

WHICH RETAILER WILL FILE NEXT? LANDLORD ISSUES FOR TENANT BANKRUPTCIES

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August 7, 2020

After a spring frenzy to negotiate rent deferrals, abatements and lease amendments, retailers and other commercial tenants are seeking, in droves, the protection of the bankruptcy courts to restructure financial obligations and shed leases for non-performing store locations. The brands are storied: J. Crew, Neiman Marcus, GNC, Ann Taylor, Lord & Taylor, Brooks Brothers, Modell's. Shopping centers, malls, mixed use spaces - few commercial landlords are spared. With no sign of a slow-down, this article provides a refresher on your rights, as a commercial landlord, in commercial tenant bankruptcies.

101: THE BASICS

- *Ipso 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 alone.
- ▶ 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?

In pre-pandemic times, a commercial landlord could rely on provisions of the Bankruptcy Code that require bankrupt tenants to continue paying rent under the lease during the pendency of the case (post-petition rent). During the pandemic, however, debtor-tenants have drawn on the equitable powers of the bankruptcy courts to suspend the obligation to make post-petition rent payments. In such cases, you should consult with counsel early in the case to ensure that appropriate measures are taken to protect your rights to receive, or, at the very least, make a claim for post-petition rent.

Recovery of unpaid rent will depend on how the debtor treats the lease as well as the financial health of the bankruptcy estate. 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 other charges, such as CAM, any damages incurred as a result of the breach of the lease. Depending on the terms of the lease, the cure costs may also include attorneys' fees incurred in connection with a breach of the lease and the bankruptcy itself. The cure amounts

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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 may be paid in full, in part or not at all. While unpaid post-petition rent constitutes an administrative claim against the estate that is entitled to priority, pre-petition 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. Frequently, debtors request that landlords waive cure claims, agree to reduced future rent or percentage of sales rents, and adjust the term of the lease.

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 whether actively pursuing remedies under the lease, including termination or eviction proceedings will lead to a desirable outcome. If the lease has expired or you have already obtained a judgment for possession prior to your tenant's bankruptcy, tear up this article!

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(after confirming with your attorney that the lease is, in fact, properly terminated and you have the right to possession).

If the lease has not expired or terminated at the time of filing, be sure to engage bankruptcy counsel to review the proceedings and protect your interests in the case. Bankruptcy counsel will negotiate the terms of any lease modification, advocate for the prompt payment of post-petition rent, 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 any requirement that you mitigate your damages after rejection or termination of the lease.

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