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Commercial Leases In Economic Distress: Pre- and Post-Bankruptcy Strategies for Landlords

Negotiating Lease Modifications With Distressed Tenants, Participating in the Bankruptcy Process

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OVERVIEW – IMPACTS OF COVID-19

The COVID-19 pandemic has had swift, far-reaching effects on the U.S. economy:

- Starting in mid- to late March, states and localities across the country ordered the closure of businesses classified as non-essential, including many retail stores, gyms, theaters and restaurants (except for delivery, drive-through and take-out orders), and issued stay-at-home orders for non-essential employees.
- As a result of business closures and stay-at-home orders, many businesses, especially in the retail, restaurant, travel and hospitality sectors, have suffered steep declines in revenue and laid off significant numbers of employees.

OVERVIEW – IMPACTS OF COVID-19 (cont.)

- Since mid-March, more than 40 million people have filed unemployment claims. The overall U.S. unemployment rate in April was 14.7%.*
- Certain sectors are experiencing higher unemployment rates including hospitality and leisure (39.3%), retail (17.1%), and construction (16.6%).**
- Other sectors are less impacted such as professional and business services (9.8%), government workers (9.4%), and financial activities (5.4%).**

* Bureau of Labor Statistics, Unemployment Weekly Claims, May 28, 2020, accessed at: <https://www.dol.gov/ui/data.pdf>.

** Statista.com, Unemployment rate in the United States by industry and class of worker in April 2020, accessed at: <https://www.statista.com/statistics/217787/unemployment-rate-in-the-united-states-by-industry-and-class-of-worker/>.

EFFECTS OF COVID-19 ON COMMERCIAL LEASES

- Although many states are now easing lockdown orders, the effect of the COVID-19 pandemic and resulting business closures and job losses have had significant effects on many commercial tenants, particularly those in the retail, restaurant, personal services, travel and hospitality sectors.
- Office tenants have been less severely impacted. In Manhattan, for example, according to real estate firm JLL, there was a significant spread between April rent payments made by office tenants (90%) and retail tenants (54%).*
- 25% of office tenants in JLL-managed properties in New York City and the tri-state (NY, NJ and CT) suburbs made rent deferral requests in April.*

* JLL Research, JLL Property Management.

CURRENT TRENDS IN COMMERCIAL TENANT BANKRUPTCIES

- Large increase in business bankruptcy filings under Chapter 7 and 11 in most sectors of the economy (not just retail).
- Extensive use of commercial tenant's rights to: (a) reject leases for underperforming locations, to downsize space needs or exit over-market leases; and/or (b) assume and assign leases as part of business sales.
- Increase in negotiation of rent and space reductions/restructurings, cure amounts and other lease terms in connection with lease assumption agreements to avoid lease rejections and preserve leasing relationships.
- Increase in landlord demands for credit enhancements and stronger recapture rights in connection with lease modification-assumption agreements or lease assignments to buyers.

INCREASE IN CH. 11 BANKRUPTCIES

Nationwide Chapter 11 Commercial Filings

- Average of 5,500 annual filings between 2015-2019.
- Approx. 3,000 annual filings between January-May 2020 (projected filings for 2020 exceed 7,500).
- COVID-19 delay in larger wave of commercial filings.

NOTABLE LARGE BANKRUPTCIES SINCE COVID-19 OUTBREAK

- Retail: J. Crew; Neiman Marcus; JC Penney's; John Varvatos Enterprises; Modell's; Stage Stores; Pier 1; True Religion Apparel; Art Van Furniture etc.
- Energy: Diamond Offshore Drilling; Whiting Petroleum; Ultra Petroleum; Pioneer Energy; etc.
- Travel/Hospitality/Entertainment: Hertz; Avianca Airlines; Virgin Australia Airlines; Latam Airlines; Flybe Airlines (UK); Owners of Ritz-Carlton Lake Las Vegas, Sheraton Downtown Orlando and The Tropicana in Las Vegas; Apex Parks Group; CMX Cinemas etc.
- Food/Restaurants: Bar Louie; Cusi; Dean and DeLuca; Craftworks etc.

