



Collection Techniques for Landlords: *Assumption, Assignment and Rejection of Lease*

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ASSUMPTION, ASSIGNMENT & REJECTION OF LEASE

A. Assumption

1. Debtor must assume contract subject to the benefits and burdens thereunder. *In re ANC Rental Corp.*, 277 B.R. 226, 238 (Bankr. D. Del. Debtor agrees to be bound by the contract and to continue to perform
2. Requirements – If lease is in default
 - (A) Debtor must cure default or provide adequate assurance of “prompt cure”
 - (a) “Prompt Cure” Factors
 - (i) Debtor’s past financial performance
 - (ii) Any inequitable acts by Debtor
 - (iii) Harm suffered by contract party by Debtor’s past defaults
 - (iv) Term of the contract
 - (B) Landlord must be compensated for losses arising from default
 - (C) Debtor must provide “adequate assurance” of future performance
 - (a) Adequate Assurance NOT defined in bk code
 - (b) Adequate Assurance can be:
 - (i) Letters of credit
 - (ii) Security deposit
 - (iii) Third party guarantee, etc.
 - (c) Factors to consider
 - (i) Debtor’s payment history;
 - (ii) Presence of a guarantee;
 - (iii) Presence of a security deposit;

- (iv) evidence of profitability;
 - (v) a plan which would earmark money exclusively for the landlord;
 - (vi) the general outlook in the debtor's industry; and
 - (vii) whether the unexpired lease is at, or below, the prevailing rate. *Id.* (citing *In re Richmond Leasing Co. v. Capital Bank; N.A.*, 762 F.2d 1303, 1310 (5th Cir. 1985)).
- (d) Special Case: Adequate Assurance of future performance of shopping center lease:
- (i) Source of rent and other consideration due under lease, and, in the case of an assignment, that the financial 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;
 - (ii) That any percentage rent due under such lease will not decline substantially;
 - (iii) That assumption or assignment of such lease is subject to all the provisions thereof, including (but not limited to) provisions such as a radius, location, use, or exclusivity provision, and will not breach any such provision contained in any other lease, financing agreement, or master agreement relating to such shopping center; and
 - (iv) That assumption or assignment of such lease will not disrupt any tenant mix or balance in such shopping center.
- (D) No preference exposure if lease is assumed because all prepetition amounts must be paid in full if the contract is assumed

B. Rejection

1. Effect

- (A) Treated as prepetition breach of the contract

- (B) Receive an unsecured claim for damages resulting from the breach
2. Rejection damages subject to a cap
- (A) Amount of unpaid “unaccelerated” prepetition rent AND
 - (B) Rent reserved under the contract which is greater of 1 year, or 15%, not to exceed 3 years of remaining lease term
 - (a) Any lease with less than 80 months (6 & 2/3 years) remaining will result in the 1 year cap.
 - (b) If the lease has over 80 months remaining, then the landlord receives 15% of the remaining term of the lease NOT to exceed 3 years.
 - (c) Note that a lease with 20 years or more remaining will result in a 3 year cap.
 - (d) By way of example, a lease with 80 or less months remaining yields a cap of 1 year’s rent

Calculation: $80 \text{ months} \times 15\% = 12 \text{ months' rent}$
 - (e) A lease with 10 years remaining would yield a cap of 18 months (1.5 years) rent:

Calculation: $10 \text{ years} \times 12 \text{ months} \times 15\% = 18 \text{ months' rent}$
 - (f) A lease with 20 years or more remaining will result in the 3 year cap:

Calculation: $20 \text{ years} \times 12 \text{ months} \times 15\% = 36 \text{ months' rent}$

C. Assignment

- 1. Can assign contract to third party even if there are anti-assignment clauses in the underlying contract
- 2. Requirements
 - (A) Must assume first (means cure all defaults)
 - (B) Need adequate assurance of future performance by assignee regardless of whether there is a default
 - (a) Adequate Assurance not defined by Bankruptcy Code

- (b) Could be providing financial statements, security deposit, etc.

