Retail Bankruptcy Cases:
Ten Things Real Estate Lawyers Need to know

American College of Real Estate Lawyers
ACRELive The Retail Bankruptcy Crisis: July 27, 2017

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Introduction

- The face and shape of bankruptcy in 2017 is significantly different than a few years ago.
- What can real estate lawyers do to minimize risk and loss at the drafting stage?
- What should real estate lawyers know to help evaluate the actual risk of default, loss of rent, and non-payment for major claims (e.g., construction, tax and environmental)?

Point 1: The bankruptcy risk of loss is greater today.

- Landlords have unique statutory rights unlike other unsecured creditors.
- Landlord's strong statutory protections are being diluted by macro factors
  - Debtors must timely perform their lease post-petition and pre-rejection.
  - Leases cannot be crammed down or restructured.
  - Entitled to adequate assurance of future performance.
  - Pre petition defaults must be cured in order to assume and assign.
- Macro factors are causing dilution of rights:
- Retail bankruptcy cases have increased in 2016 and may well continue during 2017. The huge number of store closings and lease rejections create enormous bankruptcy claims which compete for scarce assets in the estate.
- Debtors continue to devise novel and aggressive arguments and to minimize landlord claims.
- Secured lenders who control the case seek to limit landlord rights through highly accelerated sales process, DIP Orders, and others.

Point 2: Pre-bankruptcy termination is difficult and may be set aside by the bankruptcy court.

- A debtor may not assume or assign a lease if "such [lease] a lease which has been terminated under applicable nonbankruptcy law prior to the order for relief." Code section 365(c)(3).
- In such a case, there is nothing for the debtor to assume. 11 U.S.C. §365(c)(3); see, e.g., In re Gande Restaurants, Inc., 162 B.R. 345, 347 (Bankr. M.D. Fla. 1993).

- Once validly terminated under state law, a lease may not be revived. See, e.g., Walling Crate Co., Inc. v. Hickory Point Indus., Inc. (In re Hickory Point Indus., Inc.) 83 B.R. 805, 806 (M.D. Fla 1988).

- Section 362(b)(10) of the Bankruptcy Code also provides that, where a lease has been terminated by the expiration of the stated term prepetition, the automatic stay of section 362 "does not operate as a stay" "of any act by a lessor to the debtor." Thus, the landlord need not seek relief from the automatic stay to exercise its state-law remedies, such as eviction, against the debtor.

- Judicial gloss: A termination of a lease is only "final" if all "final hurdles" have been crossed and the lease is not subject to any form of equitable redemption or statutory grace period. Executive Square Office Building v. O'Connor & Assoc., 19 B.R. 143 (Bankr. N.D. Fla. 1981).

Lease termination fee is preference

- Courts have questioned whether payment of a lease termination fee is a payment on account of an **antecedent debt**, and if so, whether the payment may be avoided as a preference under Code section 547.

- Some courts have held that such lease termination fees are a preference based on the theory that all rent is a debt that becomes due when lease is entered into.

- "In my view, a lease termination fee, where the lessee-debtor obtained nothing of value except for a release from liability to pay future rent, is "a transfer for or on account of an antecedent debt owed by the debtor before such transfer was made." This view is also consistent with the purpose of the preference section of the Bankruptcy Code. A broad interpretation of antecedent debt in the lease termination context facilitates the protection of other creditors that might get shortchanged by landlords that could insulate themselves from the bankruptcy process."

- Midwest Holding #7, LLC v. Anderson, 387 B.R. 892, 895 (N.D. Ga. 2008), aff'd sub nom. In re Tanner Family, LLC, 556 F.3d 1194 (11th Cir. 2009).

Lease termination may be a fraudulent conveyance

- In re Great Lakes Quick Lube Ltd. P'ship, 528 B.R. 893, 898 (Bankr. E.D. Wis. 2015), rev'd and remanded sub nom. In re Great Lakes Quick Lube LP, 816 F.3d 482 (7th Cir. 2016)

- Judge Posner, writing for 7th Circuit, held that a termination of a lease pre-petition is a transfer of an interest in property, and that the bankruptcy estate is entitled to the "value" of the lease transferred.