INCREASE IN SMALL BUSINESS BANKRUPTCIES

- Subchapter V of Ch. 11 of Bankruptcy Code created by 2019 Small Business Reorganization Act (effective February 2020).
- Available to business debtors with non-contingent, liquidated secured and unsecured debt \leq \$7,500,000 until March 2021 under the CARES Act (debt cap originally was \$2,725,625).
- Major advantages to debtors under Subchapter V:
 - Makes Chapter 11 more accessible and less expensive for smaller businesses and increases chances of successful reorganization.
 - Affords smaller tenants leverage to renegotiate or reject leases.
 - Allows debtors to pay administrative claims over 3-5 year plan.
 - Allows owners of tenant to retain equity interests by eliminating requirement that owners contribute “new value” to the business.

COMMERCIAL LEASES AND RENT RELIEF: CURRENT PRE- BANKRUPTCY TRENDS

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COMMERCIAL LEASES AND RENT RELIEF

- The COVID-19 pandemic has prompted both commercial landlords and tenants to review their leases to understand their rights and obligations in the face of the pandemic.
- Force majeure clauses in commercial leases can excuse parties from the performance of certain obligations if specific events or conditions arise.
- However, these clauses typically do not relieve a tenant of the obligation to pay rent.
- As such, many tenants have approached their landlords to request some type of rent relief.

HIGH-LEVEL CONSIDERATIONS IN RENT RELIEF DISCUSSIONS

In entering into discussions with a tenant regarding rent relief, landlords should assess the tenant's financial condition and likelihood that the tenant's business can reasonably recover in the mid- to long-term.

- Current financial information for the tenant should be obtained and reviewed.
- It should be confirmed whether the tenant has applied for or received any aid under the CARES Act or other government programs, or insurance proceeds.
- Landlords will want to craft rent relief as a short-term bridge to tide the tenant over until the point that their business can achieve some level of sustainable recovery.

RENT RELIEF – CURRENT TRENDS

Rent relief is being negotiated on a case-by-case basis, but trends include:

- Rent deferral (as opposed to outright abatement or waiver) for an agreed period (3 months is common, for example April – June).
- Deferred rent can be handled in different ways:
 - Repayment over an agreed period later in the lease term.
 - Lease term is extended for the deferral period.
- Landlords in some cases are granting full or partial rent abatement for agreed periods.
- In some cases there is combination of rent abatement (e.g., April – May) and rent deferral for following period.

RENT DEFERRAL – KEY CONSIDERATIONS

Key issues to consider when structuring a rent deferral:

- What month(s) of rent will be deferred.
- Whether rent will be deferred in full or in part for such months.
- When repayment starts, and period of repayment.
 - The tenant will have to make repayments in addition to regularly monthly rent due during the repayment period, so assess whether tenant will be able to support this.
- In most cases, landlords will want additional rent to continue to be payable during the deferral period.
- Right to accelerate/make unpaid deferred rent immediately payable upon a future default.

RENT ABATEMENT – KEY CONSIDERATIONS

Key issues to consider when structuring a rent abatement:

- What month(s) of rent will be abated.
- Whether rent will be abated in full or in part for such months.
- Whether to extend the lease term for the abatement period.
- In most cases, landlords will want additional rent to continue to be payable during the deferral period.
- Right to reinstate/make abated rent immediately payable upon certain events of default.

ACCELERATION/REINSTATEMENT OF DEFERRED OR ABATED RENT

A lease amendment granting rent relief should allow Landlord to declare the rent deferral or abatement null and void, and make the deferred or abated rent immediately due and payable, upon the occurrence of certain defaults, including:

- A breach by Tenant of any representations, warranties, covenants or terms of the rent relief amendment.
- A default by Tenant under the lease (other than the failure to pay the abated or deferred rent when originally due) beyond any applicable notice and cure periods.
- A general assignment by Tenant or any guarantor of the lease for the benefit of creditors, or the filing of any bankruptcy petition.
- The rejection or deemed rejection of the lease in any bankruptcy or insolvency proceeding.

