



RETAIL BANKRUPTCIES RAISE COLLECTION QUESTIONS FOR LANDLORDS

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Anyone can read the provisions of the federal Bankruptcy Code that apply most often in a retail bankruptcy case. For landlords, however, it's not that simple when their tenant is now a debtor (the party filing a bankruptcy case) and they are left wondering what they can (and cannot) collect. Many of the most important concepts in retail bankruptcies are colored by interpretations of the Bankruptcy Code and play out differently depending on where a bankruptcy case is filed.

There are two approaches taken by bankruptcy courts around the country when it comes to interpreting the Bankruptcy Code's collection-related provisions for commercial landlords. They are "performance date," where collection depends on when the charge *came due*, and "proration," where collection depends on when the charge *accrued*. These inconsistent approaches may have a dramatic impact on what a landlord can collect from its bankrupt tenant.

When a retailer files a bankruptcy case, landlords must immediately assess the law in the court where the case is pending. Two popular venues for such cases are

Delaware (which utilizes the performance date method) and Virginia (which utilizes the proration method).

When it comes to assessing the collection of lease charges, the focus is on the period following the filing of the bankruptcy through the date the retailer determines what it intends to do with the lease. The Bankruptcy Code provides that, generally, debtors must "timely perform" their commercial lease obligations from the bankruptcy filing through the date a decision is made on the treatment of the lease (with a notable exception discussed below). If a charge under the lease is considered a post-bankruptcy obligation, the debtor must timely perform—but this determination differs by approach and touches on many bankruptcy concepts.

AUTOMATIC STAY

The Bankruptcy Code generally prohibits attempting to collect a pre-bankruptcy debt or seeking to obtain possession of the debtor's property (including the debtor's interests in its unexpired leases) and imposes penalties for violations.

It is essential to know which charges

are considered post-bankruptcy obligations that must be paid, and which are considered pre-bankruptcy charges that cannot be sought from the debtor. Therefore, having a proper understanding of the approach utilized where the bankruptcy case is pending is critical to understand what can and cannot be collected.

STUB RENT

One of the most talked about concepts in retail bankruptcies is "stub rent," the rent and related monthly charges calculated on a pro-rated basis from the date the case is filed through the end of that month.

Under the proration method, stub rent is a post-bankruptcy obligation that must be timely performed under the lease, as it accrued post-bankruptcy.

Under the performance date method, however, stub rent is not considered a post-bankruptcy obligation because the rent for that month was most likely payable in full on the first of the month, prior to the bankruptcy filing. However, as long as the debtor was occupying the premises as of the day they filed for bankruptcy, landlords often assert that stub rent must be paid to

account for the benefit the debtor received by occupying the premises and, generally speaking, conducting business.

The dispute between the debtor and its landlords over the payment of stub rent generally comes to a head when the debtor is seeking approval of post-bankruptcy financing or use of cash collateral, where there is a proposed budget that the debtor must adhere to. In some cases, the debtor will agree to pay stub rent by a reasonable date certain as set forth in the budget. In other instances, though, landlords and other parties in interest must assert various rights under the Bankruptcy Code to seek payment of the stub rent, often over the objection of the debtors.

Keep in mind that under either approach, the pre-bankruptcy portion of the rent due for the month of the bankruptcy filing (the first of the month through the day before the bankruptcy filing) is not payable as a post-bankruptcy expense. If the debtor rejects the lease (similar to terminating it), absent a security interest or security deposit, the landlord can assert pre-bankruptcy arrearages only as unsecured claims, which typically yield a small recovery. If the debtor assumes (retains) or assigns the lease, however, the debtor must pay any pre-bankruptcy amounts owed as part of a requirement to “cure” all arrearages under the lease.

REAL ESTATE TAXES

As is the case for stub rent, the approach, whether performance date or proration, dictates whether real estate taxes are considered post-bankruptcy charges a landlord can recover from the debtor-tenant, or pre-bankruptcy charges that may only be asserted as an unsecured claim (unless the lease is assumed or assigned, in which case all arrearages must be paid).

In a proration jurisdiction, the analysis is simple: real estate taxes are considered a post-bankruptcy charge collectible by a landlord when they accrue during a post-bankruptcy, pre-rejection period, irrespective of when they were billed or became due.

In a performance date jurisdiction, the key in determining whether a real estate tax charge is collectible is the actual due date under the lease (not to be confused with the billing date). For rent, it is almost universally the first of the month, but for taxes, this can vary significantly.

In many cases, a landlord pays real estate taxes to the municipality, and the tenant reimburses the landlord as a part of its rental obligations under the lease. In that scenario, the due date under the lease will dictate whether the tax payment is a post-bankruptcy obligation.

Where the tenant is billed directly by the municipality for its share of real estate taxes, both the lease terms and tax invoice must be considered. While the lease may provide for a specific due date—for example, within a certain number of days of receipt of an invoice—the lease may instead be more vague, providing, for example, that real estate taxes are payable when due.

If the lease does not provide enough guidance, the invoice itself will govern. Often, the invoice will state that the taxes are due by a date certain, but the tenant can pay by a later date certain after which a penalty or interest would start to accrue. In that scenario, the latter should be the true “due date” that governs whether it is a collectible, post-bankruptcy charge.

CURE

As referenced above, debtors have an obligation to cure defaults existing under the lease at the time the lease is assumed or assigned. All amounts that came due but were not paid are included in the cure amount.

In addition to pre-bankruptcy charges, the cure amount may also include attorneys’ fees. The Bankruptcy Code provides that a debtor cannot assume a lease without first compensating the landlord for “any actual pecuniary loss” resulting from a default. Depending on the lease terms, a landlord can assert that its counsel’s fees in the bankruptcy case are payable as part of the cure amount.

It is also important to note that the concept of cure may include more than just a dollar amount. Non-monetary defaults such as an outstanding maintenance obligation must also be cured at the time of assumption.

When a landlord is assessing a debtor’s proposed cure amount, in addition to the liquidated amount, it should also preserve the right to collect what may come due in the future such as reconciliations of previously billed charges (for example, real estate taxes, common area maintenance, and insurance) and indemnification from the debtor as set forth in the lease. In the case of a lease assignment, this may be accomplished by the assignee affirmatively taking on those obligations or the debtor establishing an escrow account.

If a lease is rejected, however, the debtor has no responsibility to cure pre-bankruptcy defaults, and the landlord must assert such amounts as unsecured claims.

TIMELY PERFORMANCE

While the general rule is that debtors must timely perform their commercial lease obligations, there is one notable exception that has gained much popularity and media

attention during the COVID-19 pandemic. With a showing of “cause,” a debtor can suspend the timely performance of its lease obligations for the first 60 days of the case. Under these circumstances, bankrupt retailers have generally been able to obtain this relief with little resistance from judges. Some judges have even extended retailers’ time to perform beyond the first 60 days of the case. However, there are measures landlords can take to mitigate the risk associated with this. For example, landlords can seek “adequate protection” of their interests and request that the debtor appropriately budget for the full payment of any deferred lease obligations.

CONCLUSION

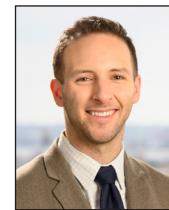
This is a broad, simplified overview of the issues facing commercial landlords during the bankruptcy cases of their retail tenants. Bankruptcy cases are complex and often move extremely quickly, and your rights are at issue very early in the case. It is therefore critical to retain counsel well versed in these matters.



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