lien on property of a discharged debtor. The lien, whether by way of security interest, judicial proceedings or statute, survives a bankruptcy discharge and may be enforced pursuant to appropriate state or nonbankruptcy law if the property serving as collateral has not been disposed of during the case"); *see also* 4 COLLIER ON BANKRUPTCY ¶ 524.02 (16th ed. 2022) ("Section 524(a)(1) provides that any judgment on a debt that is discharged is void as a determination of the debtor's personal liability. . . . By referring to the debtor's personal liability, it also makes clear that an *in rem* judgment, based upon a prepetition lien and running solely against the debtor's property, would not be affected by the discharge. As the Supreme Court explained in *Johnson v. Home State Bank*, the right to foreclose on a lien survives or passes through bankruptcy unaffected by the discharge. Thus, a creditor may enforce a prepetition judgment lien after the discharge, if the automatic stay is no longer in effect and the lien has not been avoided, paid, or modified so as to preclude enforcement."); Johnson v. Home State Bank, 501 U.S. 78, 82-3 (1991) ("A defaulting debtor can protect himself from personal liability by obtaining a discharge in a Chapter 7 liquidation. *See* 11 U. S. C. § 727. However, such a discharge extinguishes only 'the personal liability of the debtor.'" 11 U.S.C. § 524(a)(1). Codifying the rule of Long v. Bullard, 117 U.S. 617, 29 L. Ed. 1004, 6 S. Ct. 917 (1886), the Code provides that a creditor's right to foreclose on the mortgage survives or passes through the bankruptcy.").

[45]Creditor-lessors of debtors in bankruptcy retain their leasehold interests through bankruptcy unless the lessor receives in bankruptcy the value of its leasehold. JEFFREY T. FERRIELL & EDWARD J. JANGER, BANKRUPTCY § 10.07 (3rd ed. 2013) ("Insofar as bankruptcy is concerned, the interest of a lessor of real or personal property leased to the debtor is dealt with in a manner that recognizes its hybrid character. The lessor has a claim for rent. The lessor also has an interest in the property of the estate; the debtor's leasehold is property of the estate, and the lessor has certain rights and obligations with regard to its ownership of the property. Finally, the lessor has a residual property interest that is not part of the estate. The lessor's right to possess the property at the end of the lease term is a right that never belonged to the debtor; and thus does not become part of the estate.").

[46]A creditor co-tenant of a debtor in bankruptcy retains its co-tenancy interest through bankruptcy unless the non-debtor co-tenant receives in bankruptcy the value of its co-tenancy. JEFFREY T. FERRIELL & EDWARD J. JANGER, BANKRUPTCY § 10.07 (3rd ed. 2013) ("Ideally, co-owners would be unaffected by the debtor's bankruptcy. However, this is sometimes impossible. On occasion, it is necessary either to partition

rights in the nature of dower and curtesy.[47] Bankruptcy's protection of property interests is so pervasive that Jay Westbrook describes "[t]his 'property' principle" as "by far the most important exception to the principle of equality of distribution" among creditors.[48]

This distinction between breach of contract claims (which bankruptcy, including its discharge, treats harshly) and property interests (which bankruptcy respects) largely tracks the distinction between money damages (the usual remedy for breach of contract[49]) and equitable remedies (often available for violations of property rights[50]). However, an equitable remedy, specific performance, is the usual remedy for breaches of some contracts, such as contracts to convey land.[51] And specific performance is, in the parlance of Law

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the property and sell the debtor's portion or to sell the property free and clear of all owners' interests. If the latter is done, the co-owner who is not the debtor must be compensated for his interest in the jointly-owned asset.").

[47]3 COLLIER ON BANKRUPTCY ¶ 363.07 (16th ed. 2022) ("Section 363(g) permits sales of property of the estate free and clear of any vested or contingent right in the nature of dower or curtesy. This subsection must be read with subsection (i). . .which gives the debtor's spouse a "right of first refusal" with respect to the property which is to be sold. Upon sale of such property, proceeds are distributed to the debtor's spouse and the estate, less costs and expenses, not including trustee compensation, "according to the interests of such spouse . . . and of the estate"). 2 NORTON BANKR. L. & PRAC. § 44:34 ("Code § 363(g) expressly permits the trustee to sell property other than in the ordinary course of business under Code § 363(b) and in the ordinary course of business under Code § 363(c) free and clear of any vested or contingent rights in the nature of dower or curtesy. In such event, the possessor of the dower or curtesy interest may request adequate protection in accordance with Code § 363(e)").

[48]Jay Lawrence Westbrook, *A Functional Analysis of Executory Contracts*, 74 MINN. L. REV. 227, 257-58 (1989).

[49]*See supra* note 42.

[50]*See, e.g.*, Oren Bar-Gill & Nicola Persico, *Bounded Rationality and the Theory of Property*, 94 NOTRE DAME L. REV. 1019, 1021 (2019) ("Property rights are commonly enforced by property rules, which are characterized by injunctive relief for the right holder and harsh sanctions for the infringer."); *Id.* at 1022-23 ("Many view the right to exclude as the defining characteristic of property. And injunctive relief, the quintessential property rule remedy, is seen as the natural way to enforce the right to exclude."); Adam Mossoff, *The Injunction Function: How and Why Courts Secure Property Rights in Patents*, 96 NOTRE DAME L. REV. 1581, 1595 (2021) (The "principle" that "injunctions facilitate market transactions by securing a property owner's right to decide how she will use her assets and sell her products and services in the marketplace" "is well recognized by courts in tangible property cases," *citing, e.g.*, injunctions to prevent trespass); Mark A. Lemley & Philip J. Weiser, *Should Property or Liability Rules Govern Information?*, 85 TEX. L. REV. 783, 786 (2007) ("Traditionally, rights such as the ownership of real property are generally protected by injunctions, while tort and contract rights are enforced by means of compensatory damages."); Louis Kaplow & Steven Shavell, *Property Rules Versus Liability Rules: An Economic Analysis*, 109 HARV. L. REV. 713, 716 (1996) ("If I have rightful possession of some thing – such as an automobile or a home – another person ordinarily cannot take it without my permission. He cannot make a unilateral decision to borrow my automobile and pay me for my trouble, or invite himself into my home and simply pay me for the intrusion. Indeed, the inability of others to appropriate my things lies at the core of the notions of 'ownership' and 'property.'"); DAN B. DOBBS & CAPRICE L. ROBERTS, LAW OF REMEDIES: DAMAGES, EQUITY, RESTITUTION § 5.7(1) (3d ed. 2018) ("Courts frequently grant injunctions to protect the use and enjoyment interest [in land].").

[51]Tess Wilkinson-Ryan, *supra* note 42; 25 WILLISTON ON CONTRACTS § 67:65 (4th ed. 2020) ("[A] contract to convey land is specifically enforceable by the purchaser and by the vendor. . . . [A]ny piece of land is presumed to be unique, and . . . monetary damages will typically be an inadequate remedy for a

& Economics, a "property rule," because a court's specific performance order vindicates the non-breaching party's right to the specific "thing" the breaching party promised, rather than allowing the breacher to substitute money damages while keeping the promised "thing."[52] Consequently, the right to specific performance of an executory contract may well be, in *Tempnology*'s words, a right that would "ordinarily survive a contract breach." As Charles Tabb puts it, if "the creditor has an unavoidable interest in property represented by the specific performance right, then that property interest should be respected in bankruptcy."[53]

3. *Specific Performance Against the Bankruptcy Estate*

While the right to specific performance of an executory contract may well be a right that would "ordinarily survive a contract breach," and thus under *Tempnology* survive the bankruptcy estate's rejection of an executory contract, courts are generally reluctant to award creditors specific performance against the estate. The policy justification for generally denying specific performance against the estate rests on the fundamental bankruptcy principle of treating creditors equally,[54] as the estate is not likely able to pay all credi-

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breach; hence a contract purchaser may demand specific performance."); Daniel J. Bussel, *Doing Equity in Bankruptcy*, 34 EMORY BANKR. DEV. J. 13, 17-19 (2017) ("Historically, money damages is the preferred mode of legal enforcement at common law. Equitable remedies are said to be available only when damages are 'inadequate' . . . . Equitable relief has long been typically granted in cases where the subject matter of the contract is 'unique property,' or involves interests in real property.") .

[52]*See, e.g.*, Alan O. Sykes, *Economic "Necessity" in International Law*, 109 AM. J. INT'L L. 296, 323 (2015) ("Specific performance is a 'property rule' that forces a party who wishes to breach, to perform the required action anyway. The distinction originates in Guido Calabresi & A. Douglas Melamed, *Property, Rules, Liability Rules and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089 (1972)."); Eric R. Claeys, *The Right to Exclude in the Shadow of the Cathedral: A Response to Parchomovsky and Stein*, 104 NW. U. L. REV. 391, 398 (2010) ("[I]n Calabresi and Melamed's scheme, an order of specific performance is a property rule."). *See also* Kristelia García, *Super-Statutory Contracting*, 95 WASH. L. REV. 1783 (2020).

> There exists in the literature an ongoing tension between property scholars, on the one hand, and law and economics scholars on the other hand, over the lack of continuity between the idea of property qua property, and property rules. While law and economics scholars tend to conflate the terms, property scholars generally maintain that the fact that a thing is protected by a property rule doesn't necessarily mean that the underlying thing is a property right. For example, specific performance is a property rule, but "specific performance" does not constitute property. In other words, property rules build on—but are distinct from—property rights, and the term "property rules" is primarily reserved for discussion of remedies. This distinction is well-taken, but is also orthogonal to my principal claim, for which purpose I adopt the law and economics approach, and herein use the terms "property," "property regime," and "property rules" more or less interchangeably.

Id. at 1833.

[53] TABB, LAW OF BANKRUPTCY 821.

[54]*See, e.g.*, 11 U.S.C. §§ 726(a)(2), 726(b); Westinghouse Credit Corp. v. D'Urso, 278 F.3d 138, 147 (2d Cir. 2002) (referring to "the Bankruptcy Code's strong policy favoring equal treatment of creditors") (quoting N.Y. State Elec. & Gas Corp. v. McMahon (*In re* McMahon), 129 F.3d 93, 96 (2d Cir. 1997)); 4

tors in full. As Jay Westbrook explains, "permitting specific performance would prefer those creditors to which it was granted over others with equally meritorious claims, since specific performance of a contract results in full satisfaction while payment [of] money damages in bankruptcy dollars [the creditor's pro rata share of the estate] results in only partial satisfaction."[55] Similarly, Charles Tabb writes, "if specific performance is granted, that creditor will be preferred over the other creditors, who have only a pro rata claim against the debtor's assets."[56] So, "it is fairer to all creditors and more faithful to the equality principle to deny specific performance and allow that creditor only a pro rata share as well."[57]

Although § 365 has narrow exceptions permitting specific performance against the bankruptcy estate,[58] bankruptcy law's general aversion to ordering specific performance by the estate widely denies that remedy, even to parties who likely would have received it against the pre-bankruptcy debtor. For example, breaches of contracts to convey land are a classic example of breaches non-bankruptcy courts often remedy with specific performance against the seller,[59] yet bankruptcy courts deny that remedy against the seller's bankruptcy estate after its breach (rejection) of an executory contract to convey land.[60] In such cases, bankruptcy courts usually substitute money

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BANKR. SERVICE L. ED. § 38:102 (July 2021) ("[The] most basic bankruptcy policy is equal treatment of creditors.").

[55]Jay Lawrence Westbrook, *The Coming Encounter: International Arbitration and Bankruptcy*, 67 MINN. L. REV. 595, 623 (1983) (citations omitted). *Id.* ("Whatever maxims of equity might be raised here, the rule is based on the policy judgment that it is better that the creditors ordinarily entitled to specific performance should suffer for the good of all the creditors of the estate.") *See also* Jay Lawrence Westbrook, *A Functional Analysis of Executory Contracts*, 74 MINN. L. REV. 227, 257 (1989) ("Even in a case in which the bankruptcy court's estimate might give the Other Party a damage claim that is undercompensatory, denial of specific relief is the fairest result. Because bankruptcy almost always yields very low recoveries for all creditors, the Other Party's understated claim probably will result in a distribution closer to equality with the other creditors than world granting specific performance. That is, 100% performance for the Other Party will be more unequal than pro rata payment of an understated claim.").

[56]TABB, LAW OF BANKRUPTCY 821.

[57]*Id.*

[58]*See* 11 U.S.C. § 365(i) (a non-debtor already in possession of real property is entitle[d] to complete a pending sale), and § 365(n) (rejection cannot terminate the intellectual property rights of a technology licensee).

[59]Tess Wilkinson-Ryan, *supra* note 42; 25 WILLISTON ON CONTRACTS § 67:65 (4th ed. 2020) ("[A] contract to convey land is specifically enforceable by the purchaser and by the vendor. . . . [A]ny piece of land is presumed to be unique, and . . . monetary damages will typically be an inadequate remedy for a breach; hence a contract purchaser may demand specific performance."); Daniel J. Bussel, *Doing Equity in Bankruptcy*, 34 EMORY BANKR. DEV. J. 13, 17-19 (2017) ("Historically, money damages is the preferred mode of legal enforcement at common law. Equitable remedies are said to be available only when damages are "inadequate" . . . . Equitable relief has long been typically granted in cases where the subject matter of the contract is 'unique property,' or involves interests in real property.").

[60]*See, e.g., In re* Paziak, No. 22-80020, 2022 WL 1714175, at *1 (Bankr. D. Neb. May 25, 2022) (denying specific performance to Homebuyers because purchase "agreement is a rejected executory contact" and "[h]omebuyers has a remedy that can be monetized."); *In re* Spoverlook, LLC, 560 B.R. 358, 360

damages for the equitable remedy of specific performance[61] because Bankruptcy Code § 101(5)(B) defines "claim" to include a "right to an equitable remedy for breach of performance if such breach gives rise to a right to payment."[62] And most states' laws governing breach of the promise to convey land permit buyers to choose money damages over specific performance for breach of this promise.[63] So, for breach of the promise to convey land, "a state law right to seek specific performance falls squarely within § 101(5)(B)'s definition of a claim."[64]

(Bankr. D.N.M. 2016) (denying specific performance to HOA, even though state court held pre-bankruptcy Debtor breached settlement agreement "to convey the common areas to the HOA," because in bankruptcy Debtor rejected the settlement agreement and "the specific performance obligation qualifies as a 'claim' that can be monetized and discharged."); *In re* Young, 214 B.R. 905, 912 (Bankr. D. Idaho 1997) (both specific performance and monetary damages were available under Idaho law for breach of a contract to sell real property, so buyer's remedies "are limited to a lien on the property for that part of the purchase price paid, and a claim in the bankruptcy case for any rejection damages"). 11 U.S.C. § 365(j) says "a party whose executory contract to purchase real property from the debtor is rejected and under which such party is not in possession, has a lien on the interest of the debtor in such property for the recovery of any portion of the purchase price that such purchaser or party has paid." *But see In re* Shearin Family Investments, LLC, 418 B.R. 584, 588 (Bankr. E.D.N.C. 2009) ("Creditors are generally not required to elect money damages if that remedy is inferior"; creditors' "rights are claims under the Bankruptcy Code only if they choose to pursue a right to payment. The purchasers stated clearly at the hearing that they wanted the units they contracted to purchase. Should the purchasers choose to seek a monetary claim against the debtor, that claim is unsecured, but they are entitled to seek specific performance. To the extent they have elected that remedy, they do not have a claim in the bankruptcy case."); *In re* Walnut Associates, 145 B.R. 489, 494 (Bankr. E.D. Penn. 1992) (stating, without acknowledging § 101(5)(B), "if state law . . . authorize[s] specific performance under the rejected executory contract . . . the non-debtor should be able to enforce the contract against the [d]ebtor"); *In re* West Chestnut Realty of Haverford, Inc., 177 B.R. 501, 506 (E.D. Penn. 1995) (same).