OTHER PROVISIONS TO CONSIDER

- Confidentiality of amendment/rent relief terms. Remedies should include damages and equitable/injunctive relief.
- As noted above, if possible a creditworthy guarantor should guarantee payment of abated rent and deferred rent if reinstated or accelerated. If there is an existing lease guaranty, a joinder can be included in the lease amendment by which the guarantor agrees that such obligations are part of the obligations under the guaranty and otherwise affirms that the guaranty remains in full force and effect.

OTHER PROVISIONS TO CONSIDER

(cont.)

- Include representations, warranties and estoppel statements that the lease is in full force and effect, that the landlord is not in default of its obligations and has completed all improvements and paid all allowances required to be performed or paid by the landlord under the lease
- Lease amendment should contain a waiver by the tenant of all claims, defenses or setoffs against the tenant's obligation to pay base rent and other amounts due under the lease, under any legal theory, and a release of all claims the tenant may have against the landlord as of the date of the amendment.

OTHER ISSUES TO CONSIDER: COORDINATION WITH LENDERS

- Landlords may need lender consent to enter into lease modifications with tenants.
 - Landlords should review their loan documents to determine any lender consents that may be needed for proposed loan modifications.
 - If lender consent is required, it should be made clear to the tenant that entering into the amendment is contingent upon obtaining lender consent.
- Depending on the rent relief being provided (by itself or in the aggregate with other tenants), a landlord may need a forbearance or corresponding mortgage relief from its lender. This should be discussed with the lender concurrently with rent relief discussions with tenants.

OTHER ISSUES TO CONSIDER: GOVERNMENT ORDERS

- Eviction moratoriums ordered in various states.
 - New York State: by executive order, no eviction of any residential or commercial tenant until June 20, 2020. The moratorium was extended for 2 months, until August 20, 2020, only for residential and commercial tenants who qualify for unemployment benefits or are otherwise facing “financial hardship” due to COVID-19.
 - California: California Judicial Council ordered moratorium on all eviction proceedings until 90 days after California’s state of emergency is ended by the governor.
- Rent relief legislation pending in New York State: 90-day rent waiver for residential or small-business tenants who have lost income or been forced to close due to COVID-19.

IMPACT OF TENANT'S RECEIVING GOVERNMENT OR OTHER FUNDS

An option that may be included in a rent relief amendment should address what happens if the tenant receives assistance from government relief programs or insurance proceeds after the granting of the rent relief:

- The government relief proceeds (to the extent permitted under the terms of such government relief program) or insurance proceeds, as applicable, should be paid to the landlord, which will be applied first to the then-outstanding balance of the rent relief amount and second, to any other unpaid rent then due under the lease.
- Until the rent relief amount has been fully repaid to Landlord, the tenant should not pay any fees, charges, compensation or distributions to its members, shareholders, and affiliates.

FINAL THOUGHTS ON RENT RELIEF DISCUSSIONS AND AMENDMENTS

- Even after states re-open, many tenants, particularly retail and restaurant, will likely continue to face financial difficulty due to social distancing requirements and reluctance by the public to patronize businesses until a COVID-19 vaccine is developed.
- For some tenants whose prospects for recovery are unlikely, rent relief may just delay the inevitable and they may need to look at alternatives such as filing for bankruptcy.
- It will be in the interest of both landlords and tenants to communicate openly and candidly, understand the constraints facing each party, and deal with each other reasonably and in good faith.

