

WHICH RETAILER WILL FILE NEXT? LANDLORD ISSUES FOR TENANT BANKRUPTCIES

By Julie M. Murphy, Esquire, Hyland Levin Shapiro LLP

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RadioShack. Brookstone. Toys R' Us. Sears. With fifteen major retail bankruptcies filed to-date in 2018, the toppled retail behemoth has almost become a cliché, and brands once courted by commercial landlords have become major sources of risk. With no sign of a slow-down, this article provides a refresher on your rights, as a commercial landlord, in a commercial tenant bankruptcy.

101: THE BASICS.

- *Ipsa facto* clauses in a lease, which trigger default or acceleration upon the filing of a bankruptcy case, are generally unenforceable under the Bankruptcy Code. Thus, you cannot terminate a lease or stop performing your obligations under the lease on account of the bankruptcy filing.
- ▶ The filing of a bankruptcy case triggers the automatic stay, which requires all actions to enforce the lease, evict the tenant or collect a debt (including unpaid rent) to cease. Unless you have a judgment to possess the subject premises, or the lease has otherwise expired by its terms, you must not continue to pursue collection or enforcement activities.
- ▶ A commercial debtor may assume a lease and assign it to a third party, in most circumstances without your consent, even if the lease requires the consent of the landlord to assignment.
- ▶ A commercial debtor may reject a lease based on its business judgment, and you have very few (virtually no) grounds on which to object to a lease rejection.

201: WHEN WILL I GET PAID AND HOW MUCH?

The Bankruptcy Code requires bankrupt tenants to continue paying rent under the lease during the pendency of the case (post-petition rent). If a debtor does not assume a lease within 210 days of the commencement of the bankruptcy case, the lease is deemed rejected.

Depending on whether the lease is assumed or rejected and the financial health of the bankruptcy estate, rent that was unpaid as of the date of the filing (pre-petition rent) may be paid in full, in part or not at all. Tenants under assumed leases must cure all breaches under the lease, including to pay in full all unpaid pre-petition and post-petition rent and any damages incurred as a result of the breach of the lease. The cure amounts must be paid at the time the lease is assumed by the debtor or its assignee.

Landlords under rejected leases, on the other hand, are entitled to a claim against the bankruptcy estate, which, depending on the financial health of the debtor, may be paid in full, in part or not at all. While unpaid post-petition rent constitutes an administrative (or dollar-for-dollar) claim against the estate, all other pre-petition

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rent and damages caused by the rejection of the lease constitute unsecured (often, cents-on-the-dollar) claims, and will be paid pro rata with other unsecured creditors. Further, while rejection damages include the amount of rent remaining in the life of its lease, damages are statutorily capped at the greater of one year of rent or the rent for 15% of the remaining term of the lease, not to exceed three (3) years. Landlords who successfully mitigate their damages and re-let the premises may not be entitled to any claim if the rent received under the new lease is greater than or equal to the rent under the existing lease. Payments on unsecured claims are typically paid, if at all, after the debtor has confirmed a plan of reorganization.

301: DO I HAVE TO ACCEPT A RENT REDUCTION?

Bankruptcy affords the debtor tenant a unique opportunity to re-negotiate its leases. On one hand, the Bankruptcy Code prohibits the debtor from cherry picking which provisions of a lease it wants to assume and which provisions it would like to reject; instead, the Code requires the debtor to assume or reject the lease in its entirety. On the other hand, many debtor tenants leverage the specter of potential rejection to obtain significant rent concessions from landlords. Rent reduction negotiations often begin in the pre-bankruptcy period and continue in the early days of the case, with landlords being told that failure to negotiate will result in certain rejection.

You do not have to negotiate with the debtor tenant or accept a rent reduction, though doing so may increase the possibility of the assumption of your lease. Debtor tenants are more likely to reject leases:

- ▶ Not essential to the continued operation of the business,
- ▶ With above-market rent,
- ▶ In areas saturated with other debtor locations, or
- ▶ With low-performing stores.

If your lease falls outside of these categories, then the debtor may assume the lease even without obtaining a rent (or other) concession.

THE BIG PICTURE

As soon as a tenant shows signs of financial weakness, consider actively pursuing remedies under the lease, including termination or eviction proceedings. If the lease has expired or you have already obtained a judgment for possession when your tenant has filed for bankruptcy, tear up this article! (after confirming with your attorney that the lease is, in fact, properly terminated).

If the lease has not expired or terminated at the time of filing, be sure to engage bankruptcy counsel to review

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the proceedings and protect your interests in the case. Bankruptcy counsel will object to any insufficient cure amount, file a proof of claim for your damages and review any plan of reorganization to advise you of your anticipated recoveries. Even though retail bankruptcies have become commonplace, sound counsel will ensure that your rights are protected and help you get paid.

Finally, engage competent real estate professionals, who can provide an accurate assessment of current market rent and assist in finding a replacement tenant to satisfy and requirement that you mitigate your damages after rejection/termination of the lease.

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FOR MORE INFORMATION:



Julie M. Murphy, Esquire
Hyland Levin Shapiro LLP
murphy@hylandlevin.com

Practice Areas:
Bankruptcy, Workouts and Creditors' Rights
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Hyland Levin LLP
6000 Sagemore Drive, Suite 6301
Marlton, NJ 08053-3900
(p) 856.355.2900

www.hylandlevin.com

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