[61] *See infra* note 65.

[62] 11 U.S.C. § 101(5)(B). Johnson v. Home State Bank, 501 U.S. 78, 84 (1991) ("a mortgage interest that survives the discharge of a debtor's personal liability is a 'claim' within the terms of § 101(5)" because "the mortgage holder still retains a 'right to payment' in the form of its right to the proceeds from the sale of the debtor's property. Alternatively, the creditor's surviving right to foreclose on the mortgage can be viewed as a 'right to an equitable' remedy for the debtor's default on the underlying obligation. Either way, there can be no doubt that the surviving mortgage interest corresponds to an 'enforceable obligation' of the debtor"); Ohio v. Kovacs, 469 U.S. 274, 282 (1985) (not deciding whether injunction against further pollution was a "claim"); *In re* LaMont, 740 F.3d 397, 407 (7th Cir. 2014) (finding that although purchaser of county's right to collect taxes holds an equitable remedy to obtain a tax deed to debtor's home after a county tax sale, this remedy is considered a "claim" under the Bankruptcy Code because the purchaser also holds a right to payment; purchaser essentially holds "non-recourse tax lien that may be equitably enforced by obtaining a tax deed to the debtor's home. . . Accordingly, [the tax purchaser] holds a right to payment, or alternatively, a right to an equitable remedy against the debtors' property. . . Therefore, the tax purchaser holds a claim against the debtors that may be treated in bankruptcy"); Rederford v. U.S. Airways, Inc., 589 F.3d 30, 37 (1st Cir. 2009) (employee's ADA cause of action, under which she sought reinstatement, was a "claim" in employer's bankruptcy because although employee had equitable remedy of reinstatement following wrongful termination, "money damages are an alternative remedy for reinstatement following wrongful termination," so employee's "claim was within the jurisdiction of the bankruptcy court and so disallowed and discharged").

[63] *In re* Spoverlook, LLC, 560 B.R. 358, 363 (Bankr. D.N.M. 2016).

[64] *Id.* The *Spoverlook* court continued, "Consistent with the foregoing, the strong majority of courts

In a sense then, § 101(5)(B) is at variance with *Tempnology*'s statement that after rejection "rights that would ordinarily survive a contract breach . . . remain in place."[65] That is often not true of the right to specific performance. A non-bankruptcy-law right to specific performance of a promise to convey land is not likely a right that "remain[s] in place" after the estate's rejection of an executory contract. Instead, any "right" to specific performance of a promise to convey land is—when bankruptcy push comes to shove—merely a "claim" for money that bankruptcy will, through its discharge and pro rata payment, treat as harshly as bankruptcy treats other claims for money. In other words, bankruptcy law does not ask neutrally whether the relevant non-bankruptcy law usually grants a monetary or equitable remedy and then follow that course of action, which would for breach of the promise to convey land likely be an equitable remedy. Instead, Bankruptcy Code § 101(5)(B) relegates the creditor to money damages (typically much discounted to the creditor's pro rata share of the estate) unless the relevant non-bankruptcy law insists on equitable remedies only, which it does not do for breaches of promises to convey land.

In contrast, with respect to some other breaches, only equitable remedies will do. As Bankruptcy Judge Geraldine Mund wrote many years ago, not all judgments "can be converted into money" and thus "discharged [in bankruptcy] upon [the estate's] rejection of the contract. Therefore, rejection of such a contract would not be possible and the statutory scheme of § 365 would not apply."[66] For example:

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addressing the issue have held that parties like the HOA can be forced to accept claims for money damages in bankruptcy." Id. at 362–63 (citations omitted). *See also Matter of* Udell, 18 F.3d 403, 407 (7th Cir. 1994) ("One example of a 'claim' is a right to an equitable remedy that can be satisfied by an 'alternative' right to payment.")); Route 21 Assocs. of Belleville, Inc. v. MHC, Inc., 486 B.R. 75, 91 (S.D.N.Y. 2012) (denying specific performance because party seeking it could "not establish[ ] that damages [we]re not a 'viable alternative' to performance of the agreements"), *aff'd sub nom. In re* Lyondell Chem. Co., 542 F. App'x 41 (2d Cir. 2013); *In re* Young, 214 B.R. 905, 912 (Bankr. D. Idaho 1997) (under state law "specific performance is not the only remedy available. . .. TKO would have an alternative right to payment of its damages for the breach of its contract rights. . .. Thus, pursuant to Section 101(5)(B), TKO has a claim for purposes of bankruptcy"). *But see In re* Shearin Family Investments, LLC, 418 B.R. 584, 588 (Bankr. E.D.N.C. 2009) (creditors' "rights are claims under the Bankruptcy Code only if they choose to pursue a right to payment. The purchasers stated clearly at the hearing that they wanted the units they contracted to purchase. Should the purchasers choose to seek a monetary claim against the debtor, that claim is unsecured, but they are entitled to seek specific performance. To the extent they have elected that remedy, they do not have a claim in the bankruptcy case.")

[65] Mission Prod. Holdings, Inc. v. Tempnology, 139 S. Ct. 1652, 1657–58 (2019).

[66] *In re* Aslan, 65 B.R. 826, 831 (Bankr. C.D. Cal. 1986). This decision was reversed on other grounds by the district court. *See In re* Aslan, 909 F.2d 367, 369 (9th Cir. 1990) ("[T]he bankruptcy court fixed the date of breach for its damages calculations at the date that Aslan failed to fulfill its contractual obligations in 1982. On appeal by both parties, the district court held that the relevant date of breach was the day immediately prior to the filing of the bankruptcy petition. We affirm the district court."). *See also In re* Young, 214 B.R. at 912 ("If the only remedy allowed by law is non-monetary, then the equitable remedy is not considered a claim for purposes of bankruptcy and it survives the discharge of the debtor."); *In re* Kings

> if the plaintiff is seeking to enforce his right to vote on a Board of Trustees, no amount of money can take the place of that right and that right cannot be estimated by the Court in terms of dollars so as to create a contingent claim. Because this is not the type of judgment which can be converted into money, it is not a "claim" under the Bankruptcy Code and cannot be discharged upon rejection of the contract.[67]

If the estate rejects an executory contract including a duty the breach of which cannot be remedied with money damages, then this duty "passes through" bankruptcy "unaffected" despite the purported rejection.[68] And after the bankruptcy stay ends or is lifted,[69] another court may order specific performance of this duty.[70]

An example is *Sir Speedy, Inc. v. Morse*, which involved a franchisee-debtor's rejection of its franchise agreement with the franchisor, Sir Speedy.[71] This agreement prohibited the franchisee from operating a competing business during the year following termination of the Sir Speedy franchise agreement.[72] A week before filing for bankruptcy, the franchisee removed all Sir Speedy signs from its business and began operating it under a different name.[73] Sir Speedy moved for an injunction specifically enforcing the franchisee's promise not to compete. The bankruptcy court "denied Sir Speedy's motion on the grounds that the right to enforce the non-compete agreement was a 'claim' like any other to be pursued under § 101(5)(B) of the Bankruptcy Code."[74] However, the district court reversed, concluding that "breach of [the] non-compete agreement [did] not give rise to a right to payment and thus is not a 'claim' under § 101(5)(B)."[75] Therefore, Sir Speedy

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Gate Apartments, Ltd., 206 B.R. 233, 234–35 (Bankr. W.D. Okla. 1996) ("[I]f HUD does not have a 'right to payment' it then does not have a 'claim' which can be discharged in the plan. Its equitable remedies, such as injunctive relief or specific performance, are consequently unimpaired upon confirmation."). *But see* Crafts v. Pitts, 162 P.3d 382, 389 n.9 (Wash. 2007) ("[*In re Aslan*'s] language goes further than most federal circuits and seemingly ignores an important aspect of the analysis—whether the money judgment would be equal to the equitable relief.").

[67] *In re* Aslan, 65 B.R. 826, 831 (Bankr. C.D. Cal. 1986) ("Damages for rejection of an executory contract become a claim dischargeable in the bankruptcy only if under state law the creditor would have the choice of more than one possible remedy, with one of the choices being a money claim.").

[68] *In re* West Chestnut Realty of Haverford, Inc., 177 B.R. 501, 507 (E.D. Penn. 1995).

[69] 11 U.S.C. § 362(c)(2)(C) ("[T]he stay . . . continues until . . . the time a discharge is granted . . .."), 11 U.S.C. § 362(d) (relief from stay).

[70] *See, e.g.*, *Crafts*, 162 P.3d 382 (affirming the state trial court's order that the debtor perform by issuing a quitclaim deed, as the right to specific performance was not discharged in debtor's bankruptcy because money damages could not remedy the breach).

[71] 256 B.R. 657, 658 (D. Mass. 2000).

[72] *Id.*

[73] *Id.*

[74] *Id.*

[75] *Id.* at 660.

was "entitled to seek appropriate injunctive relief."[76] That is, Sir Speedy could enforce its franchisee's non-compete agreement with the remedy of specific performance.

In reaching its conclusion the district court was persuaded by three earlier franchise agreement cases that "held that despite the rejection of the entire agreement, the covenants not to compete contained in the agreement remained effective and enforceable."[77] The district court added,

> Although Morse, in rejecting the Franchise Agreement, also rejected the covenant not to compete, the very purpose of the covenant is to govern the relationship between the parties after the demise of the underlying contract. The Trustee's rejection of the Franchise Agreement did not, therefore, constitute a "termination" of that agreement.[78]

Here, the *Sir Speedy* district court noted that the promise—not to compete—the breach of which required equitable rather than monetary remedies "is to govern the relationship between the parties *after* the demise of the underlying contract."[79] In other words, to use the language *Tempnology*, which was decided after *Sir Speedy*, the franchisor's right to non-competition would "ordinarily survive a contract breach."

The First Circuit Bankruptcy Appellate Panel (BAP) applied similar reasoning in *In re The Ground Round, Inc.*[80] which involved a dispute between the DIP and its lessor over the debtor's interest in a liquor license previously used on the leased premises.[81] After the DIP rejected the lease, the BAP considered whether the lessor was entitled to specific performance of a lease provision requiring the debtor to retransfer the liquor license to the lessor.[82] The BAP first determined that because a "liquor license is an inherently 'unique' asset," specific performance was available under state law.[83] The DIP "argue[d] that even if specific performance is available under state law, any such right is subordinated by the Debtor's rejection rights in bankruptcy."[84] While the BAP acknowledged the general rule "that there is no right to specific performance of a contract rejected in bankruptcy,"[85] it said "the re-

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[76]*Id.*

[77]*Id.*

[78]*Id.*

[79]*Id.* (emphasis added).

[80]335 B.R. 253 (B.A.P. 1st Cir. 2005), *aff'd*, 482 F.3d 15 (1st Cir. 2007).

[81]*Id.* at 256.

[82]*Id.*

[83]*Id.* at 262.

[84]*Id.*

[85]*Id.*

sult is different where there is no available monetary remedy."[86] *Ground Round* held that for breach of the promise to transfer the liquor license an award of monetary damages was not a "viable alternative" to specific performance, so the lessor's right to the license could not be converted into a "claim" under § 101(5)(B). "[T]he rights of the Landlord do not constitute a claim and cannot be discharged."[87] Since "rejection constitutes only a breach, not a termination, an obligation in a rejected contract continues to bind a debtor *unless the obligation is discharged*."[88]

In sum, cases like *Sir Speedy* and *Ground Round* are exceptions to bankruptcy law's general aversion to ordering specific performance by the estate. As explained above, Bankruptcy Code § 101(5)(B) relegates the creditor to money damages (typically greatly discounted) unless the relevant non-bankruptcy law insists on equitable remedies only, which is not common, but sometimes true.

C. The Right to Arbitrate Survives Breach

1. *Arbitration Enforced Only with Specific Performance*

As the previous pages explain, bankruptcy courts often convert a creditor's right to specific performance into a mere claim for money that bankruptcy will, through its discharge and pro rata payment, treat as harshly as bankruptcy treats other claims for money. So, in contrast to *Tempnology*'s statement that after rejection "rights that would ordinarily survive a contract breach . . . remain in place,"[89] that is often not true of the right to specific performance. But it is true of specific performance in some § 365 cases—the cases that find a contractual duty the breach of which non-bankruptcy courts remedy exclusively with specific performance because money damages are not a viable alternative. Such specific-performance-only duties include the duty to arbitrate.

The core of the Federal Arbitration Act (FAA) and other modern arbitration statutes requires courts to enforce arbitration agreements with specific performance because money damages had proven an ineffective remedy for breach of the promise to arbitrate.[90] For example, suppose before enactment of these arbitration statutes Seller sued Buyer despite an arbitration agreement between them. In that era, nearly all courts in the U.S. would

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[86] *Id.*

[87] *Id.* at 263.

[88] *Id.* at 262 (*citing* Sir Speedy, Inc. v. Morse, 256 B.R. 657 (D. Mass. 2000) (emphasis in original)).

[89] Mission Prod. Holdings, Inc. v. Tempnology, 139 S. Ct. 1652, 1657-58 (2019).

[90] *See generally* Ian R. Macneil, Richard E. Speidel & Thomas J. Stipanowich, Federal Arbitration Law § 4.1.1 (1999) (modern arbitration statutes were enacted to provide a meaningful remedy for breach, specific performance, which takes the form of court orders staying litigation and compelling arbitration).

allow Seller's litigation to proceed, as they would deny Buyer's motion to stay or dismiss Seller's case.[91] While Buyer could seek money damages for Seller's breach of the arbitration agreement, how would the amount of those damages be calculated? To put Buyer in the position it would have been in had Seller performed its promise to arbitrate, (the usual "expectation" measure of contract damages,[92]) a court would have to put dollar amounts on "the additional expense and delay of litigation" and the chance of Buyer "receiv[ing] a less favorable decision in the judicial forum" than it would have received in arbitration.[93] "[T]hese costs would be virtually impossible to quantify,"[94] so courts did not even try. Instead, courts might award nominal damages of one dollar or so,[95] but Buyer would receive no other remedy for Seller's breach. In short, money damages for breach of arbitration agreements were "an illusory remedy."[96] The law permitted Seller to breach its arbitration agreement without significant consequence.