CURRENT LEGAL ISSUES IN BANKRUPTCIES OF COMMERCIAL TENANTS

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LEGAL ISSUES WHEN COMMERCIAL TENANTS FILE FOR BANKRUPTCY

- What actions are landlord and tenant allowed or prohibited from taking with respect to the lease and the parties' obligations?
- How will the bankruptcy proceeding affect the parties' rights and obligations under the lease?
- What happens if the tenant stops paying rent or rejects the lease during the bankruptcy?
- How does a tenant's sale impact the lease and premises?

AUTOMATIC BANKRUPTCY STAY

- Bankruptcy stay commences automatically from filing of the bankruptcy petition (11 U.S.C. §362(a)).



- Stay is nationwide, broad in scope and non-waivable.

SCOPE OF AUTOMATIC STAY

Automatic stay prohibits, subject to certain exceptions, all creditors or other persons/entities from:

- Commencing or continuing any judicial, administrative or other action against the debtor to recover on a claim that arose prior to the commencement of the case
- Enforcing a judgment obtained before the commencement of the case
- Taking any act to obtain possession of property of the estate or to exercise control over property of the estate
- Taking any act to create, perfect or enforce a lien against property of the estate

STAY APPLIES TO ACTIONS AGAINST PROPERTY OF DEBTOR'S ESTATE

- Property of bankruptcy estate includes all legal or equitable interests of the debtor in property as of the commencement of the case (whether property comprises real estate, personalty or mixed property).
11 U.S.C. §541(a)
- Property of estate covers debtor's rights and interests in intangible property such as leases, contract rights, causes of action, insurance policies, licenses, trademarks and other types of intellectual property.

STAY PROHIBITS MOST LANDLORD ACTIONS

- Bars giving debtor written or verbal notice of default, demand for unpaid rent or notice to quit and surrender the leased premises.
- Bars set-off of cash security deposits or pledged accounts (11 U.S.C. §362(a)(7)), or exercising self-help remedies such as lockouts.
- Bars continuing or filing any lawsuit to recover rent or possession of premises.
- Bars sending debtor a notice exercising any rights or remedies such as notices to terminate a lease, accelerate rent or exercise a right of right of first refusal.

SPECIAL SITUATIONS REGARDING THE STAY

- Guarantors: Stay does not bar landlord from enforcing (a) guarantees of third parties such as individual and corporate owners and affiliates of tenant, so long as guarantors did not also file for bankruptcy protection, and (b) rights and remedies against collateral owned by guarantors.
- Leases Expired Pre-Bankruptcy: In most cases, stay bars landlord from taking action to repossess leased premises that is still occupied by debtor-tenant even when the term of the lease expired before the bankruptcy filing. Most bankruptcy courts have held that a debtor's mere possessory interest in the premises is protected by the stay in order to sidestep 11 U.S.C. § 362(b)(10) (providing that stay does not apply to landlord's act to obtain possession under a commercial lease that expired pre-bankruptcy).
- Best Practice: When in doubt, a landlord should file a motion and obtain an order from the bankruptcy court lifting the stay to allow landlord to take action to recover possession of the premises.

LETTERS OF CREDIT AND THE STAY

- General Rule: Most courts have held that the stay does not bar a landlord from drawing on a letter of credit (LC) issued by a financial institution to landlord as beneficiary because the landlord is enforcing an obligation of the issuer of the LC (not the tenant) and LC and its proceeds are not property of the debtor's estate. See *Int'l Finance Corp. v. Kaiser Group Int'l, Inc.*, 399 F.3d 558 (3d Cir. 2005); *American Bank of Martin County v. Leasing Serv. Corp.*, 845 F.2d 293 (11th Cir. 1988); *OHC Liquidation Trust v. Discover Re*, 342 B.R. 59 (Bankr. D. Del. 2006); *Elegant Merch., Inc. v. Republic Nat'l Bank*, 41 B.R. 398 (Bankr. S.D.N.Y. 1984).
- Special Issues: (a) draw terms should not require landlord to provide notice of default or of landlord's intention to make demand under letter of credit; (b) risk of bankruptcy court enjoining draw on LC under 11 U.S.C. § 105(a); and (c) landlord may be required to return excess proceeds drawn on LC. See *Two Trees v. Builders Transport, Inc.*, 471 F.3d 1178 (11th Cir. 2006); *PNC Bank, N.A. v. Spring Ford Indus., Inc.*, 338 B.R. 255 (E.D. Pa. 2006).
- Best Practices: Landlords and their counsel should carefully review draw terms of a letter of credit and the decisions of courts in the circuit in which the tenant files its bankruptcy with respect to the stay and letters of credit.

