

THE BANKRUPT TENANT AND YOU PART 2 – WHO WILL BE YOUR TENANT?

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In April we discussed issues that arise before and just after a tenant bankruptcy is filed. In this installment we will review lease rejections, assumptions, and assignments through the bankruptcy process.

One of the benefits accorded to a bankruptcy debtor is the opportunity to reject or jettison burdensome unexpired contracts and leases in order to obtain the “fresh start” envisioned by the Bankruptcy Code. Conversely, bankruptcy debtors may assume or continue to perform under the instruments if they can meet certain criteria. A third choice – one used by many bankrupt tenants – is to assume and assign an unexpired lease to a third party who must be able to meet certain criteria. There are also strategies such as selling the rights to designate who gets a lease, but we will focus on the core issues of assumption/rejection/assignment, lest we make this article into a treatise!

A commercial tenant in bankruptcy (or a trustee if one has been appointed) has 120 days from filing the case to decide what it wants to do with an unexpired commercial real estate lease. In most cases the courts will extend this time limit another 90 days (that makes 210 days if you are counting), but after that extensions must receive the landlord’s approval. Until a lease is rejected, the law requires the tenant or trustee to pay the rent set forth in the lease. This means that you must monitor the situation carefully to make sure that rent is paid as agreed. If it is not, you may be able to compel the tenant to reject the lease so you can free the space for a paying customer. If the case is filed as a Chapter 7 liquidation, the trustee will likely seek to reject the lease as soon as practical in order to avoid any rent liability for the bankruptcy estate. If the space has been cleared out prior to the bankruptcy filing and the trustee (or tenant) does not anticipate any need for it, he/she may seek to reject the lease retroactive to the date of filing. This tactic has been generally approved by the Courts.

If the landlord senses an undue delay in the filing of a motion to reject, most debtors or trustees will allow the landlord to begin marketing the space, subject to obtaining a court order approving the rejection. You should get that type of agreement in writing. If you are dealing with a tenant who is still in the space, that party may want limitations on your ability to market the space (such as limited site visits by prospective tenants) so as not to interfere with any business that might be going on at the leased premises.

A rejection of a lease constitutes a breach for which you will have a claim for damages. While we will discuss damages/claims in the next installment of this series, please understand that future damages under a rejected lease are limited – and moreover, there is usually not enough money in the bankruptcy estate to pay those damages at 100%. Page 2

On infrequent occasions, a tenant will want to assume the lease to continue operations. This usually happens in cases where the lease is below market and/or the space is a key location. In order to assume a lease, the tenant must cure all defaults (most important – pay all back rent), pay expenses of the landlord related to the default, and provide the Court with adequate assurance that it will be able to perform the lease for the rest of its term.

In an assumption/assignment situation, the tenant usually believes it can make some extra money by assigning the lease for a premium to a third party. The “new” lessee becomes obligated for the rent and the old tenant makes a little extra money for the bankruptcy estate. Most landlords hate getting stuck with an “unknown” tenant without any consideration. Many times there are provisions in leases which assign any such “bonus” to the landlord, but the courts look at these provisions with derision as they chill the bankruptcy process.

The Bankruptcy Code tries to mollify the concerns of landlords in the assumption/assignment situation by requiring that the assignee cure any pre-petition defaults, pay allowable expenses of the landlord, and show that it can perform the lease through its term. If the space is in a shopping center, the assignee must also show that its presence will not disrupt the tenant mix and that its assumption of the lease will not violate radius, location, use, exclusivity, etc. clauses of the lease. A landlord of an underperforming property may be willing to waive some of these provisions to get a deal done. But please know that the rejection/assumption/assignment process is rife with chances for a debtor/tenant to obtain tactical advantages, so legal counsel familiar with this area of law should be consulted.