- Note: parties were not seeking to evict the new tenant—only the value of the lease–presumably the equity over the contractual rent.

- Judge Posner also stated that termination was a preference, but he did not even address the issue of whether this was a transfer on account of antecedent debt. Nor did he address whether the transfer gave more value to the landlord than it would have gotten in a chapter 7.

Lease termination is not a fraudulent conveyance

- Some courts have held that lease termination is not a conveyance and hence cannot be a fraudulent conveyance.
- But note: In re Egyptian Bros. Donut, Inc., 190 B.R. 26, 29 (Bankr. D.N.J. 1995). The plaintiffs did seek to set aside the new lease executed after termination.
- The court held that the termination was **not a fraudulent conveyance because not a transfer.**
- These courts rely on 365(c)(3) which states that a trustee may not assume or assign a lease if "(3) such lease is of nonresidential real property and has been terminated under applicable nonbankruptcy law prior to the order for relief."

"The implications of a contrary finding would render virtually every validly terminated executory contract revivable by a debtor simply initiating bankruptcy proceedings. Such a holding is not only unwarranted, but contrary to the intent of the drafters of the Code." Id. at 31.

Recommendations for pre bankruptcy termination

- Is pre-petition termination wise?
- Is there a replacement tenant? Generally, business decision to find new tenant should trump legal issues.
- Because debtor is obligated to pay rent post petition, does termination make economic sense?
- If debtor rejects lease, can the debtor pay claims and thus there is no risk of bankruptcy for landlord.
- Landlord possession starts cap; normally all prepetition rent is uncapped.

Point 3: beware the secured lender-and first day motions.

- "One of the most notable developments in chapter 11 reorganizations practice in this millennium is the dramatic expansion in the power exercised by secured creditors. Financing has experienced a sea change, and today many firms enter chapter 11 with their assets full(or almost fully) encumbered. **The reality then is that the entire reorganization is dependent on the good graces of the prebankruptcy controlling secured lender.** That means that important stakeholders—bondholders, trade creditors, tort victims, employees and shareholders to name but a few—are excluded from any recovery but for the whims of the controlling secured creditor."
- ABI Report, p 215, n. 784, citing Charles Tabb, *The Bankruptcy Clause, the Fifth Amendment, and the Limited Rights of Secured Creditors in Bankruptcy,* 2015 Ill. L. Rev. 765.
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First day motions control the bankruptcy process: may override lease and Code provisions.

- On June 11, 2017 Gymboree filed for bankruptcy protection in the District of Delaware. (Case No. 17-32986-KLP.)
- On June 12, 2017 it filed a motion for approval of store closing procedures and related relief.
- The motion indicated it would sell up to 450 underperforming brick and mortar store locations, "contingent upon lease negotiations with the Debtors' landlords." (Motion, 4).
- "In light of the tight restructuring milestones in the Debtors' postpetition financing credit agreements, the debtors are required to emerge from Chapter 11 within 110 days. (Motion, 10)
- "The debtors also respectfully request a waiver of any contractual restrictions that could otherwise inhibit or prevent the Debtors from maximizing value for creditors through the Store Closings and Sales. In certain cases, the contemplated Store Closings and Sales may be inconsistent with certain provisions of the leases, subleases, or other documents with respect to the premises in which the Debtors operate, including (without limitation) reciprocal easement agreements, agreements containing covenants, conditions, and restrictions (including, without limitation, "go dark" provisions, and landlord recapture rights,) or other similar documents or provisions."

Lease provisions on store closings may be unenforceable.

- "Certain of the Debtors' leases governing the premises of the stores subject to the Store Closings may contain provisions purporting to restrict or prohibit the Debtors from conducting store closings, liquidations or similar sales. Such provisions have been held to be unenforceable in Chapter 11 as they constitute an impermissible restraint on a debtor's ability to properly administer its reorganization case and maximize the value of its assets under section 363 of the Code.
- *See In re Ames Dept. Stores, Inc,* 136 B.R. 357, 359 (Bankr. S.D.N.Y. 1992)

Point 4: Debtor tenants are supposedly obligated to timely perform all of their post bankruptcy obligations.