BEST PRACTICE WHEN FACED WITH STAY ISSUE

- To avoid potentially violating the stay and being sanctioned, landlord should confirm it clearly does not apply or obtain advance bankruptcy court relief from the stay (your get out of bankruptcy card)



UNENFORCEABLE IPSO FACTO CLAUSES

- Bankruptcy Code bars effectiveness of most “ipso facto” clauses that terminate or modify an unexpired lease or executory contract (and any right or obligation thereunder) based upon the tenant’s bankruptcy filing or insolvency or the appointment of a trustee during the bankruptcy case. See 11 U.S.C. § 365(e)(1).
- Section 365(e)(1) renders unenforceable clauses in a lease providing that a tenant’s bankruptcy filing or insolvency automatically (a) constitutes a tenant event of default or termination of the lease, or (b) reinstates abated/waived rent under the lease or an amendment granting rent relief to tenant due to business shutdowns or losses as a result of the COVID-19 pandemic.
- Does a lease clause terminating a landlord’s duty to pay for or make tenant improvements upon tenant’s bankruptcy filing fall within the exception to Section 365(e)(1) for agreements “to make a loan, or extend other debt financing or financial accommodations to or for the benefit of the debtor” under 11 U.S.C. §365(e)(2)?

ISSUES WITH REINSTATING ABATED RENT AFTER TENANT BANKRUPTCY

- A clause reinstating abated rent upon a tenant's bankruptcy filing or insolvency event is most likely an unenforceable ipso facto clause. Alternatives to mitigate this risk and claw back the abated rent:
 - Agreement provides for rent to be deferred and waived if no event of default or bankruptcy filing occurs before expiration of the deferral period.
 - Agreement provides that abated or deferred rent would be reinstated or accelerated, respectively, upon the filing of any motion to assume the lease in the bankruptcy.
 - Require a creditworthy entity or person to guarantee payment of the abated rent if the tenant files for bankruptcy or becomes insolvent.

TENANT'S POST-PETITION PERFORMANCE OF LEASE OBLIGATIONS

- General Rule: Tenant is required to perform lease obligations arising from and after the filing of the bankruptcy until the lease is assumed or rejected, without landlord having to first demonstrate that such rent constitutes the “actual, necessary costs and expenses of preserving the estate” as is required for the payment of an administrative expense claim under Section 503(b)(1)(A). See 11 U.S.C. § 365(d)(3).
- Exceptions:
 - Tenant is not required to comply with ipso facto clauses or to pay penalties arising from failure to perform non-monetary obligations.
 - If court extends, for cause, the time for tenant's performance of obligations that arise within 60 days of filing.

STUB RENT ISSUE

- “Stub rent” refers to unpaid rent for the period after a tenant files for bankruptcy and before the next date when rent comes due. For example, if a lease requires rent on the first of each month, and the petition date falls on the 10th day of the month (and assuming that rent was not paid prior to the petition date), “stub rent” is the rent for the period from the 10th day of the month through the end of the month.
- Tenants often time their filing for after the first of the month to:
 - Preserve cash flow during the beginning of the case; and
 - Eliminate or reduce the amount of rent that must be paid during the first month of the case.