Alternatively, suppose Seller asserted its claim against Buyer in arbitration, but Buyer breached its promise to arbitrate by simply refusing to participate in that process. Prior to the FAA and other modern arbitration statutes, Seller could not get a court order compelling Buyer to participate in arbitration. So, if Seller wanted to pursue its claim against Buyer, Seller would have to do so in litigation. Seller lacked a meaningful remedy for Buyer's breach of the arbitration agreement.

The FAA changed the result in both of these scenarios. Under the FAA, the remedy for breach of an arbitration agreement is a court order of specific

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[91]*See* IAN R. MACNEIL, RICHARD E. SPEIDEL & THOMAS J. STIPANOWICH, FEDERAL ARBITRATION LAW § 4.3.2.2 (1994) (explaining that in the period 1800–1920, agreements to arbitrate future disputes were not enforced with remedy of specific performance); WESLEY A. STURGES, COMMERCIAL ARBITRATION AND AWARDS § 87 (1930). New York and New Jersey enacted statutes providing specific enforcement for arbitration agreements a few years before the FAA's 1925 enactment. *See* IAN R. MACNEIL, AMERICAN ARBITRATION LAW: REFORMATION, NATIONALIZATION, INTERNATIONALIZATION 34–47 (1992).

[92]RESTATEMENT (SECOND) OF CONTRACTS § 344(a) (Am. L. Inst. 1981).

[93]Mette H. Kurth, *An Unstoppable Mandate and an Immovable Policy: The Arbitration Act and the Bankruptcy Code Collide*, 43 UCLA L. REV. 999, 1004–05 (1996).

[94]*Id.* In addition, "the injured party would be unlikely to have incurred significant costs in reliance on the arbitration agreement. The injured party, therefore, would not be able to recover reliance damages." *Id. See also* Jay Lawrence Westbrook, *The Coming Encounter: International Arbitration and Bankruptcy*, 67 MINN. L. REV. 595, 624 (1983) ("The reason for the availability of specific performance to enforce arbitration agreements outside bankruptcy is that the harm arising from a breach of an arbitration agreement is often difficult or impossible to measure in damages.").

[95]*See* Munson v. Straits of Dover S. S. Co., 102 F. 926, 928 (2d Cir. 1900) (ship owner sued charterer despite arbitration agreement between them and charterer's offer to arbitrate; court ruled against owner; charterer sought damages in the form of lawyer's fees and costs incurred in defending the lawsuit; court held "only nominal damages are recoverable.").

[96]Kurth, *supra* note 93, at 1004 ("damages were an illusory remedy for breach of an arbitration agreement."); IAN R. MACNEIL, AMERICAN ARBITRATION LAW 20 (1992) (damages remedy was "largely ineffective").

performance to arbitrate. Consider the first scenario, Seller's suit against Buyer, despite an arbitration agreement. By staying the suit, a court effectively orders the plaintiff to perform its agreement to arbitrate as the only path for the plaintiff to receive a remedy.[97] This stay follows from FAA § 3, which says:

> If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is preferable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.[98]

Although FAA § 3 only mentions stays, not dismissals,[99] most federal circuit courts permit dismissal of the suit when the arbitration agreement covers all claims before the court.[100]

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[97]RESTATEMENT (THIRD) U.S. LAW OF INT'L COMM. ARB. § 2.1 Note a(i) (Amer. L. Inst. 2019) ("A stay is a form of indirect enforcement; it eliminates access to the court granting the stay, and to that extent curtails the plaintiff's options."); *id.* ("Unless the defendant has claims of its own to press, the defendant may seek only a stay in hopes that the plaintiff, limited to the arbitral forum, will decide not to pursue its claims."); LaPrade v. Kidder Peabody & Co., Inc., 146 F.3d 899, 903 (D.C. Cir. 1998) (a district court stay instructs plaintiff, in effect, that it may not litigate claims directly in court, but could only arbitrate them or abandon them); Cabinetree of Wisc., Inc. v. Kraftmaid Cabinetry, Inc., 50 F.3d 388, 389 (7th Cir. 1995) ("[A] defendant who wants arbitration is often content with a stay, since that will stymie the plaintiff's effort to obtain relief unless he agrees to arbitrate.").

[98]9 U.S.C. § 3.

[99]Lloyd v. Hovensa, LLC., 369 F.3d 263, 269 (3d Cir. 2004) ("the plain language of § 3 affords a district court no discretion to dismiss a case where one of the parties applies for a stay pending arbitration."); Adair Bus Sales, Inc. v. Blue Bird Corp., 25 F.3d 953, 955 (10th Cir. 1994) (where a defendant moved for a stay pending arbitration under 9 U.S.C. § 3, the District court erred in instead entering a dismissal and the proper course would have been to enter the stay); Bender v. A.G. Edwards & Sons, Inc., 971 F.2d 698, 699 (11th Cir. 1992) ("We find that the state law claims are subject to arbitration, but that it was error to dismiss these claims rather than staying them pending arbitration."); Hewitt v. St. Louis Rams P'ship, 409 S.W.3d 572, 574 (Mo. Ct. App. 2013) ("Rather than dismissal, the proper course of action for the trial court, upon finding an agreement to arbitrate, is to stay the action pending arbitration.").

[100]Next Step Med. Co., Inc. v. Johnson & Johnson Int'l, 619 F.3d 67, 71 (1st Cir. 2010) (a district court has discretion to dismiss "if *all* claims asserted in the case are found arbitrable."); Soucy v. Capital Mgmt. Servs., L.P., No. 14 C 5935, 2015 WL 404632, at *6 (N.D. Ill. Jan. 29, 2015) ("The Seventh Circuit . . . has repeatedly affirmed district courts' decisions dismissing suits where all of the claims must be arbitrated according to the agreement."); Knall Bev., Inc. v. Teamsters Local Union No. 293 Pension Plan, 744 F.3d 419, 421 (6th Cir. 2014) ("[T]he district court correctly ruled that the Act requires that this claim be arbitrated, and properly dismissed the case without prejudice."); Ozormoor v. T-Mobile USA, Inc., 354 Fed. Appx. 972, 975 (6th Cir. 2009) (rejecting argument "that 9 U.S.C. § 3 requires district

Now consider the second scenario, Buyer's refusal to arbitrate Seller's claim against it. Seller is entitled under the FAA to a court's order compelling Buyer to arbitration. This entitlement comes from FAA § 4, which says, in part:

> A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any United States district court . . . for an order directing that such arbitration proceed in the manner provided for in such agreement . . .. The court shall hear the parties, and upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement . . ..[101]

Although FAA §§ 3 and 4 by their terms apply only in federal courts, the Supreme Court cases of *Southland Corp. v. Keating*[102] and *Allied-Bruce Terminix Cos., Inc. v. Dobson*[103] made the specific performance gist of FAA §§ 3 and 4 applicable in state court, even while leaving open the question whether those provisions technically can apply in state court actions.[104]

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courts to stay suits pending arbitration rather than dismiss them."); Alford v. Dean Witter Reynolds, Inc., 975 F.2d 1161, 1164 (5th Cir.1992) ("The weight of authority clearly supports dismissal of the case when *all* of the issues raised in the district court must be submitted to arbitration."); Green v. Ameritech Corp., 200 F.3d 967, 973 (6th Cir. 2000) (same); Sparling v. Hoffman Const. Co., Inc., 864 F.2d 635, 638 (9th Cir. 1988); Choice Hotels Intern., Inc. v. BSR Tropicana Resort, Inc., 252 F.3d 707, 709-10 (4th Cir. 2001) ("Notwithstanding the terms of § 3, however, dismissal is a proper remedy when all of the issues presented in a lawsuit are arbitrable."); Bercovitch v. Baldwin School, Inc., 133 F.3d 141, 156 & n.21 (1st Cir. 1998) (remanding to dismiss or stay).

The distinction between a stay and a dismissal matters because dismissals are immediately appealable under FAA § 16, but stays are not. FAA § 16(a)(3), (b)(1). *See* Lloyd v. Hovensa, LLC., 369 F.3d 263, 270-271 (3d Cir. 2004) ("giving the District Court discretion to dismiss the action rather than enter a stay [would deprive] a party who has been held entitled to arbitration . . . of an important benefit which the FAA intended him to have—the right to proceed with arbitration without the substantial delay arising from an appeal.").

[101]9 U.S.C. § 4.

[102]465 U.S. 1, 11 (1984) (FAA § 2 applies in state court).

[103]513 U.S. 265, 281 (1995) (FAA § 2 preempts state law denying specific performance remedy to enforce arbitration agreements).

[104]*See Southland*, 465 U.S. at 24 (O'Connor, J., dissenting) ("[T]he Court reads [FAA] § 2 to require state courts to enforce § 2 rights using procedures that mimic those specified for federal courts by FAA §§ 3 and 4."); IAN R. MACNEIL, RICHARD E. SPEIDEL & THOMAS J. STIPANOWICH, FEDERAL ARBITRATION LAW § 10.8.2.4, at 10:91-10:92 (Supp.1999) ("[A]lthough the Court holds that FAA §§ 3 and 4 do not govern state courts, it is equally clear that FAA § 2, which does govern them, carries with it duties indistinguishable from those imposed on federal courts by FAA §§ 3 and 4.").

While the Court has made the core of FAA §§ 3 and 4 applicable in state court, some of its details have been held not to apply in state court. Rosenthal v. Great Western Fin. Sec. Corp., 926 P.2d 1061 (Cal. 1996) (FAA § 4's jury trial right for issues about the making of the arbitration agreement not

To recap, FAA §§ 3 and 4 require courts to enforce arbitration agreements with orders of specific performance because money damages had proven an ineffective remedy for breach of the promise to arbitrate. Because courts remedy breaches of the promise to arbitrate only with specific performance, the right to arbitrate is treated similarly to those rights vindicated in *Sir Speedy* and *Ground Round* which are also exceptions to bankruptcy law's general aversion to ordering specific performance against the estate after rejection of an executory contract. Or, to use *Tempnology*'s terminology, the right to arbitrate is a right that "survive[s] a contract breach" and thus "remain[s] in place," [105] after rejection. As Jay Westbrook observed long before *Tempnology*, "[w]hat makes an arbitration clause 'survive' the contract is that courts are willing to enforce specifically such agreements by issuing an order staying any judicial proceeding and compelling arbitration."[106] Much like the *Sir Speedy* franchisor's right to non-competition survives a contract breach because it "is to govern the relationship between the parties after the demise of the underlying contract,"[107] the same is true of the right to compel arbitration.

In other words, the right to compel arbitration is not a right that can be converted into a "claim" for money damages under § 101(5)(B) of the Bankruptcy Code. While one student commentator might be read to dismiss arbitration law's specific performance remedy as "irrelevant to determining the applicability of § 365,"[108] even one of the outlier cases noted at the start of this Article,[109] and other commentators resisting enforcement of arbitration agreements in rejected executory contracts acknowledge that "[q]uestions regarding the valuation of the claim giving rise from the rejection of an arbitration clause may" prove to be difficult.[110] That is an understatement. As discussed above, calculating money damages for breach of arbitration agree-

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applicable in state court); St. Fleur v. WPI Cable Systems/Mutron, 879 N.E.2d 27, 33 (Mass. 2008) (same; state court should apply state statute otherwise similar to FAA § 4 rather than FAA § 4).

[105]Mission Prod. Holdings, Inc. v. Tempnology, 139 S. Ct. 1652, 1657-58 (2019).

[106]Jay Lawrence Westbrook, *The Coming Encounter: International Arbitration and Bankruptcy*, 67 MINN. L. REV. 595, 623 (1983).

[107]Sir Speedy, Inc. v. Morse, 256 B.R. 657, 660 (D. Mass. 2000).

[108]Note, *Jurisdiction in Bankruptcy Proceedings: A Test Case for Implied Repeal of the Federal Arbitration Act*, 117 HARV. L. REV. 2296, 2316 (2004) ("The remedy for the breach—nullifying performance under the material-breach doctrine or compelling performance under the FAA—is irrelevant to determining the applicability of § 365.").

[109]Janvey v. Alguire, Civil Action No. 3:09-CV-0724-N, 2014 U.S. Dist. LEXIS 193394, at *113, n.29 (N.D. Tex. Jul. 30, 2014) (quoting a law review article recognizing that denying specific enforcement of arbitration agreements "recreates the problems that the Arbitration Act intended to resolve" because "[w]ithout specific performance, parties have no adequate measure of damages for nonperformance of an arbitration agreement" (quoting Kurth, *supra* note 93, at 1031)).

[110]Alexis Leventhal & Roni A. Elias, *Competing Efficiencies: The Problem of Whether and When to Refer Disputes to Arbitration in Bankruptcy Cases*, 24 AM. BANKR. INST. L. REV. 133, 157-58 (2016).

ments is not merely difficult but darn near impossible—a challenge so daunting that pre-FAA courts did not even attempt it, but instead awarded at most nominal damages. The futility of trying to calculate money damages for breach of arbitration agreements made those agreements effectively unenforceable, and thus motivated enactment of the FAA and other modern arbitration statutes to provide a meaningful remedy for breach, specific performance. The virtual impossibility of calculating money damages for breach of arbitration agreements makes completely unrealistic the notion that courts could with money remedy breaches inherent in § 365 rejections of executory arbitration agreements by converting them into claims under § 101(5)(B).[111] In short, with respect to breach of the duty to arbitrate, only specific performance will do.

Consequently, the right to compel arbitration is an equitable right that passes through bankruptcy unaffected by rejection of an executory contract. So, after the bankruptcy stay ends or is lifted, a court may order specific performance of the estate's duty to arbitrate. In fact, FAA §§ 3 and 4 say a court "shall" grant motions compelling arbitration, so unless some law other than § 365 prevents enforcement of an arbitration agreement,[112] a bankruptcy court lacks discretion to refuse enforcement with the equitable remedy of specific performance.

2. *Nearly All Courts Before and After Tempnology Enforce Arbitration Agreements, Notwithstanding Rejection*

The previous paragraph's conclusion that the right to compel arbitration is an equitable right that survives rejection of an executory contract was reached by courts long ago.[113] Well before *Tempnology*, indeed even before § 365 was enacted as part of the 1978 Bankruptcy Code, courts described arbitration as a right surviving breach, and thus enforceable notwithstanding rejection. For example, in a 1976 case decided under the Bankruptcy Act, *Truck Drivers Local Union No. 807 v. Bohack Corp.*,[114] the Second Circuit

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[111]Julian Ellis, *A Comparative Law Approach: Enforceability of Arbitration Agreements in American Insolvency Proceedings*, 92 AM. BANKR. L.J. 141, 189–192 (2018) ("assuming § 365 eliminates any specific-performance remedy—otherwise rejection of an arbitration agreement would be illusory—it is difficult to conceive how 'damages' could be calculated for breach of an arbitration agreement in and of itself.").

[112]*See, e.g.*, Anderson v. Credit One Bank, 884 F.3d 382 (2d Cir. 2018) (refusing to enforce agreement to arbitrate debtor's claim that creditor violated discharge injunction); Belton v. GE Cap. Retail Bank (*In re* Belton), 961 F.3d 612, 615 (2d Cir. 2020), *cert. denied sub nom.* GE Cap. Retail Bank v. Belton, 209 L. Ed. 2d 252, 141 S. Ct. 1513 (2021) ("Given the overwhelming similarities between this case and *Anderson*, our hands seem to be bound by that panel's decision.").

