

# Bankruptcy Claims & Protection

**ANDREW H. SHERMAN & LUCAS F. HAMMONDS**  
**SILLS CUMMIS & GROSS**

► **The Bankruptcy Code is a powerful tool for debtors in assuming or rejecting unexpired issues in commercial real estate.**

**R**ecent and looming bankruptcies of large national retailers have brought bankruptcy issues to the forefront of commercial landlords' and tenants' minds, making it important for both to understand the primary Bankruptcy Code (11 U.S.C. §§ 101, et seq.) sections pertaining to commercial leases, and the considerations for landlords and tenants contemplating their own bankruptcy filings or confronting the bankruptcy of a lease counterparty.

## **Lease Assumption And Rejection**

Section 365(a) of the Bankruptcy Code provides that, subject

to court approval, a debtor may “assume” or “reject” any unexpired lease to which it is a party. This applies both when the debtor is a lessor and when the debtor is a lessee. When a debtor assumes a lease, it continues to be bound by the lease’s terms and is required by section 365(b)(1) to cure its defaults under the lease (other than uncurable non-monetary defaults – for example, the prepetition breach of a continuous operation clause), compensate the counterparty for any pecuniary loss resulting from such defaults and provide “adequate assurance” of future performance.

As discussed in *Androse Assocs. of Allaire, LLC v. A&P (In re A&P)*, a 2012 case from the U.S. Bankruptcy Court for the Southern District of New York, “adequate assurance” of future performance is

determined by the facts and circumstances of each case. To determine adequate assurance, courts have assessed the debtor’s payment and default history, guarantee and security deposit status, and other funding considerations. Section 365(b)(3) of the Bankruptcy Code sets forth additional adequate assurance requirements for shopping center leases and must be satisfied in such cases.

With certain limited exceptions, rejection relieves a debtor of its obligations under the rejected lease. Pursuant to section 365(g), rejection typically constitutes a breach of the lease as of immediately before the debtor’s bankruptcy filing date and gives rise to a claim for damages by the lease counterparty.

## **Time to Assume Or Reject**

Under section 365(d)(4),



**Andrew H. Sherman** is chair of the Silks Cummis & Gross creditors’ rights/bankruptcy reorganization practice group. He represents clients in a broad range of complex business reorganizations, debt restructurings and insolvency matters throughout the country. Reach him at [asherman@sillscummis.com](mailto:asherman@sillscummis.com).

---

a lease of nonresidential real property under which the debtor is a lessee will be deemed rejected, and the debtor will be required to surrender the property, if the debtor does not assume or reject the lease before the earlier of 120 days after the bankruptcy filing date or the entry of an order confirming a bankruptcy plan. This deadline can be extended once, for a period of 90 days, by the court without the lessor's consent.

As discussed in *In re Simbaki, Ltd.*, a 2013 case from the U.S. Bankruptcy Court for the Southern District of Texas, most courts hold that section 365(d)(4) is satisfied by the filing of a motion to assume or reject before the applicable deadline. However, lessees may avoid unnecessary complications by obtaining the entry of an order approving assumption before the deadline passes. It is important to note that section 365(d)(4) applies only where the debtor is the lessee. The Bankruptcy Code does not contain any similar requirement where the debtor is the lessor.

### **Landlord Protections**

Landlords are protected

while a debtor-lessee determines whether to assume or reject a lease by section 365(d)(3), which requires the debtor to timely perform its postpetition lease obligations absent extension by the Bankruptcy Court. However, the remedies available to a landlord in the event that a debtor does not comply with its section 365(d)(3) obligations are not entirely settled. As discussed in *In re Bella Logistics LLC*, a 2018 case from the U.S. Bankruptcy Court for the Western District of Texas, Bankruptcy Courts are divided on the question of whether section 365(d)(3) independently grants a landlord's claim for postpetition rent and other charges priority as an administrative expense outside of section 503(b), which governs most administrative expenses. The majority of courts hold in the affirmative, but others require the landlord to file a separate request and demonstrate that it has provided an "actual, necessary" benefit to the bankruptcy estate consistent with section 503(b)(1) to obtain administrative priority for its claim. Still others

hold that section 365(d)(3) automatically creates an administrative expense claim under section 503(b). Courts may also grant additional relief, including relief from the automatic stay of section 362(a) to continue eviction proceedings against the debtor. Landlords and debtor-lessees should therefore consider the applicable interpretation of section 365(d)(3), as well as additional potential forms of relief, when developing their bankruptcy strategies.

### **Tenant Protections**

Real property lessees are protected in the event of lease rejection by a debtor-landlord by section 365(h)(1), which permits a lessee to either treat the lease as terminated or retain its rights thereunder – including with respect to amount and timing of rent, and the right to possession – to the extent those rights are enforceable under nonbankruptcy law. In the event of the latter election, section 365(h)(1)(B) limits the lessee's remedy for nonperformance of the debtor's lease obligations to an offset of any resulting damages



Lucas F. Hammonds is of counsel to the Sills Cummis & Gross creditors' rights/bankruptcy reorganization practice group. He represents debtors, creditors, creditors' committees and other parties in complex Chapter 11, Chapter 9 and Chapter 7 cases and related proceedings. Reach him at [lhammonds@sillscummis.com](mailto:lhammonds@sillscummis.com).



against future rent.

As noted in *IDEA Boardwalk, LLC v. Polo North Country Club, Inc.*, a 2017 case from the U.S. District Court for the District of New Jersey, courts are divided on the question of whether a debtor's sale of real property under section 363(f), which provides for sale free and clear of interests in the property, strips a lessee of its section 363(h) rights. Lessors and lessees should therefore be aware that, depending on the jurisdiction, a bankruptcy sale may cut off a debtor's possessory and other rights under a lease notwithstanding section 363(h).

### **Bankruptcy Claims**

Claims for amounts owed under a lease typically fall into one of three

categories: prepetition claims, postpetition claims and claims for damages arising from lease rejection. As discussed above, claims for postpetition amounts owed under a lease are generally afforded priority as administrative expenses. In contrast, claims for prepetition amounts owed are treated as general unsecured, nonpriority claims to the extent they exceed the value of any security provided under the lease.

Because rejection under section 365(a) is treated as a breach occurring as of the date immediately before the bankruptcy filing, claims for rejection damages are treated like prepetition claims. However, these claims are capped under section 502(b)(6) in an amount equal to (1) the

rent reserved by the lease, without acceleration, for the greater of one year, or 15 percent, not to exceed three years, of the remaining term of the lease, following the earlier of the bankruptcy petition date and the date the lessor repossessed, or the lessee surrendered, the leased property; plus (2) any unpaid rent due under the lease, without acceleration, on the earlier of those dates. Like other provisions of the Bankruptcy Code governing commercial leases, courts vary in their application of section 502(b)(6), with the majority reading "15 percent" to mean 15 percent of the total amount due under the lease from the relevant date and the minority reading it to mean 15

percent of the remaining lease term.

### **Know Your Rights**

The Bankruptcy Code provides a powerful tool to debtors in the ability to assume or reject unexpired leases under section 365(a), but significant protections to landlords and lessees under sections 365(d)(3) and (h)(1). Landlords and lessees must understand these provisions, their intersections with other provisions of the Bankruptcy Code and their applications in the relevant jurisdiction to protect their rights with respect to commercial real property leases. ■

---

*The views and opinions expressed in this article are those of the authors and do not necessarily reflect those of Sills Cummis & Gross P.C.*