3. Why assign?

- (A) Ex. Office Lease. Debtor/Tenant leases office space for \$10k a month from landlord. Debtor/Tenant assumes and assigns lease to third party for \$15k a month. Debtor/Tenant captures \$5k increase. Landlord does NOT get the value of the increase.
- (B) How does landlord feel about this? If landlord is owed significant unpaid rent, it may want the debtor to assign since part of the requirement of assignment is that any monetary defaults are cured.
- (C) So if landlord is owed \$100k on the lease and debtor assigns to third party, debtor has to cure and pay \$100k in unpaid rent to landlord
- (D) If landlord is not owed a material amount, then perhaps landlord wants debtor to reject the lease so landlord itself can go out and try to find someone who will pay \$15k a month directly to landlord

D. **Timeline for Decisions Regarding Assumption, Rejection, Assignment** - 11 U.S.C. § 365(d)(4)(A)

- 1. Debtor's ability to assume an unexpired non-residential real property lease terminates on the earlier of 120 days after:
 - (A) Entry of the order for relief, or
 - (B) Date of the entry of the order confirming the plan.
- 2. 120-day period may be extended by the court upon motion for 90 days for "cause."
 - (A) Timing for filing a motion to extend
 - (a) Some courts hold only motion to extend must be filed before the 120-day period.
 - (b) Other courts hold that the *order* extending the period must be entered prior to the 120-day period. *In re Tubular Tech., LLC*, 348 B.R. 699, 709 (Bankr. D.S.C. 2006).
 - (B) Factors for cause to extend 120 period for an additional 90 days:
 - (a) Whether the debtor was paying for the use of the property;

- (b) Whether the debtor's continued occupation could damage the lessor beyond the compensation available under the Bankruptcy Code;
 - (c) Whether the lease is the debtor's primary asset; and
 - (d) Whether the debtor has had sufficient time to formulate a plan of reorganization. *In re Monahan Ford Corp. of Flushing*, 390 B.R. 493, 500 (Bankr. E.D.N.Y. 2008).
- 3. 210-day cap may be further extended *only* upon prior written consent of the lessor. 11 U.S.C. § 365(d)(4)(B)(ii).
- 4. Landlord may file a motion to shorten 120-day period upon a showing of cause. *In re Dana Corp.*, 350 B.R. 144, 147-48 (Bankr. S.D.N.Y. 2006).
 - (A) Based on the particular facts of each case
 - (B) Factors
 - (a) The importance of the contracts to the debtor's business and reorganization;
 - (b) The debtor's failure or ability to satisfy postpetition obligations;
 - (c) The nature of the interests at stake;
 - (d) The balance of hurt to the litigants and the good to be achieved;
 - (e) Whether the debtor has had sufficient time to appraise its financial situation and the potential value of its assets in formulating a plan;
 - (f) The safeguards afforded the litigants;
 - (g) The damage the nondebtor will suffer beyond the compensation available under the Bankruptcy Code;
 - (h) Whether there is a need for judicial determination as to whether an executory contract exists;
 - (i) Whether exclusivity has been terminated;
 - (j) Whether the action to be taken is so in derogation of Congress's scheme that the court may be said to be arbitrary; and

- (k) The purpose of chapter 11, which is to permit successful rehabilitation of debtors. *Id.* at 147-48.

TENANT'S OBLIGATIONS DURING THE GAP PERIOD

A. Continued Performance

1. Debtor must timely and fully perform under the lease until it assumes or rejects the lease. 11 U.S.C. § 365(d)(3). *In re Goody's Family Clothing, Inc.*, 392 B.R. 604, 608-09 (Bankr. D. Del. 2008) ("Section 365(d)(3) of the Bankruptcy Code provides, in pertinent part, that the trustee must "timely perform all the obligations of the debtor . . . arising from and after the order for relief under any unexpired lease of nonresidential real property, until such lease is assumed or rejected, notwithstanding section 503(b)(1).").
2. "This provision was added to the Code to 'alleviate the unique financial strains the Code placed upon the commercial lessor,' namely that the lessor was formerly unable to collect rent from the debtor-tenant while at the same time prevented from taking any action to re-let the premises." *In re Iron Age Corp.*, 378 B.R. 419, 423 (Bankr. D. Mass. 2007).
3. 60-Day Extension:
 - (A) Bankruptcy court may extend, for cause, debtor's performance of any obligation that arises within the 60 days following the petition date.
 - (B) Bankruptcy court, however, may not extend performance beyond such 60-day period.