- General rule: a debtor is obligated to perform its obligations "from and after the order for relief" and until the lease is assumed or rejected.

- "The trustee shall timely perform all the obligations of the debtor… arising from and after the order for relief… until the lease is assumed or rejected, notwithstanding section 503(b)(1) of this title."
  - Section 365(d)(3).

Billing date v. accrual rule : What is the meaning of, "from and after the order for relief . . . ."?

- Section 365(d)(3) states that a debtor need only "timely perform" obligations which arise "after" the order for relief- that is, post petition obligations.
- The courts are split on when a rent obligation "arises."
- Some courts hold the rent obligation arises on the billing date, when it is due to be paid.
- Other courts hold that rent accrues over time.

Landlord's ability to collect rent during case is adversely affected by "billing date rule."

- Billing date rule can generate massive conversion of post petition rent into pre-petition unsecured claim, thus giving debtor free "financing."

- If rent is due on January 1, and debtor files on January 2, then all of January is a pre petition claim, which is a general unsecured claim; landlord may receive only a small fraction of this claim.

- Billing date rule can be lethal re real property taxes: if taxes are billed on January 1, and debtor files on Jan 3, then the six month tax period may be a general unsecured claim.

Point 5: debtors right to assume or reject a lease is based on minimal showing of "business judgment."

- A court "may largely defer to the debtor's view that rejection or assumption will benefit the estate, provided that the debtor is not conflicted and has taken sufficient steps to maximize value. A debtor must simply put forth a showing that assumption or rejection of the lease will benefit the Debtor's estate. . . . **Adverse effects on the non-debtor contract party arising from the decision to assume or reject are irrelevant."**

- In re Great Atlantic & Pacific Tea Company, 544 B.R. 43 (Bankr. S.D.N.Y. 2016).

Time period for debtor to either assume or reject leases is now 210 days---some complain this has destroyed retail bankruptcies.

- In 2005 Congress dramatically changed the law and imposed an iron clad 210 day time period unless a landlord consented.

- 365(d)(4)(A)
  - Subject to paragraph (B), an unexpired lease of real property under which the debtor is the lessee shall be deemed rejected, and the trustee shall immediately surrender that nonresidential real property to the lessor if the trustee does not assume or reject the unexpired lease by the earlier of—
    - (i) the date that is 120 days after the date of the order for relief; or
    - (ii) the date of the entry of an order confirming a plan.

    - (B)(i) The court may extend the period determined under subparagraph (A) prior to the expiration of the 120 day period for 90 days on motion of the trustee or lessor for cause.
      - (ii) If the court grants an extension only under clause (i) the court may grant a subsequent extension only upon written **consent of the lessor** in each instance.

Point 6: debtor's right to assume includes right to cure defaults *despite* lease provisions.

365(b)(1)(A)

- (b)(1) If there has been a default in an… unexpired lease… the trustee may not assume such contract or lease, the trustee–
  - (A) Cures, or provides adequate assurance that the trustee will promptly cure, such default other than a default… to perform a nonmonetary obligations… if it is impossible for the trustee to cure such default by performing nonmonetary acts at and after the time of assumption… [for leases] then such default shall be cured by performance at and after the time of assumption… and pecuniary losses [paid].

- The Code effectively provides a federal cure right, that overrides any contrary provision in a lease that may not provide for a cure.
- Key issues:
  - No need to cure nonmonetary defaults that are impossible to cure.
  - No need to cure ipso facto clauses, such as default arising from insolvency or bankruptcy.
  - No need to cure some cross default provisions, unless non-lease contract is strongly tied to the lease.

Point 7: debtors can assign a lease *despite* anti-assignment clauses.