STUB RENT ISSUE CONT'D

- Is tenant required under Section 365(d)(1) to pay stub rent?
There's a split among the courts over this issue:
 - Billing Date Rule: Many courts follow the “billing date” approach, whereby the rent obligation arises when it becomes payable under the lease. If the payment date falls after the petition date, tenant's post-petition payment is required (meaning only part of the stub rent must be paid); but if it falls before the petition date, it is not (meaning no stub rent has to be paid). Approach adopted by the Courts of Appeal for the Third, Sixth and Seventh Circuits.
 - Proration Rule: Other courts employ the alternative proration approach whereby the tenant is required to pay all stub rent . Approach adopted by the Second, Fourth and Ninth Circuits.

LANDLORD ADMINISTRATIVE RENT CLAIMS

- As an alternative to landlord right to post-petition rent under Section 365(d)(3)(and to obtain stub rent in billing date jurisdictions), landlords may also be entitled to rent as an administrative expense under 11 U.S.C. §503(b)(1)(A), if the landlord generally demonstrates that debtor occupied or operated at the premises, thereby conferring a benefit on the debtor's estate. See, e.g., *In re Goody's Family Clothing Inc.*, 610 F.3d 812 (3d Cir. 2010).
- Allowed landlord administrative rent expense claims have priority over unsecured creditors' claims. See 11 U.S.C. § 507(a)(2).
- Administrative rent expense claims are often paid in the ordinary course; however, the court may defer payment until the time of lease assumption or plan confirmation.

NON-PAYMENT OF POST-PETITION RENT

- Debtor lacks sufficient cash flow to paying its reasonable operating, payroll and other administrative expenses due to continuing losses (debtors in Barney's, Toys R Us and Forever 21 cases became administratively insolvent during proceeding).
- Debtor's authority to use its cash and receivables is limited or terminated under the terms of the orders approving debtor-in-possession financing (DIP financing) and/or use of cash collateral .
- Court converts Ch. 11 case to Ch. 7 liquidation.
- Best Practices: (1) regularly monitor bankruptcy for events showing that debtor's case is going "sideways"; and (2) promptly after tenant misses rent payment, landlord should file a motion to lift the stay to repossess the premises or, alternatively, to compel payment of post-petition rent.

LEASE ASSUMPTION OR REJECTION

- Leases of nonresidential property are deemed rejected if the Debtor-tenant does not assume the lease within 120 days after bankruptcy filing. 11 U.S.C. §365(d)(4)(a)(1). Debtor may assume or reject all other executory contracts until time of confirmation of a plan.
- Court ordinarily will extend lease assumption/rejection period up to 90 days for “cause” if debtor files extension motion within initial 120 day period. 11 U.S.C. §365(d)(4)(b)(1).
- Court may further extend the period “only upon written consent of the lessor”. 11 U.S.C. §365(d)(4)(b)(2). This often occurs when there are ongoing negotiations with landlords regarding lease modifications, especially where debtor is paying “over-market” rents.

LANDLORD MOTION TO COMPEL EARLY LEASE ASSUMPTION OR REJECTION

- Landlord should consider filing motion to compel tenant to assume or reject lease before the expiration of the 120 day period under 11 U.S.C. §365(d)(2). Court's determination of motion is within its discretion and ordinarily entails balancing the relative harm to tenant's estate against risk of landlord economic loss and uncertainty.
- Risk of significant harm or loss to landlord if time for lease assumption or rejection is not accelerated as a result of:
 - Landlord expenditure of substantial funds if, for example, it is required to perform base building or tenant improvements, or commence restoring premises after a casualty event;
 - Tenant's likely closure of its operations at leased premises in near term;
 - Likely administrative insolvency of tenant (especially if tenant waived its right to surcharge secured creditors' collateral for administrative expenses including post-petition rent under 11 U.S.C. § 506(c)); and/or
 - Landlord's securing of replacement tenant.