[113]And by thoughtful commentators well before *Tempnology*. *See, e.g.*, George R. Calhoun, *Arbitration Clauses Not Invalidated by Rejection*, AM. BANKR. INST. J., July/August 2007, at 36, 37 ("Rejection constitutes a mere breach . . .. As a result, rejection—even of a severable arbitration provision—will not render an arbitration provision unenforceable.").

[114]541 F.2d 312, 320–21 (2d Cir. 1976), *cert. denied*, 439 U.S. 825 (1978).

stated:

> If the contract is rejected by the bankruptcy court, it will be deemed to have been breached as of the date of filing of the petition under Ch. XI. But like any other unilateral breach of contract, it does not destroy the contract so as to absolve the parties (particularly the breaching party) from a contractual duty to arbitrate their disputes.[115]

In other words, rejection of contract containing an arbitration agreement does not prevent courts from specifically enforcing that arbitration agreement by ordering the parties to arbitration.

To the same effect is an early Bankruptcy Code case, *Societe Nationale Algerienne Pour La Recherche, La Prod., Le Transp., La Transformation et La Commercialisation des Hydrocarbures v. Distrigas Corp.*,[116] a 1987 federal district court ruling. In *Distrigas*, the debtor in bankruptcy rejected "in its entirety" a contract containing an international arbitration agreement, but the non-debtor party (a creditor of the debtor) nevertheless sought to arbitrate its claim against the debtor.[117] The bankruptcy court denied the creditor's motion to compel arbitration on the ground that the arbitration agreement was "moot" in view of the debtor's rejection of the executory contract, [118] but the district court reversed and granted the creditor's motion to compel arbitration, observing that under §365(g) rejection breached rather than terminated the executory contract.[119]

Throughout the succeeding decades, several courts continued to rely on the distinction between rejection and termination in enforcing arbitration agreements notwithstanding rejection. For example, in the 1999 case of *In re Weinstock*,[120] the debtor in bankruptcy brought an adversary proceeding against his former partnership, which then moved to compel arbitration based on the arbitration clause in the partnership agreement. While the debtor contended that the partnership agreement was rejected in bankruptcy,[121] the court nevertheless granted the partnership's motion to compel arbitration.[122] The court "rejected the Debtor's view on the consequences of rejection" because of "the distinction between contract rejection, a bankruptcy concept, and contract termination."[123]

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[115] *Truck Drivers*, 541 F.2d at 321 n.15.

[116] 80 B.R. 606 (D. Mass. 1987).

[117] *Id.* at 607.

[118] *Id.*

[119] *Id.* at 607-08. *Distrigas* is discussed further in Part II.D.1.

[120] *In re* Weinstock, No. 96-31147DWS, 1999 WL 342764 (Bankr. E.D. Pa. May 25, 1999).

[121] *Id.* at *3 (debtor "appears to be seeking a declaration that the partnership agreement was rejected").

[122] *Id.* at *10 ("The adversary proceeding is STAYED pending arbitration of Counts I through IV.").

[123] *Id.* at *3.

In 2003, the district court in *Southeastern Pa. Transp. Auth. v. AWS Remediation Inc.*, enforced an arbitration agreement even though the contract containing it had been rejected under § 365,[124] stating:

> To allow a party to avoid arbitration by simply terminating the contract would render arbitration clauses illusory and meaningless. A party not wishing to arbitrate its alleged breach could simply terminate that contract and avoid any obligation to arbitrate. . . [a] [s]imilar rational[e] applies when a debtor rejects a contract.[125]

Similarly, a 2007 district court decision, *In re Fleming Companies, Inc.*, enforced an arbitration clause in a supply agreement that had been rejected by the estate. [126] After rejection, a post-confirmation trust (PCT) acting on behalf of the estate sought to arbitrate its claims against the non-debtor party to the supply agreement.[127] *Fleming* affirmed the bankruptcy court order "concluding that PCT's rejection of the Supply Agreement, pursuant to 11 U.S.C. § 365, was 'not a termination of the Supply Agreement, but [was] simply a breach of that Agreement as of the Petition Date (§ 365(g)), and the arbitration clause contained therein is otherwise enforceable by the PCT.'"[128]

A 2018 bankruptcy court decision, *In re Paragon Offshore PLC*,[129] similarly involved claims brought by a trust created by the bankruptcy estate. When the defendants moved to compel arbitration,[130] the trust argued "that the Arbitration Provision was extinguished as part of the rejection of the [contract containing it] in the bankruptcy proceedings."[131] Nevertheless the court compelled arbitration of the trust's unjust enrichment claims[132] because rejection is only "a breach of a contract, *and the terms of the contract still control the relationship of the parties.*"[133]

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[124]No. Civ.A. 03-695, 2003 WL 21994811 at *3 (E.D. Pa. Aug. 18, 2003) ("While a debtor may reject a contract in its 'entirety,' it may not invalidate freely negotiated methods of dispute resolution as they apply to pre-petition acts.").

[125]*Id.* (internal citations omitted).

[126]No. 03-10945 MFW, 2007 WL 788921, at *4 (D. Del. Mar. 16, 2007).

[127]Technically, it was not the estate directly but rather "the Trustee of the Post Confirmation Trust for Fleming Companies, Inc." (the debtor in bankruptcy) that "assumed all collection efforts on behalf of Fleming's bankruptcy estate in July 2004." *Id.* at n.1.

[128]*Id.* at *2.

[129]*In re* Paragon Offshore PLC, 588 B.R. 735 (Bankr. D. Del. 2018).

[130]*Id.* at 741.

[131]*Id.* at 749.

[132]*Id.* at 759.

[133]*Id. at* 749 (emphasis in original). *See also In re* Bateman, 585 B.R. 618, 626 (Bankr. M.D. Fla. 2018), *aff'd*, No. 8:14-BK-5369-RCT, 2019 WL 4644385 (M.D. Fla. Sept. 24, 2019) (refusing on other grounds to compel arbitration, while stating "[I]f the Customer Agreement was executory and if it was impliedly rejected, the rejection simply means that the contract is in 'breach.' Few would argue that a 'breach' of a

To recap, the previous paragraphs show courts in each of the decades before *Tempnology* enforced arbitration agreements in rejected contracts. And several of these courts did so based on reasoning later used in *Tempnology*, which emphasizes that rejection under § 365 is merely a breach and does not operate as a termination or rescission of contract, so rights that ordinarily survive a contract breach survive post-rejection. All these courts treated the specific performance right to compel arbitration as a right that survives rejection.[134] None of them came close to converting the specific performance right to compel arbitration into a "claim" for money damages under Bankruptcy Code § 101(5)(B).

Similarly, since *Tempnology* at least one court has cited it in holding that rejection does not prevent specific enforcement of an arbitration agreement against the estate.[135] In *HCB Enterprises, LLC v. Dickey's Barbecue Restaurants, Inc.*, a franchisee filed for chapter 11 bankruptcy and rejected agreements, containing arbitration clauses, with its franchisor. The franchisee's reorganization "plan specifically rejected the arbitration clauses in those agreements."[136] The franchisee in bankruptcy brought several claims against the franchisor in federal district court, and the franchisor moved to stay that action and submit the case to arbitration. In granting the franchisor's motion, the court quoted *Tempnology*'s statement that "'[a] rejection breaches a contract but does not rescind it. And that means all the rights that would ordinarily survive a contract breach . . . remain in place.'"[137] The *HCB* court said, "rejection constitutes a breach of the agreement. As a result, the court finds that, under the unambiguous language of [FAA] § 2, the bankruptcy code does not render arbitration clauses in rejected executory contracts inoperative."[138]

In sum, courts have long overwhelmingly held that rejection of an executory contract does not prevent enforcing the contract's arbitration agreement against the estate with the remedy of specific performance. *Tempnology* reinforces this long-standing consensus. In contrast are the two outlier cases

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contract would terminate an arbitration clause contained in the contract. It is the very reason for the arbitration clause in the first place.").

[134]*See also* Thomas H. Oehmke & Joan M. Brovins, *Arbitration and Mediation of Bankruptcy Disputes, § 44 Contract Rejection*, 105 AM. JUR. TRIALS 125 (2007 & Supp. 2020) (many courts have determined an agreement to arbitrate survives rejection under § 365, and thus have enforced arbitration agreements under the rejected contract based on the reasoning that "rejection terminates the debtor's obligations prospectively"); George R. Calhoun, *Arbitration Clauses Not Invalidated by Rejection*, 26 AM. BANKR. INST. J. 36, 36 (July/August 2007) (praising courts recognizing that rejection "does not 'cancel, repudiate, rescind or in any other fashion terminate'" the rejected contract).

[135]HCB Enter., LLC v. Dickey's Barbecue Restaurants, Inc., No. 2:20-CV-407 JCM(VCF), 2020 WL 3643430, at *2 (D. Nev. July 6, 2020).

[136]*Id.* at *1.

[137]Id. at *2 (quoting Mission Prod. Holdings, Inc. v. Tempnology, 139 S. Ct. 1652, 1657-58 (2019)).

[138]HCB Enter., 2020 WL 3643430 at *2.

noted at the start of this Article. The earlier of them, *Janvey v. Alguire*,[139] arose in the context of a federal receivership commenced at the request of the Securities and Exchange Commission.[140] The *Janvey* district court refused to enforce an arbitration agreement because the receiver had rejected it under receivership law analogous to § 365.[141] The *Janvey* district court said, "the appropriate remedy in this circumstance cannot be for the Court to require specific performance."[142] For this dubious proposition, the *Janvey* district court cited non-arbitration cases, including *Lubrizol*, and a 2012 Seventh Circuit case, *Sunbeam Prods., Inc. v. Chi. Am. Mfg., LLC*,[143] which said, "After rejecting a contract, a debtor is not subject to an order of specific performance."[144] The *Janvey* district court's erroneous conclusion that rejection of an arbitration agreement prevents its specific enforcement was not approved by the Fifth Circuit, which affirmed on other grounds. The Fifth Circuit concluded that the receiver's predecessor was not a party to the arbitration agreements, so the receiver was not bound by them,[145] except with respect to one agreement where the right to compel arbitration had been waived.[146]

The *Janvey* district court's erroneous conclusion that rejection of an arbitration agreement prevents its specific enforcement was followed by the other outlier case noted at the start of this Article—the 2021 case of *In re Highland Cap. Mgmt. L.P.*[147] In *Highland*, the pre-bankruptcy debtor formed a limited partnership agreement (LPA) with an arbitration clause. According to the bankruptcy court, "the LPA, as an executory contract, was rejected under 11 U.S.C § 365 in connection with the court's order confirming High-

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[139]Janvey v. Alguire, Civil Action No. 3:09-CV-0724-N, 2014 U.S. Dist. LEXIS 193394 (N.D. Tex. Jul. 30, 2014).

[140]*Id.* at *93.

[141]*Id.* at *110-16 (N.D. Tex. Jul. 30, 2014); *id.* at *114 ("[T]he current state of equity receivership law on the 'assume or reject' doctrine remains similar to bankruptcy law."). *See also* Janvey v. Alguire, 847 F.3d 231, 238-39 (5th Cir. 2017) ("[T]he district court concluded that the Receiver had rejected the arbitration agreements and that such rejection was permissible. The district court, drawing from well-established bankruptcy law, determined that an equity receiver, like a bankruptcy trustee, has the power to assume or reject any executory contract. The district court concluded that executory arbitration agreements are analyzed as separable from the contracts in which they are contained. Turning to the arbitration agreements in this case, the district court rejected the defendants' argument that the Receiver had not rejected the agreements, noting that federal equity receivers have no obligation to affirmatively reject an executory contract. The district court determined that the Receiver's rejection of the arbitration agreements was permissible, explaining that it would be "unjust and inequitable" to burden and deplete the receivership estate by requiring the Receiver to adopt the arbitration agreements.").

[142]*Janvey*, 2014 LEXIS 193394, at *113.

[143]686 F.3d 372, 377 (7th Cir. 2012).

[144]*Janvey*, 2014 LEXIS 193394, at *113 n.27 (quoting *Lubrizol* and *Sunbeam*).

[145]*Janvey*, 847 F.3d at 242 ("Because the Receiver brings his claims on behalf of the Bank and the Bank has not consented to arbitration, the motions to compel arbitration fail.").

[146]*Id.* at 244 ("Giusti has waived his right to arbitration, and so the Receiver cannot be compelled to arbitrate its claims against him.").

[147]No. 19-34054-SGJ-11, 2021 WL 7541482 (Bankr. N.D. Tex. July 14, 2021).

land's plan of reorganization."[148] Nevertheless, other parties to that contract relied on its arbitration agreement in moving to compel arbitration of an adversary proceeding the debtor (Highland) brought against them.[149] The bankruptcy court denied the motions to compel arbitration, persuaded by the debtor's argument that it "is no longer bound by the LPA's provisions that impose specific performance obligations on it—provisions such as the Arbitration Clause."[150] The *Highland* bankruptcy court rightly said "Highland's argument finds support in" the *Janvey* the district court decision.[151] The court in *Highland* "found *Janvey* to be more persuasive than"[152] *In re Fleming Companies, Inc.*,[153] which, as noted above, correctly held that rejection of an executory contract does not prevent specific enforcement of the arbitration clause in that contract.[154] Not relying entirely on its contrary belief about the effect of rejection, *Highland* also found an alternative ground for denying enforcement of the arbitration agreement at issue—waiver of the right to compel arbitration by the defendants.[155]

As Ronit J. Berkovich and Eric Einhorn note in an insightful blog post, the *Highland* bankruptcy court did not discuss *Tempnology*.[156] "It is interesting to consider how Judge Jernigan would have decided the [*Highland*] case had the parties put the [*Tempnology v.*] *Mission Product* case in front of her."[157] Hopefully, this Article will help future parties put that Supreme Court case before judges tempted to rule that rejection of an executory contract prevents specific enforcement of its arbitration clause. As explained above, *Tempnology* supports a long line of cases specifically enforcing arbitration agreements notwithstanding their rejection under § 365.

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[148]*In re* Highland Cap. Mgmt., L.P., No. 19-34054-SGJ11, 2021 WL 5769320, at *3 (Bankr. N.D. Tex. Dec. 3, 2021).

[149]*Id.*

[150]*Id.* at *5.

[151]Janvey v. Alguire, Civil Action No. 3:09-CV-0724-N, 2014 U.S. Dist. LEXIS 193394 (N.D. Tex. Jul. 30, 2014).

[152]*In re* Highland Cap. Mgmt., L.P., No. 19-34054-SGJ-11, 2021 WL 5769320, at *7 (Bankr. N.D. Tex. Dec. 3, 2021).

[153]325 B.R. 687 (Bankr. D. Del. 2005).

[154]*See supra* notes 126-28 and accompanying text.

[155]"Even if this court is in error in determining that the Arbitration Clause is no longer binding on Highland because it was rejected pursuant to Bankruptcy Code section 365, the court finds as a matter fact that the Dondero/Dugaboy Defendants have waived any right to invoke the Arbitration Clause." *Highland Cap. Mgmt.*, 2021 WL 5769320, at *8.