- General standards for assignment:

- In order to assign a lease a debtor must (1) "assume the lease" under the provisions of the Code, and (2) provide adequate assurance of future performance by the assignee, whether or not there has been a default.
  - Code Section 365)(f)(2).

- Assignment of lease may occur notwithstanding any provision which prohibits or restricts assignment. 365(f)(1).

- "Except as provided in subsections (b) and (c) of this section, **notwithstanding** a provision in an executory contract or unexpired, lease of the debtor, or in applicable law, **that prohibits,** restricts, or conditions the assignment of such contract or lease the **trustee may assign** such contract or lease under paragraph (2) of this subsection."

"De-facto" anti-assignment clauses may also be non-enforceable provisions (non-shopping centers).

- "Provisions that have the effect of restricting assignments cannot be enforced. See In re Rickel Home Centers, Inc., 240 B.R. 826, 831 (D.Del.1998)

- In re Dura Auto. Sys., Inc., No. 06-11202 KJC, 2007 WL 7728109, (Bankr. D. Del. Aug. 15, 2007)
- De facto anti-assignment provisions may be found in a variety of forms including lease provisions **that limit the permitted** use of the leased premises, lease provisions that require payment of some portion of the proceeds or profit realized upon assignment, and cross-default provisions.

- Matter of U.L. Radio Corp., 19 B.R. 537 (Bankr.N.Y.1982) (debtor could assume and assign its lease to assignee who would operate premises as a small bistro even though lease contained clause providing that lessee could use premises only for television service and sales store);

- In re Jamesway Corporation, 201 B.R. 73 (Bankr.S.D.N.Y.1996) (lease provision requiring tenant to pay landlord 50% to 60% of the "profits" received by tenant from the assignee or sublessee is unenforceable pursuant to § 365(f)(1));

- In re Convenience USA, Inc., 2002 WL 230772, *7 (Bankr.M.D.N.C.2002) (when a debtor is a party to a number of unexpired leases, cross-default clauses that would prevent the debtor from assuming some of the leases without assuming others are unenforceable under § 365(f)).

In re E-Z Serve Convenience Stores, Inc., 289 B.R. 45, 50 (Bankr. M.D.N.C. 2003).

Shopping center leases can be assigned on showing of adequate assurance of future performance.

- **Assignment of a shopping center lease requires a higher standard of adequate protection, as set forth in 365(b)(3).**

- The phrase "adequate assurance" includes adequate assurance "that assumption or assignment of such lease is subject to all the provisions thereof, including (but not limited to) provisions such as 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. . ." 365(b)(3).

- **Limit on restrictions? "**Although the court has broad authority under section 365(f)(1) to authorize the assumption or assignment of leases in **violation of their terms,** this discretion is **severely constrained** if the assumption or assignment involves a lease of real property in a shopping center."

  - *In re Three A's Holdings LLC,* 364 B.R. 550, 559-60 (Bankr. D. Del. 2007).

Even shopping center leases may be subject to assignment despite restrictive use clause.

- In In re Trak Auto Corp., 367 F.3d 237 (4th Cir. 2004), a shopping center lease provided that the premises had to be used "only as a Trak Auto Store" and only limited permitted uses to "sale at retail of automobile parts. . ."
- Debtor sought to assume and assign lease to A&E Stores, an apparel merchandiser. No bids were received from auto parts retailer.
- Parties agreed that assignment did not have to be to a "Trak Auto" store but use provision should be enforced as to the kind of store.
- Fourth Circuit held that assignment violated the requirement of 365(b)(3)(C); that this specific section trumped section 365(f)(1) (prohibiting anti-assignment clauses).
- **Key dicta: "A shopping center lease provision designed to prevent any assignment whatsoever might be a candidate for application of section 365(f)(1). . [Legislative history reflects that] "the amendment is not intended to enforce requirements to operate under a specified trade name." Id. at 245.**

Point 8: debtors may readily reject a lease on minimal showing of "business judgment." .