B. Administrative Priority

1. Split of authority whether postpetition rent claims are typically given administrative priority under 11 U.S.C. § 503.
 - (A) Some courts have held that landlord need not show that the postpetition rent claims are actual and necessary expenses to preserve the estate. *Iron Age Corp.*, 378 B.R. at 423.
 - (B) *In re JS Marketing and Communications, Inc.*, No. 05-65426-7, 2008 WL 219970, at *5-6 (Bankr. D. Mont. Jan. 24, 2008) (discussing majority and minority views of reasonable and necessary requirement of Section 503 as applied to postpetition rent claims and noting that "one bankruptcy court noted a split of authority with the minority of courts requiring that if a debtor does not pay rent as it becomes due the lessor must establish under § 503(b)(1)(A) that the rent is reasonable and necessary to preserve

the estate in order to receive administrative expense priority for its claim).

- (C) *But see In re Goody's Family Clothing, Inc.*, 610 F.3d 812, 818 (3d Cir. 2010) ("For a commercial lessor's claim to get administrative expense treatment under § 503(b)(1), the debtor's occupancy of the leased premises must confer an actual and necessary benefit to the debtor in the operation of its business."). Goody's noted that the debtor used the premises for store-closing sales and that the "[t]he sales required a physical venue, and remaining in existing premises was just as necessary and beneficial to the estate as leasing new premises specifically for store-closing sales. *Id.* at 819.
 - (a) For example, if the tenant is no longer occupying the space, a bankruptcy court may be inclined to hold that postpetition rent payments are not "actual and necessary" expenses of preserving the estate.
 - (b) This will be determined on a case by case basis and will depend upon in which jurisdiction the bankruptcy case has been filed.

C. Stub Rent And Obligations That Straddle Prepetition and Postpetition Periods (Taxes, Insurance, Etc.)

1. Billing Date/Performance Rule

- (A) If rent is due on January 1 and the tenant files for bankruptcy on January 15, under the billing-date approach, the rent obligation is a prepetition obligation and is not subject to payment under § 365(d)(3).
- (B) Third, Sixth, and Ninth Circuits uphold the billing date as the date to determine whether the obligation arose prepetition or postpetition and, therefore, whether such obligation would be treated as prepetition unsecured claim or postpetition. *In re Montgomery Ward Holding Corp.*, 268 F.3d 205 (3d Cir. 2001); *In re Cukierman*, 265 F.3d 846 (9th Cir. 2001); and *In re Koenig Sporting Goods, Inc.*, 203 F.3d 986 (6th Cir. 2000).
- (C) Ex. *In re Oreck Corp.*, 506 B.R. 500 (Bankr. M.D. Tenn. 2014)
 - (a) Tenant's lease ran from April 1, 2013, to May, 31, 2015, with base rent of \$37,500 per month plus \$1,566.50 for parking and storage
 - (b) All rent was "due and payable" in advance on the first of each month

- (c) Tenant filed Chapter 11 on May 6, 2013
- (d) At May 6, 2013 petition date, Oreck had not paid rent for May 2013
- (e) Oreck continued to occupy and use leased space and paid in full all rents that became due *after* May 1, 2013.
- (f) Landlord asserted prorated stub rent of \$31,505.25 for postpetition period for 25 days in May as administrative expense claim under 11 U.S.C. § 365(d)(3) and/or § 503(b)(1)(A).
- (g) Court concluded that landlord's claim for stub rent—from May 6, 2013 to May 31, 2013—arose on May 1, before the petition, and is not within the scope of § 365(d)(3).

2. Accrual/Proration Method

- (A) Should be prorated and based on the actual accrual of the obligation, rather than the billing date
- (B) Lessors are entitled to lease payments under 11 U.S.C. § 363(d)(3) arising during and attributable to the period after the order for relief.
- (C) Under the 'proration rule,' rent, taxes and other payments coming due under the lease after the order for relief are prorated between the prepetition and postpetition period." *In re Van Vleet*, 383 B.R. 782, 795 (Bankr. D. Colo.).

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