TENANT REJECTION OF LEASE

- Tenant rejection of a lease is within business judgment of debtor and generally impossible for landlord to successfully object to. Effects of rejection of lease:
 - Lease is no longer property of the debtor's estate and tenant is relieved of further compliance with lease obligations.
 - Tenant is required to surrender possession of premises to landlord. See 11 U.S.C. § 365(d)(4)(A).
 - Rejection constitutes tenant's breach immediately before the petition date (not treated as a termination of lease). See 11 U.S.C. § 365(g)(1).
 - Landlord will have a general unsecured claim for pre-petition rent and damages, and post-petition rejection damages.

TENANT ASSUMPTION OF LEASE

- Debtor may assume an executory contract or unexpired lease by curing existing defaults and providing adequate assurance of future performance. 11 U.S.C. §365(b)(1).
- Benefits of Assumption: (a) unpaid pre- and post-petition rents paid in full; and (b) landlord no longer subject to preference exposure for payments received during 90 day period before bankruptcy filing.
- Best Practice: It is critical that landlord diligently monitor the bankruptcy to ensure that it knows when debtor files a motion to assume or reject its lease so that landlord can timely object, especially to the amounts that debtor proposes to pay to cure lease default.

SPECIAL LEASE ASSUMPTION SITUATIONS

- Go Dark Defaults: If a default includes tenant's failure to operate at the premises, debtor's cure obligations will require it to commence operating and paying landlord any pecuniary losses resulting from such default. 11 U.S.C. §365(b)(1)(a).
- Shopping Centers: Where debtor leases space in a shopping center, debtor is required to provide adequate assurance with respect to: payment of percentage rent; compliance with radius, location, use or exclusivity provisions; and tenant mix or balance within the center. 11 U.S.C. §365(b)(3)

LEASE ASSUMPTION AND SALES

- Increasing number of “liquidating Chapter 11s” involving a sale of tenant’s business followed by a liquidating plan.
- Sale process often represents a landlord’s best – and often only – opportunity to obtain payment of rent arrearages (instead filing an unsecured claim).

BANKRUPTCY SALE PROCESS

Sale Procedures Approved – Court approves bidding, auction, cure notice, and other sale procedures.



Cure Notices – Debtor notifies contract counterparties of the proposed “cure amount” for each executory contract. Counterparties have an opportunity to object.



Bid Solicitation – After due diligence, bidders designate assets (including executory contracts) they want to acquire.



Auction and Sale Hearing – If multiple bids are received, Debtor holds an auction. Court determines “highest and best” bid, hears objections and (typically) approves sale.



Closing – Sale closes and assets and/or stock are transferred. Cure amounts are paid to counterparties of assumed and assigned contracts.

ASSIGNMENT OF LEASES

- Requirements for assigning a lease under 11 U.S.C. § 365(f)(2):
 - Tenant must first satisfy requirements for assuming lease including curing defaults under the lease; and
 - Tenant must also demonstrate that the proposed assignee's (and its owner's) financial resources and operating experience will provide adequate assurance of its future performance under the lease.
- Tenants are permitted to assign an unexpired lease notwithstanding a provision “that prohibits, restricts, or conditions the assignment” of the lease. 11 U.S.C. § 365(f)(1). Anti-assignment provisions of leases should be preserved for future application.

ASSIGNMENT OF LEASES CONT'D

- Additional requirements of adequate assurance must be satisfied with shopping center leases (11 U.S.C. § 365(b)(3)), including:
 - Assignee will comply with all “radius, location, use, or exclusivity provision[s]” of the lease or any other lease, financing agreement, or master agreement relating such shopping center.
 - “[F]inancial condition and operating performance of the proposed assignee and its guarantors, if any, shall be similar to the financial condition and operating performance of the debtor and its guarantors, if any, as of the time the debtor became the lessee under the lease.”
 - Assignment must “not disrupt any tenant mix or balance in such shopping center.”
 - If lease requires the payment of percentage rent, tenant must demonstrate “that any percentage rent due under such lease will not decline substantially”.