- Section 365(a) permits a debtor to reject a lease.
- No statutory standard: business judgment rule.
- Tenant is obligated to "surrender possession" upon rejection.
- Rejection constitutes a breach "immediately before the date of the filing of the petition". 365(g)
- The rejection claim is a pre petition, general unsecured claim.

The rejection claim is subject to a statutory cap

- A claim will be allowed except
- "(6) if such claim is the claim of a lessor resulting from the termination of a lease of real property, such claim exceeds—
  - (A) the rent reserved, without acceleration, for greater of one year or 15 percent, not to exceed three years of the remaining term, of such lease, following the earlier of—
    - (ii) the date of the filing of the petition
    - (ii) the date in which the lessor repossessed or the lessee surrendered the lease premises, plus
  - (B) any unpaid rent due under such lease, without acceleration, on the earlier such dates."

  - Section 502(b)(6)

Capped claims are only those "resulting from termination."

- Statutory standard for permitting rejection is whether the claim is one "resulting from termination" and is "rent reserved."

- Two competing rules:
- Claims which would have occurred even without termination/lease rejection are viewed as not subject to any cap under Section 502(b)(6). *See El Toro Materials Co., Inc.,* 504 F.3d 978 (9th Cir. 2007); followed by *In re Filene's Basement, LLC.,* 2015 WL 1806347 (Bankr. D. Del. April 16, 2015).*;Kupfer v. Salma,* 852 F.3d 853 (9th Cir. 2016).
- But see "single damage theory: all damages, even those unrelated to termination, are deemed part of the rejection claim, and are capped. *See e.g., In re Foamex International, Inc.,* 368 B.R. 383, 393-94 (Bankr. D. Del. 2007).

Point 9: rejection of a lease may cause termination of sub lease.

- Bankruptcy courts have long been divided over whether the rejection of a prime lease by a tenant also causes the sub-tenant's interest to be extinguished.
- Case support both view.
- Under New York law, "when a prime lease fails, so does the sublease." However, if there is a voluntary surrender then the subtenant may become the immediate tenant of the landlord."
- Bankruptcy court declined to determine whether the voluntary surrender doctrine applies in context of a summary motion for rejection under section 365(a).
- The rejection which occurs in bankruptcy will leave the [over-landlord] and the [subtenant] to vie for possession according to New York law."
- *In re Great Atlantic & Pacific Tea Company*, 544 B.R. 43 (Bankr. S.D.N.Y. 2016) citing to *Dial-A-Tire, Inc.*, 78 B.R. 13 (Bankr. W.D.N.Y. 1987).

Point 10: letters of credit counts against the cap on damages.

A letter of credit is applied to the cap– but is still better than cash security deposit.

- Thus, a landlord may only recover the caped amount, including what it gets from the "independent source."
  - Solow v. PPI Enterprises (U.S.) Inc., 324 F3d 197 (3rd Cir. 2003).

- Once the § 502(b)(6) calculation is complete, the prevailing view, and the view adopted by the Bankruptcy Court here, favors deduction of a security deposit from the § 502(b)(6) cap of a landlord's claim. ("[It is] well-settled that a security deposit held by a lessor on a rejected lease must be applied against the maximum claim for lease termination damages allowed to the lessor under § 502(b)(6)."). Equating a letter of credit with a security deposit, the Bankruptcy Court held that "because Solow drew down the letter of credit for $650,000 subsequent to termination of the lease, Solow's § 502(b)(6) claim should be reduced by that amount."

In re PPI Enterprises (U.S.), Inc., 324 F.3d 197, 208 (3d Cir. 2003).

Alternative view: Letter of credit does not count against cap if no proof of claim is filed

- EOP- Colonnade of Dallas Limited Partnership v. SBTI, (In re Stonebridge Technologies, Inc.) 430 F.3d 260 (5th Cir. 2005)
- Landlord may draw on letter of credit if has not filed a proof of claim.
- Rationale: the cap only applies to the "claim" and not a right against a third party.
- Risk: debtor files claim on behalf of landlord.
- Risk: decision is reversed and landlord without proof of claim gets zero from the estate.