[156]Ronit J. Berkovich & Eric Einhorn, *Arbitrate? You Can't Make Me! Rejection Trumps Arbitration, Says Texas Bankruptcy Court*, Weil Gotshal & Manges LLP, Jan. 13 2022, https://www.lexology.com/library/detail.aspx?g=4f7ac5e2-2bd2-435f-ab32-a5840bc1c623&utm_source=Lexology+Daily+Newsfeed&utm_medium=HTML+email+-+Body+-+General+Section&utm_campaign=SVAMC+subscriber+daily+feed&utm_content=Lexology+Daily+Newsfeed+2022-01-18&utm_term=.

[157]*Id.*

II. ARBITRATION LAW'S SEPARABILITY DOCTRINE MEETS BANKRUPTCY CODE § 365

A. Overview

The previous Part shows the vast majority of courts before and after *Tempnology* correctly holding that rejection of an executory contract does not prevent specific enforcement of the contract's arbitration agreement against the estate. However, § 365 cases and bankruptcy commentators have been uneven in their handling of arbitration law's separability doctrine,[158] which holds that "arbitration clauses as a matter of federal law are 'separable' from the contracts in which they are embedded."[159] The separability doctrine may at least initially seem to conflict with § 365 cases stating that an executory contract must be assumed or rejected in its entirety—the all-or-nothing rule. Difficulties combining the separability doctrine with §365 have produced erroneous statements by several courts, including the Third Circuit's oft-cited decision in *Hays and Company v. Merrill Lynch, Pierce, Fenner, & Smith, Inc.*[160] The following pages explain the separability doctrine and integrate it with bankruptcy law. This analysis shows, contrary to the outlier cases noted at the start of this Article and some commentators, that the separability doctrine is compatible with, and further supports, most courts' conclusions that rejection of an arbitration agreement under § 365 does not prevent specific enforcement of it against the estate.

B. The Separability Doctrine Increases Enforcement of Arbitration Agreements

1. *The Separability Doctrine Enforces Executory Arbitration Agreements, Notwithstanding Challenges to the Validity of the Contracts Containing Them*

The Supreme Court adopted arbitration law's separability doctrine in its 1967 decision in *Prima Paint Corp. v. Flood & Conklin Manufacturing Co.*[161] Prima Paint bought F&C's painting business, including a list of F&C's customers. F&C promised not to sell paint to those customers for six years,[162] and promised to consult for Prima Paint during those six years.[163] The consulting agreement, which included an arbitration clause,[164] required Prima Paint to make payments to F&C.[165] Prima Paint failed to make these

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[158]*See infra* Part II.D.

[159]Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395, 402 (1967).

[160]885 F.2d 1149 (3d Cir. 1989).

[161]388 U.S. 395, 402–04 (1967).

[162]*Id.* at 397.

[163]*Id.*

[164]*Id.* at 398.

[165]*Id.*

payments, but contended that F&C had fraudulently represented that it was solvent and able to perform its contract but was in fact insolvent and intended to file for bankruptcy shortly after forming its consulting agreement with Prima Paint.[166] F&C served on Prima Paint a "notice of intention to arbitrate."[167] Prima Paint then sued in federal court for rescission of the consulting agreement because of the alleged misrepresentation and for an order enjoining F&C from proceeding with arbitration.[168] F&C cross-moved to stay the suit pending arbitration. The trial court granted F & C's motion to stay litigation and the Second Circuit dismissed Prima Paint's appeal.[169] The Supreme Court affirmed this stay of litigation pending arbitration.[170]

Although the Supreme Court ruled against Prima Paint's attempt to litigate rather than arbitrate, the Court did not address Prima Paint's argument that F&C fraudulently induced Prima Paint to sign the consulting agreement containing the arbitration clause. The Supreme Court held that no court should address this argument because it raised an issue for the arbitrator to resolve. In other words, the Court ruled that Prima Paint must go to arbitration for a ruling on whether it formed an enforceable contract containing an arbitration clause.[171] The Court held that "arbitration clauses as a matter of federal law are 'separable' from the contracts in which they are embedded,

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[166]*Id.*

[167]*Id.*

[168]*Id.* at 398-99.

[169]*Id.* at 399.

[170]*Id.* at 406-07.

[171]The Court said that its result is compelled by FAA § 4, which provides that if

> [a] party [claims to be] aggrieved by the alleged failure . . . of another to arbitrate . . . [t]he court shall hear the parties, and upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration . . .. If the making of the arbitration agreement or the failure, neglect, or refusal to perform the same be in issue, the court shall proceed summarily to the trial thereof.

Prima Paint, 388 U.S. at 403-04 (discussing 9 U.S.C. § 4) More simply, § 4 says that the court shall not order the parties to arbitration if "the making of the arbitration agreement" is in issue. If the making of the arbitration agreement is in issue, then the court must proceed to trial on that issue. If the trial determines that the parties made an arbitration agreement, then the court must order the parties to arbitration. On the other hand, if the trial determines that the parties did not make an arbitration agreement then the court must not order the parties to arbitration.

Prima Paint held that no trial would determine whether the parties made an arbitration agreement because Prima Paint alleged fraud inducement of, not the arbitration agreement in particular, but rather of the broader consulting contract containing the arbitration agreement. The phrase "arbitration agreement," as used in FAA § 4, refers specifically to the arbitration clause itself, not more broadly to the consulting contract of which the arbitration clause was a part. If Prima Paint had argued fraud "directed to the arbitration clause itself," then the making of the arbitration agreement would have been at issue and Prima Paint would have been entitled to a trial on that issue. But the Supreme Court held that FAA § 4 "does not permit the federal court to consider claims of fraud in the inducement of the contract generally." *Prima Paint*, 388 U.S. at 404.

and that where no claim is made that fraud was directed to the arbitration clause itself, a broad arbitration clause will be held to encompass arbitration of the claim that the contract itself was induced by fraud."[172] *Prima Paint* thus adopted the "separability doctrine."

Prima Paint arose before arbitration occurred, but courts also use the separability doctrine after arbitration occurs.[173] If parties participate in arbitration and the arbitrator rules that the contract containing the arbitration agreement is unenforceable, then the separability of the arbitration agreement nevertheless preserves the arbitrator's contractual authority (or "jurisdiction") to make that ruling.[174] The following discussion uses the phrase "pre-arbitration separability" to refer to the separability doctrine as used in cases like *Prima Paint* before arbitration occurs, as opposed to after.

2. *Expanding the Pre-Arbitration Separability Doctrine to State Courts, Adhesion Contracts, and a Wide Range of Contract Defenses*

In *Buckeye Check Cashing, Inc. v. Cardegna*, the Supreme Court expanded the pre-arbitration separability doctrine, which it called "severability," to state courts, adhesion contracts, and a wide range of contract defenses.[175] In contrast to *Prima Paint*, which involved a major contract be-

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[172]*Id.* at 402.

[173]*See, e.g.*, Hamblen v. Hatch, 398 P.3d 99, 104-07 (Ariz. 2017) (agreeing with the party (Hamblen) arguing "that the separability doctrine applies to not only pre-arbitration challenges to motions to compel arbitration, but also post-arbitration proceedings").

[174]David Horton, *Mass Arbitration and Democratic Legitimacy*, 85 U. COLO. L. REV. 459, 485 (2014) ("By dividing arbitration clauses from the container contract, separability prevents an arbitrator's ruling that the container contract is invalid from simultaneously destroying her authority to make any such ruling."). Statements of this sort are especially common in the context of international commercial arbitration. *See, e.g.*, RESTATEMENT (THIRD) U.S. LAW OF INT'L COMM. ARB. § 2.7 TD No 4 (Amer. L. Inst. 2015) ("As a consequence" of separability, "an arbitral tribunal is able to find on the merits that the underlying agreement is invalid or unenforceable, without retroactively undermining the tribunal's authority to make that determination in the first place."); George A. Bermann, *The "Gateway" Problem in International Commercial Arbitration*, 37 YALE J. INT'L L. 1, 22 (2012) ("As an agreement separate and apart from the main contract, an arbitration clause remains valid even though the contract of which it forms a part is not, thus permitting the former to survive the demise of the latter."); William W. Park, *Determining Arbitral Jurisdiction: Allocation of Tasks Between Courts and Arbitrators*, 8 AM. REV. INT'L ARB. 133, 143 (1997) ("[T]he separability doctrine permits arbitrators to invalidate the main contract (e.g., for illegality or fraud in the inducement) without the risk that their decision will call into question the validity of the arbitration clause from which they derive their power."); GARY B. BORN, INTERNATIONAL COMMERCIAL ARBITRATION 68 (2d ed. 2001) ("Another possible consequence of the separability doctrine is that, if an arbitral tribunal or court concludes that the parties' entire underlying contract was void, that conclusion would not necessarily deprive the parties' arbitration agreement— and hence, in a Catch-22 turn, the arbitrators' award—of validity."); Robert H. Smit, *Separability and Competence-Competence in International Arbitration: Ex Nihilo Nihil Fit? Or Can Something Indeed Come from Nothing?*, 13 AM. REV. INT'L ARB. 19, 20-21 (2002) ("[S]eparability means that . . . a party's challenge to the validity of the underlying contract does not automatically deprive the arbitral tribunal of jurisdiction to resolve the parties' dispute concerning the challenged contract.").

[175]546 U.S. 440, 449 (2006) (holding that "regardless of whether the challenge is brought in federal or

tween businesses,[176] *Buckeye* involved an adhesion contract pursuant to which Buckeye Check Cashing, Inc. provided John Cardegna with cash in exchange for a personal check in the amount of the cash plus a finance charge.[177] Cardegna sued in Florida state court, "alleging that Buckeye charged usurious interest rates and that the Agreement violated various Florida lending and consumer-protection laws, rendering it criminal on its face."[178] Buckeye moved to stay the litigation and compel arbitration of Cardegna's claims. The Florida Supreme Court ruled for Cardegna, holding that "the Florida courts, and not an arbitrator, must first determine the contract's legality before [Cardegna] may be required to submit to arbitration under a provision of the contract."[179] The U.S. Supreme Court reversed, holding that the separability doctrine requires Cardegna to assert his illegality defense, much like Prima Paint's fraudulent misrepresentation defense, in arbitration.[180] In short, *Buckeye* expanded *Prima Paint*'s pre-arbitration separability doctrine to preempt state law and to apply to contract defenses beyond misrepresentation, including in consumer adhesion contracts. Courts have also applied the pre-arbitration separability doctrine to other contract defenses, such as mistake, duress, undue influence, unconscionability, frustration of purpose, and incapacity.[181]

3. *Both Sides of Debates About the Separability Doctrine Agree that it Makes Arbitration Agreements More Enforceable*

The pre-arbitration separability doctrine of *Prima Paint*'s and *Buckeye* has its critics,[182] but we can readily appreciate the pre-arbitration separability doctrine's practical value in quickly and cheaply enforcing arbitration agreements without first requiring courts to hear alleged defenses to the contracts containing them.[183] Whether those values outweigh the costs—to consent

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state court, a challenge to the validity of the contract as a whole, and not specifically to the arbitration clause, must go to the arbitrator"). *Buckeye* shifted the doctrine's foundation from § 4 of the FAA to § 2. *Buckeye* said that, "[a]lthough [FAA] § 4, in particular, had much to do with Prima Paint's understanding of the rule of severability, this rule ultimately arises out of § 2, the FAA's substantive command that arbitration agreements be treated like all other contracts." *Id.* at 447.

[176]*Prima Paint* involved the sale of a business. *Prima Paint*, 388 U.S. at 397.

[177]Stephen J. Ware, *Arbitration Law's Separability Doctrine After Buckeye Check Cashing, Inc. v. Cardegna*, 8 NEV. L.J. 107, 110 (2007).

[178]*Buckeye*, 546 U.S. at 443.

[179]Cardegna v. Buckeye Check Cashing, Inc., 894 So. 2d 860, 865 (Fla. 2005).

[180]*Buckeye*, 546 U.S. at 445-46.

[181]Stephen J. Ware, *The Centrist Case Against Current (Conservative) Arbitration Law*, 68 FLA. L. REV. 1227, 1236 (2016).

[182]*See id.*

[183]Thomas J. Stipanowich, *The Third Arbitration Trilogy: Stolt-Nielsen, Rent-A-Center, Concepcion and the Future of American Arbitration*, 22 AM. REV. INT'L ARB. 323, 345 (2011) ("[T]he doctrine of separability (or severability) was—and continues to be—justified on the ground that the vitality of arbitration clauses will be undermined by allowing parties to waylay the process through front-end challenges to the whole contract.").

and the right to litigate—of pre-arbitration separability is subject to debate.[184] But commentators across the spectrum of normative views agree on the descriptive fact that the separability doctrine makes arbitration agreements more enforceable—more quickly, cheaply, and reliably enforced—than they would be without the separability doctrine. Disagreements are on the normative questions of whether such enforcement is worth the costs in various contexts, especially consumer and employment adhesion contracts.

4. *Rent-A-Center's "Super-Separability" Sacrifices Still More to Enforce Still More Arbitration Agreements*

Suppose a consumer argues that the arbitration clause in her loan agreement is unconscionable and so should not be enforced against her. Before 2010, a court likely would have heard and resolved that argument (rather than sending it to the arbitrator) because it is an argument "directed to the arbitration clause itself" and thus for the court, under *Prima Paint* and *Buckeye*.[185] So, a large body of case law developed about which arbitration clauses were unconscionable.[186] Courts "struck down terms within arbitration clauses that chose distant venues, severely restricted discovery, reduced statutes of limitations, saddled plaintiffs with hefty costs, and eliminated the right to recover attorney's fees or remedies."[187] However, the Supreme Court's 2010 decision in *Rent-A-Center, West, Inc. v. Jackson*,[188] effectively shifted from courts to arbitrators many parties' arguments that their arbitration clauses are unconscionable.

In *Rent-A-Center*, the Supreme Court enforced a clause providing that "the Arbitrator, and not any federal, state, or local court or agency, shall have exclusive authority to resolve any dispute relating to the interpretation, applicability, enforceability or formation of this Agreement including, but not limited to any claim that all or any part of this Agreement is void or voidable."[189] This "delegation clause"[190] was contained in a freestanding "Mutual Agreement to Arbitrate Claims" required by Rent-A-Center of its at-will

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[184]*Compare* Stephen J. Ware, *The Centrist Case Against Current (Conservative) Arbitration Law*, 68 FLA. L. REV. 1227, 1266 (2016), *with* Christopher R. Drahozal, *Buckeye Check Cashing and the Separability Doctrine*, 1 Y.B. ARB. & MED. 55 (2009).

[185]Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395, 402 (1967); Buckeye Check Cashing, Inc. v. Cardegna, 546 U.S. 440, 442 (2006).

