Survey of Emerging Landlord Bankruptcies and Related Trends

Presented at the 14th Annual (Virtual) Bankruptcy Bench/Bar Conference
April 8, 2021

By: Judge Chris Lopez, Michelle Shriro, and Katharine Battaia Clark[1]

[1] The Honorable Christopher M. Lopez was appointed to serve as a bankruptcy judge for the Southern District of Texas on August 14, 2019. Before his appointment to the bench, Judge Lopez was a member of the Business, Finance & Restructuring Group of Weil, Gotshal & Manges LLP; Michelle Shriro is a shareholder in the law firm of Singer & Levick PC representing both creditors and debtors in reorganization matters with a particular expertise in handling matters for commercial landlords in retail and restaurant bankruptcy cases nationwide; Katharine Battaia Clark is a partner at Thompson Coburn LLP and represents clients before bankruptcy courts, federal and state trial courts, and arbitration panels nation-wide, and serves as a Subchapter V Trustee for the Eastern and Northern Districts of Texas. Ms. Clark appreciates the research assistance of fellow Thompson Coburn attorney, Katie A. Lee.

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A. Introduction

Prior to 2020 and the dawn of the COVID era, retailers and their lenders had been adjusting to ecommerce trends (or failing to do so and going out of business accordingly), which decreased the demand for traditional retail space. And while in the last several years analysts had been foreboding a retail tenant apocalypse, the rate of retail bankruptcy filings had reached a point of relative stasis.

The comparative rate of 2020 and 2021 bankruptcy filings (and attempts at out-of-court workouts) to pre-COVID times has brought obvious and extensive disruption to the traditional retail landscape and beyond. Bloomberg reported[2] at least twenty-five major retailers filed for bankruptcy from January 2020 to early August 2020, alone. Moreover, current forecasts suggest more than a retail tenant crisis. It seems no business segment is immune to distress, as the complexity of dealing with already changing consumer demands meets the long road back to equilibrium the economy is facing due to the COVID-19 pandemic and recent major weather events across the country.

This paper explores the spread of distress across industries and up the chain to landlords and related trends in real estate bankruptcies and provides a refresher on certain real estate bankruptcy basics to help prepare bankruptcy practitioners for the ever-changing landscape and quickening pace of real estate cases in the current cycle.

B. The Broad Swath of Distress Across Industry Types Impacting Commercial Landlords and Their Lenders

The COVID-era chapter 11 filings have included retailer giants and an expansion well beyond consumer retailers. The following are examples of 2020-2021 chapter 11 filings representing various economic segments:

1. Clothing and Consumer Retailers. *Paper Source, Inc., et al.*, Eastern District of Virginia, Case No. 21-30660 (KLP) (March 2, 2021); *Belk, Inc.*, Southern District of Texas, Case No. 21-30630 (MI) (Feb. 23, 2021); *Solstice Marketing Concepts [a leading retailer of sunglasses in the U.S.]*, Southern District of New York, Case No. 21-10306 (MG) (Feb. 17, 2021); *L'Occitane, Inc.*, District of New Jersey, Case No. 21-10632 (MBK) (Jan. 26, 2021); *Loves Furniture Inc.*, Eastern District of Michigan, Case No. 21-40083 (TJT) (Jan. 6, 2021); *Francesca's Holding Corp., et al.*, District of Delaware, Case No. 20-13076 (BLS) (Dec. 3, 2020); *Guitar Center, Inc., et al.*, Eastern District of Virginia, Case No. 20-34657 (KRH) (Nov. 21, 2020); *Steinmart, Inc., et al*., Middle District of Florida, Case No. 20-02387 (JAF) (Aug. 12, 2020); *Lord & Taylor [Le Tote, Inc., et al.]*, Eastern District of Virginia, Case No. 20-33332 (KLP) (Aug. 2, 2020); *Men's Wearhouse [Tailored Brands, Inc., et al.]*, Southern District of Texas, Case No. 20-33900 (MI) (Aug. 2, 2020); *Ann Taylor [Ascena Retail Group, Inc., et al.]*, Eastern District of Virginia, Case No. 20-33113 (KRH) (July 23, 2020); *Brooks Brothers Group, Inc*., District of Delaware, Case No. 20-11785 (CSS) (July 8, 2020); *Lucky Brand Dungarees, LLC, et al.*, District of Delaware, Case No. 20-11769 (CSS) (July 3, 2020); *Tuesday Morning Corp., et al.*, Northern District of Texas, Case No. 20-31476 (HDH) (May 27, 2020); *Centric Brands Inc., et al.*, Southern

[2] *See* Katherine Doherty and Jeremy Hill, *Busted Retailers Use Bankruptcy to Break Leases by the Thousands*, (BLOOMBERG BUSINESS Aug. 6, 2020) (available at https://www.bloomberg.com/news/articles/2020-08-06/busted-retailers-use-bankruptcy-to-break-leases-by-the-thousands) (last visited Aug. 30, 2020).