LANDLORD OBJECTIONS TO AUCTION AND ASSIGNMENT PROCEDURES

- Potential objections of landlords to debtor's motion to approve auction, sale and lease assumption and assignment procedures:
 - Procedures fail to provide landlord adequate notice and time to object to assignment with respect to proposed cure amounts, the identification of the successful bidder and the delivery of its adequate assurance information.
 - Procedures fail to require disclosure of sufficient adequate assurance information with respect to the financial condition of the winning bidder and any guarantor, or the heightened requirements for shopping center leases.
 - Procedures fail to provide for payment by tenant or assignee of: (a) unbilled year-end adjustments and reconciliations and third party claims; and (b) rent during any designation of rights period.
 - Procedures fail to allow landlord to bid on its lease, credit bid the amounts due under the lease and qualify as a bidder without a deposit.

LANDLORD MAY BID AT LEASE AUCTION

- Landlords may choose to bid on their own leases to secure ability to terminate them for various reasons:
 - Prevent sale to unknown third party buyer.
 - Prevent sale to third party buyer for objectionable use of premises.
 - Secure landlord's ability to redevelop the property.
 - Secure landlord's ability to assemble multiple spaces or pads that include debtor's premises for lease to new tenant.
- In Toys "R" Us the bankruptcy court authorized landlords to submit bids to terminate their own leases, including by "credit bidding" the amount of rent arrearages. Landlord may augment credit bid with cash bid to compete against other bidders.

LANDLORD PROOF OF CLAIM

- Landlord entitled to file unsecured proof of claim for:
 - Uncapped Claim: All unpaid pre-petition rent, damages, interest and attorney's fees authorized under the lease; and
 - Capped Claim: Damages resulting from termination or rejection of the lease capped at the rent due under the lease, without acceleration, for the greater of either (a) 1 year, or (b) 15% of the remaining lease term (not to exceed 3 years' rent). The foregoing rent starts on the earlier of the bankruptcy filing date or the date on which landlord repossessed or accepted tenant's surrender of the premises (under applicable state law). See 11 U.S.C. § 502(b)(6).

LANDLORD PROOF OF CLAIM CONT'D

- Disposition of tenant security deposit and letter of credit?
- Many courts require a landlord to apply cash security deposit and letter of credit proceeds to reduce the capped portion of landlord's rejection damage claim. See, e.g., *Solow v. PPI Enterprises (U.S.), Inc. (In re PPI Enterprises (U.S.), Inc.)*, 324 F.3d 197 (3d Cir. 2003); and *AMB Property, L.P. v. Official Creditors ex rel. AB Liquidating Corp. (In re AB Liquidating Corp.)*, 416 F.3d 961 (9th Cir. 2005); contra *EOP-Colonnade of Dallas Ltd. P'ship v. Faulkner (In re Stonebridge Technologies, Inc.)*, 430 F.3d 260 (5th Cir. 2005)(landlord did not file proof of claim because its claim was fully covered by its cash security deposit and letter of credit proceeds).

DEBTOR ELIGIBILITY FOR PPP LOAN

- Are tenants in bankruptcy eligible for loans under the CARES Act's Paycheck Protection Program (PPP)?
- CARES Act silent as a bankruptcy bar; however, under the SBA's interim rule, a company is ineligible to apply for a PPP loan after it files for bankruptcy, or to receive during the bankruptcy funds from a PPP loan applied for pre-petition.
- Bankruptcy courts have split on enforcing versus enjoining the SBA's rule with respect to debtors. Compare Hidalgo County Emerg. Serv. Fund v. Caranza, Case No. 19-20497, Adv. P. No. 20-2006 (Bankr. S.D. Tex. April 25, 2020)(enjoining SBA rule), with Cosi, Inc. v. SBA, Case No. 20-10417, Adv. P. No. 20-50591 (Bankr. D. Del. April 30, 2020)(upholding SBA rule).

Thank You

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