[186]*See* Aaron-Andrew P. Bruhl, *The Unconscionability Game: Strategic Judging and the Evolution of Federal Arbitration Law*, 83 N.Y.U. L. REV. 1420, 1422 (2008); Susan Landrum, *Much Ado About Nothing?: What the Numbers Tell Us About How State Courts Apply the Unconscionability Doctrine to Arbitration Agreements*, 97 MARQ. L. REV. 751, 776 (2014); Susan Randall, *Judicial Attitudes Toward Arbitration and the Resurgence of Unconscionability*, 52 BUFF. L. REV. 185, 194-96 (2004).

[187]David Horton, *Mass Arbitration and Democratic Legitimacy*, 85 U. COLO. L. REV. 459, 492 (2014).

[188]561 U.S. 63 (2010).

[189]*Id.* at 66.

[190]Christopher R. Drahozal, *Confidentiality in Consumer and Employment Arbitration*, 7 Y.B. ON ARB. & MEDIATION 28, 46 (2015) ("A delegation clause is a contract provision specifying that the arbitrator

workers[191] that resulted in an adhesive arbitration agreement required as a condition of employment.

In *Rent-A-Center*, a former employee, Jackson, sued Rent-A-Center for racial discrimination and retaliation.[192] When Rent-A-Center moved to compel arbitration, Jackson argued that the arbitration agreement was unconscionable, so he should have been free to litigate, rather than arbitrate, his claims against Rent-A-Center.[193] While the Ninth Circuit held that Jackson could pursue his unconscionability theory in court,[194] the Supreme Court reversed and relegated Jackson's unconscionability argument to arbitration on the ground that the just-quoted "delegation clause" constituted his agreement to arbitrate whether or not other portions of his arbitration agreement were unconscionable.[195] As Chris Drahozal and Peter Rutledge explain, "*Rent-A-Center* extended the separability principle by treating the arbitration agreement itself as entailing two separate contracts. This double separability principle enabled a further allocation of power to the arbitrator—now arbitrators could resolve challenges to the arbitration agreement, and courts retained only the ability to resolve challenges directed specifically at the delegation provision."[196]

Rent-A-Center has been interpreted broadly by lower courts who, as David Horton writes, understand it "to establish a kind of 'super-separability' rubric in which every contract that contains a delegation clause breaks down into 'three agreements[,] each nested inside the other': (1) a delegation clause, (2) an arbitration clause, and (3) the container contract."[197] Horton adds that post-*Rent-A-Center* courts have taken "to extremes the idea that plaintiffs needed to argue that the delegation provision itself is unconscionable. If a plaintiff failed to mention the magic words 'delegation clause' in her pleadings, she—like Jackson in *Rent-A-Center*—would be forced to challenging the fairness of the arbitral process in arbitration itself."[198] And even specifically challenging the delegation clause is "a formidable hurdle for plaintiffs."[199] As Horton suggests, "even if Jackson had contested the enforceability of the delegation clause, he likely would have lost."[200] That is, *Rent-A-Center* explains,

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and not a court will have the final and exclusive authority to rule on challenges to the enforceability of the arbitration agreement.").

[191]Rent-A-Ctr., W., Inc. v. Jackson, 561 U.S. 63, 65 (2010).

[192]*Id.*

[193]*Id.*

[194]Jackson v. Rent-A-Ctr. W., Inc., 581 F.3d 912, 918–19 (9th Cir. 2009), *rev'd,* 561 U.S. 63 (2010).

[195]*Rent-A-Ctr.*, 561 U.S. at 73.

[196]Christopher R. Drahozal & Peter B. Rutledge, *Contract and Procedure*, 94 MARQ. L. REV. 1103, 1121 (2011).

[197]David Horton, *Arbitration About Arbitration*, 70 STAN. L. REV. 363, 397 (2018).

[198]*Id.*

[199]*Id.* at 396.

[200]*Id.* at 396-97.

because Jackson's objections to the "arbitration procedures called for by the contract—the fee-splitting arrangement and the limitations on discovery . . . were to be used during arbitration under both the agreement to arbitrate employment-related disputes and the delegation provision."[201] But to get a court (rather than an arbitrator) to consider his unconscionability argument, *Rent-A-Center* continues, Jackson would have to argue "that these common procedures as applied to the delegation provision rendered that provision unconscionable"; and this "would be, of course, a much more difficult argument to sustain than the argument that the [contract's allocation of arbitration fees and its discovery] limitation renders arbitration of his fact bound employment-discrimination claim unconscionable."[202] In other words, a court is likely to decide that minimal discovery and fees are needed to arbitrate whether the arbitration clause is unconscionable, so a court will likely decide that an arbitrator (not the court) should decide whether requiring arbitration of the employment discrimination claim is unconscionable.[203]

George Bermann defends *Prima Paint*'s pre-arbitration separability doctrine in writing that defenses "of fraud, duress, or mistake raise core substantive contract law issues that, at the very least, verge on the merits of a contract dispute. To that extent, arbitral tribunals, not courts, should be deciding them. Much the same may even more clearly be said of an unconscionability defense."[204] And "on none of these issues should a court's sending the matter to the arbitrators for decision offend our sense of justice."[205] By contrast, Bermann is critical of *Rent-A-Center* describing the "majority's reasoning . . . deeply flawed and indeed disingenuous."[206] "[T]he majority's use of the separability doctrine in *Rent-A-Center* is nothing less than a perversion

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[201]Rent-A-Ctr., W., Inc. v. Jackson, 561 U.S. 63, 74 (2010).

[202]*Id.*

[203]Karen Halverson Cross, *Letting the Arbitrator Decide Unconscionability Challenges*, 26 OHIO ST. J. ON DISP. RESOL. 1, 48-49 (2011) ("[T]he effect of *Rent-A-Center* is to elevate any arbitration agreement containing a delegation clause over other forms of contract. The decision sets up an almost insurmountable obstacle to unconscionability challenges because the factors that have been the basis for a successful challenge in the past (one-sided procedure, class action waiver, excessive fees, remote forum) for the most part are either not specifically relevant to the delegation clause or are applicable to the entire arbitration agreement.").

[204]George A. Bermann, *The "Gateway" Problem in International Commercial Arbitration*, 37 YALE J. INT'L L. 1, 35 (2012).

[205]*Id.* ("The party resisting arbitration effectively concedes the existence of the contract containing the arbitration clause. Having acknowledged that the contract came into existence, and that the contract contains an otherwise valid arbitration clause, it should not object to allowing the arbitral tribunal, which derives its authority from that contract, to decide whether the contract is in fact for any reason unenforceable.").

[206]George A. Bermann, *Arbitration in the Roberts Supreme Court*, 27 AM. U. INT'L L. REV. 893, 896-99 (2012).

of it."[207] Unlike the "solid logical basis" for courts sending to arbitration challenges to the contract containing an arbitration agreement, a party that

> challenges an arbitration agreement on the basis of defects unique to it mounts a fundamental challenge to the arbitral tribunal's legitimacy, and indeed to the tribunal's authority to decide anything, much less the arbitration agreement's basic fairness. Moreover, determinations concerning the enforceability of an arbitration agreement do not implicate the merits of the underlying dispute in the way that challenges to the enforceability of substantive contract provisions do.[208]

Bermann's support of *Prima Paint* and opposition to *Rent-A-Center* is an example of how the separability doctrine has become increasingly controversial as the Court has expanded it to enforce more and more arbitration agreements, including agreements to arbitrate the enforceability of the arbitration agreement. And much as commentators across the spectrum of normative views about separability agree that it makes arbitration agreements more enforceable (more quickly, cheaply, and reliably enforced), commentators across the spectrum agree that *Rent-A-Center*'s "super-separability" enforcement of delegation clauses makes arbitration agreements more enforceable (more quickly, cheaply, and reliably enforced) than they would be without "super-separability."

In sum, the separability doctrine is emphatically about *increasing* enforcement of arbitration agreements.

C. Bankruptcy's All-or-Nothing Rule for Assumption or Rejection

1. *Assume or Reject all Executory Portions of Contract*

Arbitration law's separability doctrine may initially seem incompatible with cases under Bankruptcy Code § 365 stating that an executory contract must be assumed or rejected in its entirety—the all-or-nothing rule. While the separability doctrine makes separating two executory agreements contained in a single document the well-established norm in arbitration law, it is a rarity in cases under § 365.

Courts applying § 365 have long stated that the trustee or DIP representing the estate must assume or reject an entire contract, rather than assuming only contract terms that benefit the estate while rejecting terms that

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[207]George A. Bermann, *The Supreme Court Trilogy and Its Impact on U.S. Arbitration Law*, 22 Am. Rev. Int'l Arb. 551, 554-55 (2011).

[208]Bermann, *supra* note 206.

do not. In other words, an estate may not "cherry-pick" the parts of a contract it wishes to assume.[209] As the Supreme Court stated in *National Labor Relations Board v. Bildisco & Bildisco*, "[s]hould the debtor-in-possession elect to assume the executory contract . . . it assumes the contract *cum onere*," that is, with all the burdens.[210] For this proposition, *Bildisco* cited *In re Italian Cook Oil Corp.*, applying the Bankruptcy Code's predecessor, the Bankruptcy Act. [211] *Italian Cook Oil* said:

> A trustee is, of course, under no obligation to complete executory contracts of a debtor. By Section 70, sub. b of the [Bankruptcy] Act, the trustee is given the right to adopt or reject an executory contract. He must do one or the other. If the trustee deems the contract to possess no equity or benefit for the estate he rejects it as burdensome. If, on the other hand, he concludes that the executory contract does have an equity for the estate he adopts it. These principles of law have become too well established to permit of doubt. The trustee, however, may not blow hot and cold. If he accepts the contract he accepts it *cum onere*. If he receives the benefits he must adopt the burdens. He cannot accept one and reject the other.[212]

This seventy-year-old "cum onere" (all-or-nothing) rule remains at a general level good law.[213] The Supreme Court endorsed this rule in *Bildisco*, albeit in dicta.[214] And post-*Bildisco* circuit courts have applied the *Italian Cook Oil/*

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[209]*In re* Atlantic Computer Sys., Inc., 173 B.R. 844, 849 (S.D.N.Y.1994) (noting that a debtor may not "cherry-pick" pieces of a contract it wishes to assume or reject).

[210]N.L.R.B. v. Bildisco & Bildisco, 465 U.S. 513, 531-32 (1984).

[211]190 F.2d 994, 996-97 (3d Cir. 1951).

[212]*Id.* (citations omitted).

[213]2 WILLIAM L. NORTON III, NORTON BANKR. L. & PRAC *3d* § 46:11 (3d ed. 2021) ("The trustee or debtor-in-possession may not assume favorable provisions while casting unfavorable provisions aside. A contract or lease assumed must be assumed cum onere, taking the bad with the good."); *In re* CellNet Data Systems, Inc., 327 F.3d 242, 249 (3d Cir. 2003) ("This election [to assume] is an all-or-nothing proposition—either the whole contract is assumed or the entire contract is rejected.").

[214]*Bildisco* did not involve an estate seeking to assume some terms of a contract while rejecting others. In *Bildisco*, the pre-bankruptcy debtor (an employer) and a labor union representing many of its employees formed a collective bargaining agreement (CBA). 465 U.S. at 518. The pre-bankruptcy debtor failed to make some payments required by the CBA, so the union filed unfair labor practice charges with the National Labor Relations Board (NLRB), which ruled in favor of the union. *Id.* at 518-19. After Bildisco, the employer, filed for Chapter 11 bankruptcy, the DIP continued to breach some of its duties under the CBA. *Id.* at 518-19 The DIP won bankruptcy court approval to reject the CBA. *Id.* at 518. Before the Supreme Court, the Union and the NLRB argued "that in light of the special nature of rights created by labor contracts, Bildisco should not be permitted to reject the collective-bargaining agreement unless it can demonstrate that its reorganization will fail unless rejection is permitted." *Id.* at 524. But the Supreme Court found those arguments "wholly unconvincing" and "fundamentally at odds with the policies of flexibility and equity built into Chapter 11." *Id.* at 524. So, the Court adopted an easier standard for

Bildisco all-or-nothing rule to prevent estates from assuming some terms of a contract while rejecting others.[215]

However, some cases have held the all-or-nothing rule does not require courts to treat "every document denominated a 'contract' or a 'lease' . . . as a single, indivisible whole."[216] These courts recognize that a single document may contain more than one agreement. For instance, the Fifth Circuit explained in *Stewart Title Guar. Co. v. Old Republic Nat. Title Ins. Co.*, that "[i]f a single contract contains separate, severable agreements the debtor may reject one agreement and not another."[217] The pre-bankruptcy debtor in *Stewart Title* leased from its lessor the right to use various personal property.[218] When the lessee filed for bankruptcy, the trustee representing the

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debtor-employers to meet, "the Bankruptcy Court should permit rejection of a collective-bargaining agreement under § 365(a) of the Bankruptcy Code if the debtor can show that the collective-bargaining agreement burdens the estate, and that after careful scrutiny, the equities balance in favor of rejecting the labor contract." *Id.* at 526.

In addition, the Supreme Court rejected the NLRB's argument that it may find an "unfair labor practice for unilaterally rejecting or modifying a collective-bargaining agreement before formal rejection by the Bankruptcy Court." *Id.* at 516-17. The Court pointed that the "practical effect" of the NLRB's "action would be to require adherence to the terms of the collective-bargaining agreement" which "would run directly counter to the express provisions of the Bankruptcy Code and to the Code's overall effort to give a debtor-in-possession some flexibility and breathing space." *Id.* at 532. Among those express provisions, the Court said, is § 365(g)(1), which provides that rejection of an executory contract is treated as though the contract was breached by the pre-bankruptcy debtor. *Id.* at 530. This, the Court said in a passage adopting the all-or-nothing rule, means big "implications" follow from the estate's decision to reject or assume:

> Damages on the contract that result from the rejection of an executory contract, as noted, must be administered through bankruptcy and receive the priority provided general unsecured creditors. See 11 U.S.C. §§ 502(g), 507. If the debtor-in-possession elects to continue to receive benefits from the other party to an executory contract pending a decision to reject or assume the contract, the debtor-in-possession is obligated to pay for the reasonable value of those services . . . . Should the debtor-in-possession elect to assume the executory contract, however, it assumes the contract *cum onere, In re Italian Cook Oil Corp.*,190 F.2d 994, 996 (CA3 1951), and the expenses and liabilities incurred may be treated as administrative expenses, which are afforded the highest priority on the debtor's estate, 11 U.S.C. § 503(b)(1)(A).

465 U.S. at 531-532 (citations omitted).

[215]*See In re* Fleming Companies, Inc., 499 F.3d 300, 308 (3d Cir. 2007) (holding that debtor could not assume and assign store lease because an essential term of it required service from a warehouse whose lease had already been rejected); *Matter of* Chicago, Rock Island & Pac. R. Co., 860 F.2d 267, 272 (7th Cir. 1988) (denying motion to exclude (and thus reject) a contract's termination provision while assuming the rest of the contract's terms); *Matters of* Crippin, 877 F.2d 594, 598 (7th Cir. 1989) (denying employee-debtor's motion to reject agreement to contribute to Employee Stock Investment Plan while assuming the remaining terms of employment). *See also In re* Ann Arbor Consultation Servs., Inc., 614 B.R. 789, 796 (Bankr. E.D. Mich. 2020) (denying trustee's motion to assume option to purchase for half of market value after having rejected the lease containing the valuable option).