District of New York, Case No. 20-22637 (SHL) (May 18, 2020); *J. C. Penney Company, Inc., et al*., Southern District of Texas, Case No. 20-20182 (DRJ) (May 15, 2020); *Neiman Marcus Group LTD LLC, et al.*, Southern District of Texas, Case No. 20-32519 (DRJ) (May 7, 2020); *J. Crew [In re Chinos Holdings, Inc., et al.]*, Eastern District of Virginia, Case No. 20–32181 (KLP) (May 4, 2020); and *Pier 1 Imports, Inc., et al*., Eastern District of Virginia, Case No. 20-30805 (KRH) (Feb. 17, 2020).

2. Fitness and Related Service and Products Providers. *YouFit Health Clubs, LLC*, District of Delaware, Case No. 20-12841 (MFW) (Nov. 9, 2020); *Yogaworks, Inc.*, District of Delaware, Case No. 20-12599 (KBO) (Oct. 14, 2020); *Town Sports International, LLC [New York Sports Club]*, District of Delaware, Case No. 20-12168 (CSS) (Sept. 14, 2020); *GNC Holdings, Inc*., District of Delaware, Case No. 20-11662 (KBO) (June 23, 2020); *24 Hour Fitness Worldwide, Inc., et al*., District of Delaware, Case No. 20-11558 (KBO) (June 15, 2020); *Gold's Gym [GGI Holdings, LLC]*, Northern District of Texas, Case No. 20-31318 (HDH) (May 4, 2020); and *In re Modell's Sporting Goods, Inc*., District of New Jersey, Case No. 20-14179 (VFP) (March 11, 2020).

3. Food Service Industry. *Snap Kitchen Services LLC* [Subchapter V], Southern District of Texas, Case No. 20-60090 (CML) (Dec. 4, 2020); *Sizzler USA Restaurants, Inc.*, Northern District of California, Case No. 20-51400 (MEH) (Sept. 21, 2020); *Garbanzo Mediterranean Grill, LLC, et al.*, Eastern District of Missouri, Case No. 20-43963 (BSS) (Aug 12, 2020); *California Pizza Kitchen, Inc*., Southern District of Texas, Case No. 20-33752 (MI) (July 29, 2020); *SLT Holdco, Inc. [Sur La Table]*, District of New Jersey 20-18368 (MBK) (July 8, 2020); *NPC International, Inc. [largest franchisee of Wendy's and Pizza Hut-branded eateries]*, Southern District of Texas, Case No. 20–33353 (DRJ) (July 1, 2020); *Chuck E. Cheese [CEC Entertainment, Inc.]*, Southern District of Texas, Case No. 20-33163 (MI) (June 25, 2020); *Dean & DeLuca New York, Inc., et al*., Southern District of New York, Case No. 20-10916 (MEW) (March 31, 2020); and *FoodFirst Global Restaurants [Brio Tuscan Grill]*, Middle District of Florida, Case No. 20-02159 (KJ) (April 10, 2020).

4. Office Space Providers and More. *Alamo Drafthouse Cinemas*, District of Delaware, Case No. 21-10474 (MFW) (Mar. 3, 2021); *Eagle Hospitality Trust [diversified portfolio of freehold, international branded hotels]*, District of Delaware, Case No. 21-10036 (CSS) (Jan. 18, 2021); *Studio Movie Grill*, Northern District of Texas, Case No. 20-32633 (SGJ) (Oct. 23, 2020); *In re Townhouse Hotel, LLC*, Southern District of Florida, Case No. 20-19997 (RAM) (Sept. 16, 2020); *RGN-Group Holdings, LLC [operator of Regus co-working affiliate]*, District of Delaware, Case No. 20-11961 (BLS) (Aug 17, 2020); and *The Hertz Corporation*, District of Delaware, Case No. 20-11218 (MFW) (May 22, 2020).

With such a variety of distress in industry type, case size, and place of filing, these representative samples provide a flavor of what landlords and their lenders have been grappling with over the last year, as well as the challenges and opportunities that lie ahead. As one article recently observed, "even as vaccines herald the slow return to normal life, it's increasingly clear the fundamentals of real estate have been altered" and, when coupled with the increase in

commercial loan maturities that were already on the horizon pre-pandemic, "lenders and borrowers [must] come to terms about what buildings are worth in a world the pandemic reshaped."[3]

C. Landlord Bankruptcies

Given the relative increase in bankruptcy filings in the COVID-era that directly impact commercial rental occupancy, it is not surprising that landlords themselves are beginning to show signs of distress.