The end

- Appendix of other key points follow

A guarantee is not subject to the stay or the cap:

- A guarantor is not subject to the cap. [thus, the letter of credit should not be]
- Using a SPE to guarantee a lease supported by letter of credit may be good protection.
- Debtors have been able to obtain temporary injunctions against proceedings against guarantors, despite general rule that action against issuing bank on LC cannot be maintained.
- Query: if court enjoins suit against guarantor under 105 would that make draw on guarantor letter of credit wrongful?

Ten things transactional lawyers should know about retail bankruptcy cases

1. Landlords have strong statutory protections in the Code: macro factors are adversely diluting those rights.
2. Pre-bankruptcy termination is difficult and may be set aside by the bankruptcy court.
3. The compressed time for a debtor to assume or assign a lease has made retail reorganization nearly impossible.
4. A landlord's ability to collect post-petition rent has been hampered by growing acceptance of the "billing date rule."
5. Debtors have right to assume or assign a lease on a meager showing of "business judgment." Harm to the landlord is not relevant
6. The right of a debtor to assume and assign includes the right to cure almost any pre bankruptcy default.
7. Anti-assignment clauses are mostly ineffective, and not much better in shopping center leases.
8. Debtors may freely reject a lease; rejection damages are capped and may not fully compensate landlord for major loss.
9. Rejection of a lease may cause termination of sub lease.
10. Letters of credit are the best security deposit but won't defeat the cap.

First factor: huge increase in cases as America rethinks the mall experience.

- Aeropostale: 800 teen clothing stores.
- April 16, 2016: Vestis Retail Group: closing 56 stores (Bob's Stores; Sport Chalet).
- April 7, 2016: Pacific Sunwear of California; 600 stores.
- March 2, 2016: Sports Authority: Closing 140 of 450 stores. $1.0 billion in assets.
- February 2, 2016: Hancock Fabrics: closed 70 stores.
- January 16, 2016: Wet Seal; teen fashion retailer.
- October 2015: American Apparel.
- September 2015: Quicksilver.
- June 2015: Anna's Linens
- April 2015: Frederick's of Hollywood
- February 2015: RadioShack
- February 2015: Cache, Inc.
- January 2015: Body Central Corp.

Third factor: The ABI Commission to Study the Reform of Chapter 11

- Landlord's rights were part of the focus of the ABI Commission report.
- In 2011, the American Bankruptcy Institute established the Commission to Study the Reform of Chapter 11.
- The Commission undertook an in-depth three year study on financially distressed businesses under Chapter 11.
- Over 250 corporate insolvency professionals worked on the study. The Commissioners were among the most prominent insolvency and restructuring practitioners in the United States.
- The Commission met on a regular basis from January 2012.
- The Commission conducted field hearings starting in April 2012, throughout the United States, took written and live testimony, and heard from various groups including the ICSC, the LSTA and many others.
- The Commission had thirteen advisory committees, **one of which included executory contracts and leases.**
- The Commission adopted its Report on December 1, 2014.
- It is now widely read, quoted in pleadings, referred to by judges, and viewed as a responsible and fair-minded approach even though profound differences continue.

Billing date rule appears dominant

- **Third Circuit:** In re Montgomery Ward Holding Corp., 268 F.3d at 209–10 (3rd Cir. 2001) (debtor obligated to reimburse landlords for real estate taxes which were billed post petition, including those for pre-petition and post petition period); the "clear and express intent of § 365(d)(3) is to require the [debtor] to perform the lease in accordance with its terms." Id. at 209. We thus held that "an obligation arises under a lease for the purposes of § 365(d)(3) when the legally enforceable duty to perform arises under that lease." Id. at 211.
- **Sixth Circuit:** In re Koenig Sporting Goods, Inc., 203 F.3d at 989 (6th Cir. 2000) (debtor liable for all rent for the month during which the lease was rejected because the due date for rent preceded the rejection date).
- **Seventh Circuit:** HA-LO Industries, Inc., 342 F.3d 794, 798–800 (7th Cir. 2003) (applying "billing date" approach to month during which lease is rejected. But see Handy Andy Home Improvement Centers, Inc. 144 F.3d 1125 (7th Cir. 1998) (applying accrual rule to pre petition taxes billed post petition (referring to prepetition taxes as "sunk costs")
- **Eighth Circuit.** Burival v. Roehric (In re Burival), 613 F.3d 810 (8th Cir. 2010) (§365(d)(3) (creates a bright-line rule under which the debtor must timely perform all post-petition, pre-rejection lease obligations as they become due, with no proration).