[216]2 WILLIAM L. NORTON III, NORTON BANKR. L. & PRAC § 46:11 (3d ed. 2021).

[217]83 F.3d 735, 741 (5th Cir. 1996).

[218]*Id.* at 737.

bankruptcy estate rejected the lease.[219] However, the lease provided that upon its termination the lessee would retain rights to reproduce various records.[220] Those "reproduction rights," like other property of the pre-bankruptcy debtor, became property of the estate,[221] so the bankruptcy trustee auctioned and sold the reproduction rights to raise money for the estate.[222] The Fifth Circuit approved both of these actions by the trustee, thus permitting the estate to reject the lease under § 365, while the estate still benefitted from the reproduction rights the lease conferred on (conveyed to) the pre-bankruptcy debtor.

This *Stewart Title* ruling did not violate the *Italian Cook Oil/Bildisco* all-or-nothing rule, the Fifth Circuit said, because "[t]he issue of assumption or rejection" under § 365 "relates only to those aspects of the contracts which remain unfulfilled as of the date the petition is filed. Thus, where a single document embraces several distinct agreements, some of which are executory and some of which are fully or substantially performed, only the executory portions of the document are subject to rejection."[223] So, *Stewart Title* held that "when the bankruptcy trustee rejected the Lease pursuant to § 365 the debtor materially breached the Lease only to the extent that the Lease remained executory—i.e., only in regard to the Use Rights."[224] In contrast, the Fifth Circuit concluded as a matter of law, "the rejection of the Lease did not render the Reproduction Rights . . . unenforceable."[225] *Stewart Title* thus severed two agreements contained in a single document in the course of holding that only one of those agreements was executory while the other had already been performed by one or both parties.[226]

To reiterate, the all-or-nothing rule requires the trustee or DIP representing the estate to assume or reject all *executory portions* of a contract, rather than assuming some while rejecting others. In contrast, the Fifth Circuit held, already-performed portions of a contract—such as the reproduction rights conveyed by the lessor to the pre-bankruptcy debtor in *Stewart Title*—are not implicated by the all-or-nothing rule.

Distinguishable from *Stewart Title* are the rare § 365 cases that sever

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[219]*Id.*

[220]*Id.*

[221]11 U.S.C. 541.

[222]*Stewart Title*, 83 F.3d 735, 737-38 (5th Cir. 1996).

[223]*Id.* at 741-42 (internal quotations omitted).

[224]*Id.* at 742.

[225]*Id.*

[226]In other words, Stewart Title conceived of the pre-bankruptcy debtor as having received a conveyance of property ("reproduction rights") rather than a mere promise to permit the pre-bankruptcy to access and reproduce various records. *See also In re* Cutters, Inc., 104 B.R. 886, 889 (Bankr. M.D. Tenn. 1989) (permitting estate to sever from performed sale of assets the executory agreement to use best efforts to sell slow inventory, so estate could reject the executory agreement.).

two *executory* agreements contained in a single document, so the estate may assume one executory agreement while rejecting the other. An oft-cited example is a 1987 Eleventh Circuit case, *In re Gardinier, Inc.*[227] Before filing for bankruptcy, the *Gardinier* debtor contracted to sell a parcel of land to Burley. Paragraph Eight of this contract obligated the debtor to pay 10 percent of the sales price to Kilgore, the real estate broker who apparently facilitated the sale.[228] The Eleventh Circuit sought to determine "whether an agreement to pay a brokerage commission, contained within the same document as a purchase and sale agreement, is a separate and distinct contract from the purchase and sale agreement."[229] It said that, "[a]lthough there is only one document memorializing this transaction," "the terms of the instrument demonstrate that the parties intended to make two separate contracts."[230] With the contract for the sale of land thus separated from the contract to pay the broker, the Eleventh Circuit allowed "the trustee to assume the contract for the sale of land and reject the separate brokerage agreement."[231] The Eleventh Circuit effectively severed Paragraph Eight from the contract document containing it, thus enabling the estate to reject Paragraph Eight and thereby "relegate[e] Kilgore to the status of a general unsecured creditor,"[232] while assuming the remaining terms of the contract document, which related to the sale of land. The benefit of severing to the estate can be appreciated by anyone who has ever sold a house after committing to pay 6 percent of the sale price to a real estate broker who found the buyer and facilitated the sale. If that common situation had the severing effected by *Gardinier*, the seller could reduce the broker's commission dramatically—to pay the broker just pennies on the dollar—thus enabling the seller to keep, not merely 94 percent of the sale price, but perhaps 99 percent or more.

Gardinier is not the only case permitting an estate to sever executory agreements contained in a single document, thus enabling the estate to assume one executory agreement while rejecting the other(s). But research revealed no other such appellate cases, and very few other cases.[233] Nearly all

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[227]831 F.2d 974, 976 (11th Cir. 1987).

[228]*Id.* at 975.

[229]*Id.*

[230]*Id.* at 976.

[231]*Id.* at 978.

[232]*Id.* (meaning Kilgore was likely to "reap only a percentage of its $500,000 commission," and thus experience "the harsh reality of bankruptcy.").

[233]*See also In re* Cafeteria Operators, L.P., 299 B.R. 384, 394 (Bankr. N.D. Tex. 2003) (applying Michigan law to find Master Sublease Agreement, which establishes common terms for 43 individual leases (of 43 different cafeterias in 43 different K-Mart stores) divisible into each of its individual leases, so the estate could reject some while assuming others); *In re* Convenience USA, Inc., No. 01-81478, 2002 WL 230772, at *6-7 (Bankr. M.D.N.C. Feb. 12, 2002) (applying North Carolina law to "Energy Lease" document by which pre-bankruptcy debtor leased 27 convenience stores from six different lessors; holding "that the Energy Lease is a divisible contract such that each of the 27 leased properties may be regarded as

cases applying Bankruptcy Code § 365 require the estate to treat all *executory portions of* a contract document as a unified whole for assumption or rejection. So, the *Gardinier* exception to, or clarification of, the *Italian Cook Oil/Bildisco* all-or-nothing rule is a narrow rarity.

2. *Comparing Rare Exceptions to Bankruptcy's All-or-Nothing Rule with Arbitration Law's Separability Doctrine*

The infrequency with which § 365 cases separate two executory agreements contained in a single document sharply contrasts with arbitration law which, as explained above, routinely separates two executory agreements contained in a single document. Moreover, under the pre-arbitration separability doctrine, courts must enforce an executory arbitration agreement even when a party alleges that the contract containing it is unenforceable. In other words, the pre-arbitration separability doctrine severs one of several executory agreements contained in a single document to *enforce* the one while taking no position on the enforceability of the rest. In an important sense then, the pre-arbitration separability doctrine is the opposite of *Gardinier*, which severed one of several executory agreements contained in a single document to *reject*, and thus weaken enforcement of the one while assuming the rest.[234]

To recap, the FAA requires courts to enforce arbitration agreements and to do so with an especially strong means of enforcement—court orders staying litigation and compelling arbitration. Then *Prima Paint*'s pre-arbitration separability doctrine goes further to enforce arbitration agreements that would not otherwise be enforced, those in contracts subject to allegations of fraudulent inducement. *Buckeye* and *Rent-A-Center* expanded *Prima Paint*'s pre-arbitration separability doctrine to require state as well as federal courts to compel arbitration of most or all contract defenses including, if a delegation clause is present, defenses directed to the arbitration agreement itself. And the Supreme Court has done this in the context of arbitration clauses in the adhesion contracts required of individuals seeking storefront check-cashing or a job at a rent-to-own company. The Supreme Court has expanded the pre-arbitration separability doctrine far beyond *Prima Paint*'s misrepresentation allegations between businesses in federal court, so pre-arbitration separability, including the "super-separability" of *Rent-A-Center*, is now central to the enforcement of adhesive arbitration agreements, even in allegedly unconscionable or usurious contracts, against consumers and employees. These expansions of the pre-arbitration separability doctrine have uniformly *increased* enforcement of arbitration agreements. No suggestion can be found in these Supreme Court cases, or lower court cases applying them, that arbitration

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the subject of a separate executory contract that stands on its own and may be dealt with separate and apart from the other leased properties").

[234] *See supra* notes 228-34 and accompanying text.

law's separability doctrine permits severing an arbitration agreement to prevent its enforcement. The whole point of severing arbitration agreements is to enforce them. One can read non-bankruptcy arbitration cases for decades (as I have) without seeing any suggestion that a court is severing an arbitration agreement *to prevent its enforcement.* As Chris Drahozal writes, "With separability, it is the main contract that is challenged as unenforceable, not the arbitration clause, and the issue is whether the unenforceability of the main contract infects the arbitration clause, not the other way around."[235]

D. Integrating the Separability Doctrine with § 365

1. *Arbitration Agreements are Separable Executory Contracts*

As early as 1983, Jay Westbrook integrated arbitration law's separability doctrine with § 365.[236] After discussing cases deciding whether to enforce arbitration agreements in bankruptcy, Westbrook said, "[s]urprisingly, none of these courts analyzed these cases as a traditional executory contract problem."[237] To provide that analysis, Westbrook began with the separability doctrine: "It is now firmly established in the United States, as well as in many other countries, that an arbitration clause is considered a separable contract between the parties which survives as an obligation of the promisor even if the underlying contract is voidable."[238] Westbrook then combined the separability doctrine with § 365: "Viewed as an independent contractual obligation of the parties, an arbitration agreement is a classic executory contract, since neither side has substantially performed the arbitration agreement at the time enforcement is sought."[239]

Also recognizing the separability of an arbitration agreement in the context of § 365 is *Societe Nationale Algerienne Pour La Recherche, La Prod., Le Transp., La Transformation et La Commercialisation des Hydrocarbures v. Distrigas Corp.*[240] *Distrigas* is a 1987 federal district court ruling by Judge

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[235]Christopher R. Drahozal, *Buckeye Check Cashing and the Separability Doctrine*, 1 Y.B. Arb. & Med. 55, 57 (2009).

[236]Jay Westbrook, *The Coming Encounter: International Arbitration and Bankruptcy*, 67 Minn. L. Rev. 595, 623 (1983).

[237]*Id* (citations omitted).

[238]*Id.*

[239]*Id.*; *See also* Jason S. Brookner & Monica S. Blacker, *The Rejectability of Arbitration Clauses*, Am. Bankr. Inst. J., April 2007, at 1, 77 ("An arbitration clause provides for reciprocal obligations to resolve any future dispute through arbitration. Thus, at the time the bankruptcy case is filed, each party still has a future obligation to arbitrate any disputes that arise under the principal contract. This reciprocal future obligation would appear to make the arbitration clause executory"); Zach Zunshine, *Pre-Petition Arbitration Agreements in Bankruptcy and Hays and to. v. Merrill Lynch*, 7 Ohio St. J. on Disp. Resol. 157, 163 (1991) (Once one realizes "that a contract containing an arbitration clause is in fact actually two separate contracts," one sees that "[t]he material breach test is easily satisfied in the situation where the only unperformed obligation under the contract is a promise to arbitrate disputes.").

[240]80 B.R. 606 (D. Mass. 1987).

William Young, co-author of a contracts casebook.[241] In *Distrigas*, the debtor in bankruptcy rejected "in its entirety" a contract containing an arbitration agreement, but the non-debtor party (a creditor) nevertheless sought to arbitrate its claim against the debtor.[242] The bankruptcy court denied the creditor's motion to compel arbitration on the ground that the arbitration agreement was "moot" in view of the debtor's rejection of the executory contract in its entirety.[243] But Judge Young's opinion for the district court reversed and granted the creditor's motion to compel arbitration to determine the damages resulting from the debtor's rejection of the contract containing the arbitration agreement.[244] Judge Young "heartily approve[d] of the general propositions, cited by Distrigas, that an executory contract must either be accepted or rejected in its entirety," but citing *Prima Paint*,[245] said "a different tack is more appropriate with respect to arbitration clauses which represent the freely-negotiated method of dispute resolution selected *in advance* by the parties."[246] "In such circumstances," Judge Young wrote, "a strong argument can be made for construing arbitration agreements as 'separable' from the principal contract even though they are physically embodied in the same instruments."[247]

In contrast are erroneous statements by several courts, including the Third Circuit's oft-cited 1989 decision in *Hays and Company v. Merrill Lynch, Pierce, Fenner, & Smith, Inc.*[248] Before entering bankruptcy, the debtor in *Hays*, Monge Oil Corporation, had an account, subject to an arbitration agreement, with a securities broker, Merrill Lynch (Merrill).[249] In seeking to litigate the estate's securities claims against Merrill, the debtor's

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[241] E. ALLAN FARNSWORTH & WILLIAM F. YOUNG, CASES AND MATERIALS ON CONTRACTS (5th ed. 1995).

[242] *Distrigas*, 80 B.R. at 607.

[243] *Id.*

[244] *Id.* at 607-08.

[245] Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395 (1967).

[246] *Distrigas*, 80 B.R. at 609. "As in the instant case, it may be safely assumed that arbitration clauses are not thoughtlessly incorporated into complex, international commercial contracts as mere ballast or as a meaningless nod in the direction of international comity. This assumption is further bolstered where both parties have equal bargaining power and are represented in their transactions by experienced and accomplished legal counsel." *Id.*

[247] *Id.* "Indeed, the First Circuit has expressed this preference and suggested that allowing an arbitration clause to be automatically invalidated along with the principal agreement would be akin to destroying 'precisely what the parties had sought to create' as a dispute resolution device." *Id.* (*citing* Lummus Company v. Commonwealth Oil Refining Company, Inc., 280 F.2d 915, 924 (1st Cir.), *cert. denied*, 364 U.S. 911 (1960); *see also Prima Paint*, 388 U.S. 395). Judge Young further found "[t]his notion of separability" "implicitly acknowledged in a well-established line of Massachusetts state court decisions which hold that even a contract's termination does not necessarily terminate arbitration provisions or other forms of dispute resolution procedure." *Id.* (*citing* Mendez v. Trustees of Boston University, 362 Mass. 353, 356, 285 N.E.2d 446 (1972)).

[248] 885 F.2d 1149 (3d Cir. 1989).

[249] *Id.* at 1150.

bankruptcy trustee (Hays) sought "to reject the Merrill Lynch Customer Agreement as an executory contract."[250] The bankruptcy court denied the trustee's motion to reject,[251] "conclud[ing] that the existence of the arbitration provision alone does not render the contract executory and thus subject to rejection by the trustee."[252] This statement ignores the separability doctrine and incorrectly lumps together the arbitration agreement with the contract containing it, as though the lump (singular) must be executory or not.

