Post-Bankruptcy Issues for Commercial Landlords – Assumption and Rejection of Leases in Chapter 11 Cases

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The following is the third in what will be a series of posts addressed to commercial landlords regarding bankruptcy.

Consider the following - A Chapter 11 bankruptcy case is filed. The landlord now has a tenant that is in bankruptcy. This is a disaster for the commercial landlord, right? Not necessarily. It actually may be of benefit to the landlord in the short and the long term. Indeed, the landlord very well may end up with a better tenant and all outstanding defaults cured.

Under section 365 of the Bankruptcy Code, a debtor may reject a lease or it may assume and then even assign the lease to a third party. The debtor has an initial 120-day period to make this decision, however the debtor may obtain an additional 90-day period extension from the court. After this one additional extension, any further extensions are subject to a landlord agreeing to such extensions in writing. In other words, the landlord has the absolute right to force decision by the debtor to assume or reject a lease within 210 days of the bankruptcy filing.

If the debtor rejects a lease, it is treated as a breach and the landlord is able to retake possession of the premises. The landlord may file a proof of claim for the pre-bankruptcy damages, the lease rejection damages for future rent – which is subject to a statutory cap (calculation of the cap is for another blog), and any other damages. Separately, the landlord may file a separate request for the payment and the allowance as an administrative expense claim for pre-rejection post-bankruptcy filing amounts due under the lease. The advantage of holding an administrative expense is the amounts must be paid for the debtor to confirm its Chapter 11 plan.

In order to assume a lease, the debtor must cure or provide adequate assurance that it will promptly cure all defaults under the lease. The debtor must also adequately assure the landlord of future performance under the lease. As a result, assumption is often ideal for a landlord because they will not only have all amounts due under the lease paid in full, but they will also have some assurance that the reorganized debtor can perform under the lease.
Often a lease is not just assumed, but it is assigned to a third-party buyer of the assets of the debtor. Can a debtor assign a lease without the landlord's consent? The answer in this case is 'yes.' The Bankruptcy Code does not recognize anti-assignability provisions in a lease. However, the Bankruptcy Code does protect landlords in connection with a lease assignment. Again, the assignee must provide adequate assurance that it will be able to perform under the lease.

If the lease qualifies as "a lease for real property in a shopping center," the landlord is entitled to adequate assurance for certain specific obligations in connection with the assumption and assignment of the lease. "Adequate assurance" is intended to protect a landlord from a decline in value of the demised premises if a lease is assumed. It includes requirements that: (1) the financial condition and operating performance of any assignee be similar; (2) percentage rent not decline substantially; (3) all other provisions of the lease continue to apply, such as exclusive use clauses; and, (4) the tenant mix or balance at the shopping center must not be disrupted.

The above is a short summary of a somewhat technical area of law, is for informational purposes only and does not constitute legal advice. You should always work with your attorneys at Shutts & Bowen to assist you with this process and we hope this has helped to provide you with some background to better discuss your needs with counsel.

About James A. Timko

James A. Timko is a partner in the Orlando office of Shutts & Bowen, where he is a member of the Creditors' Rights/Bankruptcy Practice Group and a business litigator. James has received Martindale-Hubbell's highest rating as an attorney whose practice involves distressed assets, bankruptcy and commercial litigation. He's also a certified circuit civil mediator. James represents creditors, debtors, secured, lenders, mortgage companies, landlords, franchisors, bankruptcy trustees and other business enterprises in chapter 7 and chapter 11 bankruptcy cases and in assignment for the benefit of creditors' cases. James also has significant experience resolving general commercial disputes, including copyright disputes. He's also represented institutional lenders in connection with asset based lending transactions and real estate transactions.

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Post-Bankruptcy Issues for Commercial Landlords - Assumption and Rejection of Leases in Chapter 11 Cases