Accrual rule may still apply to real estate tax obligations in some jurisdictions.

- Billing date rule presents opportunity for debtor manipulation on real estate tax obligations.
- Tax bill issued on January 1, 2009 may pertain to all of 2008; but if debtor files on January 2, 2009 could the taxes then be "prepetition" general, unsecured claim?

- Some courts may use accrual rule for tax obligations. See Matter of Handy Andy Home Improvement Centers, Inc. 144 F.3d 1125 (7th Cir. 1998).
- In re Phar-Mor, Inc., 290 B.R. 319 (Bankr. N.D. Ohio, 2003). Use of the billing date rule for real estate taxes "would allow landlords to manipulate the billing date and improve their priority." Id. at 326.
- The Phar-Mor Court distinguished the use of the billing date when real estate taxes are involved. "Monthly rental payments should be paid regularly and promptly during the post petition period because the debtor is using the landlord's resource. Tax obligations, on the other hand, are incurred as they accrue. . . . Debtors. . .should be relieved of past expenses that have no present relevance to the present operation of the company." Id. at 328.

- See also In re Dunn Indus., LLC, 320 B.R. 86, 92 (Bankr. D. Md. 2005).

Stub rent

- Issues over “stub rent” typically arise in a billing date jurisdiction.
- Stub rent arises when a lease requires payment of rent on the first day of the month and the debtor files for bankruptcy on any subsequent date. Under the billing date rule, none of the rent due on the month of the filing is considered to have arisen post-petition, and hence is not entitled to the automatic priority under §365(d)(3).
- To be entitled to “stub rent” the landlord must satisfy a different legal standard– section 503(b)--
- A landlord may be entitled to stub rent if it can satisfy the requirements of §503(b) and show that the rental obligation is an “administrative expense” –those necessary and actual expense of preserving the estate. In re Goody's Family Clothing Inc., 610 F.3d 812, 818 (3d Cir. 2010).

ABI Commission recommendation- favors accrual rule

"The Commission also discussed the split in the courts regarding the method– i.e., the billing approach or the accrual approach- that should be used to determine whether certain rent owed under the lease should be deemed a prepetition or postpetition. . . Ultimately the Commission decided that the accrual method, which allocates rent between the prepetition and postpetition based on the date of filing was a fair method and most closely aligned with the purpose of section 365(d)(3)."

Note: Because this is a judicial interpretation some courts might be persuaded to revert to the accrual method.

Shortened period to assume/reject gives secured lenders excessive leverage

- A critical result of the shortened time period is that debtors lack the time to "meet liquidity needs and obtain extended postpetition financing—the lynchpin to any successful retail reorganization." ABI Rpt. 133

- Post petition lenders now require debtors to make their decisions as early as 120 to 150 days after the petition date to permit lenders to preserve their security interests in leaseholds prior to the expiration of the deadline. ABI Rpt. 133

- In essence, **the short time period has accelerated the liquidation of the estate and arguably harmed creditors.**

ABI Commission Report recommends one year to assume or reject.

- "Empirical and anecdotal evidence since 2005 suggests that this change in a debtor in possession's time to assume or assign nonresidential real property leases is at least a contributing factor to both the decline in retail filings. . ." ABI Rpt. 131.

- [T]he 210 day period "discourages reorganization, and impairs secured creditor recoveries." ABI Rpt. 131.

- **ABI Recommendation**: The time to assume or reject "should be extended from 210 days to one year after the petition date." ABI Rpt. 133.