Although the *Monge Oil* bankruptcy court's decision was not appealed,[253] what the Third Circuit said about it in *Hays* deepened the failure to apply the separability doctrine. In a footnote of *Hays*, the Third Circuit said:

> The trustee sought leave of the bankruptcy court to reject the Customer Agreement, but the bankruptcy court held that the Customer Agreement was not an executory contract. 120a-132a. That decision was not appealed. There is support for this position. *Societe Nationale Algerienne v. Distrigas Corp.*, 80 B.R. 606, 608-10 (D.Mass.1987); *see* Westbrook, *The Coming Encounter: International Arbitration and Bankruptcy*, 67 Minn.L.Rev. 595, 623 n. 112 (1983).[254]

This footnote misreads both *Distrigas* and Westbrook as supporting the incorrect view that "the Customer Agreement was not an executory contract." This view is incorrect because it fails to apply the separability doctrine and instead lumps together the arbitration provision with the other terms of the contract containing it, so a court must decide whether the combined lump is executory. In contrast, as discussed above, *Distrigas* separated the arbitration agreement from the contract containing it and then properly enforced the executory arbitration agreement notwithstanding the debtor's attempt to prevent such enforcement by rejecting the combined lump "in its entirety."[255] Like *Distrigas*, and unlike *Hays*, Westbrook's article similarly recognized that "an arbitration agreement is a classic executory contract, since neither side has substantially performed the arbitration agreement at the time enforcement is sought."[256] Westbrook also showed how the separability doctrine compatibly blends into the "rights that survive breach" rationale for enforcing arbitration agreements notwithstanding rejection of the contracts containing

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[250]*Id.*

[251]*In re* Monge Oil Corp., 83 B.R. 305, 308 (Bankr. E.D. Pa. 1988).

[252]*Id.* at 309.

[253]*Hays*, 885 F.2d at 1150.

[254]*Id.* at 1153.

[255]*Distrigas*, 80 B.R. at 609.

[256]*Id.*

them. Westbrook wrote, "an arbitration clause is considered a separable contract between the parties which survives as an obligation of the promisor even if the underlying contract is voidable."[257]

Hays' failure to use the separability doctrine seems to have led a bankruptcy court the following year to deny the separability of an arbitration agreement from the contract containing it. The bankruptcy court decision, *In re Chorus Data Systems,*[258] said:

> The debtor also argues that the arbitration clause is a separate and distinct agreement subject to the Bankruptcy Code Section 365 rejection power. There is no authority to support this proposition. On the contrary, this contention was rejected in *Hays and Company v. Merrill Lynch, Pierce, Fenner, & Smith, Inc.*, 885 F.2d 1149, 1153, n. 5 (3d Cir.1989).[259]

This passage, read broadly, would deny that an arbitration agreement is separable from the contract containing it, thus clashing head on with the separability doctrine, and therefore the FAA. The key to avoiding that unfortunate reading is to notice that *Chorus Data* does not deny "the arbitration clause is a separate and distinct agreement," but only denies "the arbitration clause is a separate and distinct agreement subject to the Bankruptcy Code Section 365 rejection power." So, we might charitably read *Chorus Data* as saying that although the arbitration clause is a separate and distinct agreement,[260] the debtor may not reject it under § 365. But even that would be incorrect because, as Part I of this Article shows, an estate may reject an executory arbitration agreement, although doing so does not prevent that rejected agreement from being specifically enforced against the estate.

Chorus Data is not the only post-*Hays* case incorrectly describing an executory arbitration agreement as "not executory." Another example is *In re Ebell Media, Inc.*,[261] which enforced the arbitration agreement despite the debtor's argument that he sought to reject the contract, including its arbitra-

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[257]*Id.*

[258]122 B.R. 845 (Bankr. D.N.H. 1990). In *Chorus Data*, MELA filed in arbitration a claim against the pre-bankruptcy debtor, alleging breach of an agreement that contained an arbitration clause. *Id.* at 846. The pre-bankruptcy debtor participated in arbitration, through discovery, and then filed for bankruptcy. *Id.* at 848. MELA moved for relief from stay in order to enforce the arbitration clause. *Id.* at 848. The bankruptcy court granted MELA's motion to proceed with arbitration. *Id.* at 855.

[259]*Id.* at 853–54.

[260]While Chorus Data cited *Prima Paint* it did so in rejecting a different argument by the debtor than the debtor's separability argument. *Chorus Data*, 122 B.R. at 852–53 ("The debtor argues that under New Hampshire law its 'fraud in the inception' contention would not be arbitrable.").

[261]No. 08-BK-21000-RN, 2010 WL 11545460 (C.D. Cal. Mar. 30, 2010), *aff'd*, 462 F. App'x 674 (9th Cir. 2011).

tion clause, under § 365.[262] The bankruptcy court incorrectly said this particular contract was no longer executory because it was breached,[263] and the District Court affirmed, ruling that the contract was not executory because there were no outstanding obligations when the Debtor filed his petition,[264] even though the separable agreement to arbitrate was executory.

2. *Tempnology Defeats Arguments that Separability Enables Rejection of an Arbitration Agreement to Prevent its Enforcement*

The cases just discussed—*Monge Oil, Hays, Chorus Data*, and *Ebell Media*—failed to apply the separability doctrine. But they reached the right result of enforcing arbitration agreements notwithstanding (attempted) rejection. In contrast, the two outlier cases noted at the start of this Article—the *Janvey* district court and *Highland*—do the opposite. These two outlier cases recognize that arbitration agreements are separable from the contracts containing them, but then wrongly conclude rejection of an executory arbitration agreement prevents its enforcement with an order compelling arbitration. Both outlier cases quote Westbrook's observation that "an arbitration agreement is a classic executory contract,"[265] and the *Janvey* district court criticizes *Hays* for "simply assert[ing], with little to no analysis, that arbitration agreements are nonexecutory."[266] However, neither the *Janvey* district court opinion, which preceded *Tempnology*, nor the *Highland* opinion, which followed *Tempnology*, discussed it or explained why rejecting an executory arbitration agreement should prevents courts from specifically enforcing it against the estate. The *Highland* court says approvingly, "[a] counterparty to a rejected executory contract can merely seek monetary damages, Highland argues, but it cannot force a debtor to perform under a rejected executory contract."[267] This is incorrect because, as Part I of this Article explains, money damages' inadequacy for enforcing arbitration arbitrations is why the FAA and other modern arbitration statutes insist on specific enforcement, and why the vast majority of bankruptcy cases specifically en-

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[262]*Id.* at *3.

[263]*Id.* ("The Bankruptcy Court . . . explained that, even if the arbitration provision might have been subject to rejection if it was contained in an executory contract, the contract at issue had expired and was no longer executory.").

[264]*Id.* at *9-10 ("By the time of the bankruptcy filing, the time for the parties to perform had long passed. There were no longer any 'outstanding obligations at the time the petition for relief [was] filed,' and neither side had to perform anything further under the contract. The contract was therefore not executory.") (citations omitted).

[265]Janvey v. Alguire, Civil Action No. 3:09-CV-0724-N, 2014 U.S. Dist. LEXIS 193394, at *113 (N.D. Tex. Jul. 30, 2014); *In re* Highland Cap. Mgmt., L.P., No. 19-34054-SGJ11, 2021 WL 5769320, at *7 (Bankr. N.D. Tex. Dec. 3, 2021).

[266]*Janvey*, 2014 U.S. Dist. LEXIS 193394, at *113, n. 28.

[267]*In re* Highland Cap. Mgmt., L.P., 2021 WL 5769320, at *5.

force arbitration agreements against the estate, notwithstanding rejection. Moreover, Part I explains that *Tempnology*'s holding that rejection is breach, not rescission, supports this long line of cases holding, contrary to *Highland*, that the counterparty to a rejected arbitration agreement can compel the debtor or trustee to perform that agreement.

The *Janvey* district court quotes a law review article recognizing that denying specific enforcement of arbitration agreements "recreates the problems that the [Federal] Arbitration Act intended to resolve" because "[w]ithout specific performance, parties have no adequate measure of damages for nonperformance of an arbitration agreement."[268] But the *Janvey* district court tries to rebut this concern by quoting Supreme Court decisions saying "[t]he purpose of the FAA 'was to place an arbitration agreement upon the same footing as other contracts.'"[269] Yet, the Supreme Court's holdings requiring state courts to use specific performance rather than money damages to enforce arbitration agreements show that, on this crucial question of remedy for breach, the Supreme Court recognizes that the FAA places arbitration agreements on a stronger footing than most other contracts.[270] The view that "[a]rbitration agreements are nothing other than privately negotiated agreements," so they "should operate with no more force than any other privately agreed-upon contractual provision in bankruptcy,"[271] stops short of the crucial question of remedy for breach. The FAA emphatically requires courts to enforce arbitration agreements with the remedy of specific performance—this is the main reason for the FAA's enactment.[272] And although the U.S. Constitution allows federal bankruptcy law to override state law,[273] the Bankruptcy Code has no such priority over the FAA. So, nearly

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[268]*Janvey*, 2014 U.S. Dist. LEXIS 193394, at *113, n.29 (quoting Mette H. Kurth, *supra* note 93, at 1031).

[269]*Id.* at *117 (quoting Dean Witter Reynolds, Inc. v. Byrd, 470 U.S. 213, 219 (1985)). *See also* André Albertini, *Arbitration in Bankruptcy: Which Way Forward?*, 90 AM. BANKR. L.J. 599, 603 (2016) (quoting Dean Witter Reynolds, Inc. v. Byrd, 470 U.S. 213, 220 (1985)). *See also Id.* at 625 (the FAA did not make an arbitration agreement "a super-contract that" "enjoy[s] a preferential treatment."); Jason S. Brookner & Monica S. Blacker, *The Rejectability of Arbitration Clauses*, 26 AM. BANKR. INST. J. 1, 76-77 (April 2007) (the FAA "requires that arbitration contracts be given [only] the same deference as other contracts."); Note, *Jurisdiction in Bankruptcy Proceedings: A Test Case for Implied Repeal of the Federal Arbitration Act*, 117 HARV. L. REV. 2296, 2313-17 (2004) ("[E]xpress purpose of the FAA: to make arbitration contracts as enforceable as other forms of contract, but not more so.").

[270]Allied-Bruce Terminix Cos., Inc. v. Dobson, 13 U.S. 265, 281 (1995) (FAA § 2 preempts state law denying specific performance remedy to enforce arbitration agreements).

[271]Patrick M. Birney, *Reawakening Section 1334: Resolving the Conflict Between Bankruptcy and Arbitration Through an Abstention Analysis*, 16 AM. BANKR. INST. L. REV. 619, 666 (2008).

[272]*See supra* Part I.C.1.

[273]U.S. CONST. art. VI, cl. 2; Perez v. Campbell, 402 U.S. 637, 652 (1971) (holding that an Arizona discharge statute conflicted with, and thus was preempted by, federal bankruptcy law; "the controlling principle [is] that any state legislation which frustrates the full effectiveness of federal law is rendered invalid by the Supremacy Clause."); Sherwood Partners, Inc. v. Lycos, Inc., 394 F.3d 1198, 1203 (9th Cir.

all bankruptcy cases enforce the FAA's specific performance remedy, despite rejection under § 365, and rightly so.

Critics of specifically enforcing rejected arbitration agreements against the estate point out that § 365 gives the estate "the opportunity to reject unprofitable contracts."[274] And it is true that the estate might well, in many cases, be increased by allowing the estate to litigate rather than arbitrate whatever disputes are involved, perhaps because arbitrators are less likely than courts to rule for the estate on such disputes.[275] But breaches of agreements to arbitrate are not, as discussed above, the only breaches bankruptcy remedies with specific performance against the estate, notwithstanding the estate's rejection of the relevant contract.[276] And much as specifically enforcing an arbitration agreement against the estate might reduce the size of the estate, specifically enforcing against the estate other promises of the pre-bankruptcy debtor might also reduce the size of the estate. Both sorts of reductions follow from bankruptcy law under § 101(5)(B) deferring to non-bankruptcy law on which breaches cannot be converted into claims for money. That deference is well established.[277] So, any attempt to reduce that deference with respect to the right to compel arbitration, but not to other rights non-bankruptcy law protects only with equitable remedies, would discriminate against arbitration, and thus create an unnecessary conflict between bankruptcy law and the FAA. Bankruptcy law under § 101(5)(B)

2005) (discussing how the Bankruptcy Code preempts contrary state laws); *see also* Int'l Shoe Co. v. Pinkus, 278 U.S. 261, 265 (1929) ("States may not pass or enforce laws to interfere with or complement the Bankruptcy Act or to provide additional or auxiliary regulations."); *In re* Caliva, 992 F.2d 323 (5th Cir. 1993) ("the Bankruptcy Code . . . preempts state law by operation of the Supremacy Clause"); *In re* Goerg, 844 F.2d 1562, 1565 (11th Cir. 1988) ("Owing to the supremacy clause, federal bankruptcy law preempts state law.").

[274]Note, *Jurisdiction in Bankruptcy Proceedings: A Test Case for Implied Repeal of the Federal Arbitration Act*, 117 HARV. L. REV. 2296, 2313-17 (2004). *See also* André Albertini, *Arbitration in Bankruptcy: Which Way Forward?*, 90 AM. BANKR. L.J. 599, 624-26 (2016) (allowing estate to prevent enforcement of executory arbitration agreements "would further the pro-estate policy of the Bankruptcy Code by allowing the debtor-in-possession or trustee in bankruptcy to preserve and/or maximize, always under the supervision of the bankruptcy court, the value of the estate depending on the particulars of the case."); Jason S. Brookner & Monica S. Blacker, *The Rejectability of Arbitration Clauses*, 26 AM. BANKR. INST. J. 1, 76-77 (April 2007) ("[T]he [Bankruptcy] Code permits DIPs to retain contracts that are valuable to the estate and reject those that are not. To the extent an arbitration clause is not of value or benefit to the estate, it should be treated the same as other executory contracts and should be subject to rejection by the DIP or the trustee."). *See generally* TABB, LAW OF BANKRUPTCY, 820 ("[I]f the non-bankruptcy law would give the non-debtor party an equitable remedy in the event of the debtor's breach, bankruptcy policy must be considered to determine the ultimate effect of rejection. That is, even if the non-debtor would enjoy an equitable remedy outside of bankruptcy, they ultimately might not prevail in bankruptcy, because there may be other bankruptcy policies that supersede the non-debtor's equitable remedies. One such bankruptcy policy is the fresh start, and another is equality of treatment of creditors.").

[275]*See* Kurth, *supra* note 93, at 1004-05.

[276]*See supra* Part I.B.3.

[277]*Id.*

harmonizes with the FAA by treating the right to compel arbitration as it treats other rights non-bankruptcy law protects only with equitable remedies.

III. CONCLUSION

In sum, arbitration agreements are separable executory contracts specifically enforceable, despite rejection under § 365. So, either party—the estate or its counterpart—is entitled to specific performance of the pre-bankruptcy debtor's arbitration agreement regardless of whether the rest of the contract containing it is executory. And either party is entitled to specific performance of the arbitration agreement regardless of whether the estate has rejected it and the broader contract containing it or rejected only the arbitration agreement while assuming the broader contract containing it. Bankruptcy law harmonizes with the FAA by treating the right to compel arbitration as it treats other rights non-bankruptcy law protects only with equitable remedies. A long line of cases recognizes and applies this. *Tempnology* reinforces this long line of cases and should prevent outliers like the two noted at the start of this Article.