Pennsylvania Real Estate Investment Trust (PREIT), an owner of approximately 30 retail properties in the mid-Atlantic states, filed a prepackaged Chapter 11 in Delaware on November 1, 2020, and was jointly administered under Case No. 20-12737 (KBO). The proposed plan contemplated an exit credit facility to increase liquidity, the conversion of existing unsecured debt into secured debt while extending maturities, but effected no balance sheet deleveraging. *See* Dkt. No. 17 (Nov. 2, 2020) (Disclosure Statement). The Debtors resolved the objection of the lone, hold-out lender[4] and confirmed their plan within 30 days of the petition date. The final decree closing out the lead debtor's bankruptcy case was entered without objection on March 11, 2021,[5] meaning the landlord was in bankruptcy only four months.

CBL & Associates Properties, Inc. (CBL), which controls more than 100 retail properties, including malls and shopping centers, sought Chapter 11 bankruptcy protection on the same day as PREIT, albeit in the Southern District of Texas, and is jointly administered as Case No. 20-35226 (DRJ). In a discussion of CBL's financial challenges in its declaration in support of its first day motions, CBL noted that over 30 of its national retail tenants had filed their own chapter 11 cases.[6] While it was not a prepackaged plan, the debtors had obtained a pre-bankruptcy restructuring support agreement (or RSA). The debtors' senior-secured term lenders were not signatories to the RSA and instead argued certain debtors could not even authorize a bankruptcy filing in the first instance, given the lenders' agent's prepetition exercise of power in respect of the pledged equity.[7] CBL and its senior-secured lender began trial in a pending adversary proceeding opened on the issue, but reached a settlement that involved entering into a new RSA. CBL filed the amended RSA on March 22, 2021, which includes a term sheet for a consensual plan of reorganization.[8]

While PREIT and CBL have been the first notable post-COVID retail landlord bankruptcy filings, more are expected based on, among other things, (i) the ripple effect of tenant distress and

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[3] Noah Buhayar, John Gittelsohn and Jackie Gu, *Commercial Real Estate's Pandemic Pain Is Only Just Beginning*, (BLOOMBERG BUSINESS Dec. 22, 2020) (available at https://www.bloomberg.com/graphics/2020-commercial-real-estate/) (Last visited March 31, 2021).

[4] *See In re Pennsylvania Real Estate Investment Trust, et al.*, Case No. 20-12737, Dkt. No. 155.

[5] *Id*. at Dkt. No. 276.

[6] *See In re CBL & Associates Properties, Inc., et al.*, Case No. 20-35226, Dkt. No. 3 at p. 3.

[7] Prior to the bankruptcy filing, the term lenders' agent had called non-monetary defaults and accelerated $1.1 billion in obligations in an attempt to seize control of the entities whose equity was pledged to the lenders, and to direct hundreds of tenants at 22 properties to send rent payments directly to lenders' agent. Post-petition, the debtors sought and received a temporary restraining order against the lenders' agent to at least temporarily prevent interference with operations of properties comprising the lenders' collateral.

[8] *Id*. at Dkt. No. 980.

(ii) impending, ordinary course maturities of billions of dollars in commercial loans over the next several years.

Just as there are many iterations of retail tenant bankruptcy cases, landlord bankruptcies run the gamut. Landlord cases may involve something relatively simple, as in the case of a single property owner with a few tenants, a company with a portfolio of different property types, tenant mix, lease terms, etc., a landlord under a ground lease, or a complex enterprise where certain debtors act as landlords while others act as tenants and still others act as master tenants that sublet to other tenants (think the most recent Sears filing).

Landlord debtors frequently consider whether to work toward a sale of their real property (free and clear of liens, claims and encumbrances), whether to re-tenant their property (via lease rejections)[9] with more profitable tenants (if any), or a combination of the two. There are frequently three non-governmental buckets of parties in interest in landlord bankruptcies: the landlord's lender, the tenants, and the tenants' lender. As the volume of landlord distress increases, bankruptcy practitioners should consider dusting off or retooling skillsets particular to issues landlord bankruptcies present.

D. Emerging Trends and Real Estate Bankruptcy Refreshers

If COVID-era large case bankruptcies were game shows, they would be in a perpetual lightning round—the pace of the average matter involving retail space to restructure and/or shed[10] is challenging for the lawyers directly involved in the proceeding to manage, much less the average creditor client to absorb. Savvy and sophisticated debtors are coming to bankruptcy court prepared with a list of demands and bankruptcy courts are indicating that such preparedness is to be rewarded.

1. Rent Considerations.

Following the onset of the COVID-19 pandemic, commercial tenant debtors have routinely sought to postpone many obligations, including rent payments. This type of remedy and the legal bases remain in flux, even as Congress has attempted to step in on the issue with temporary Bankruptcy Code amendments applicable in limited circumstances.[11]

a. **Rent deferral/abatement**.

Bankruptcy Code section 365(d)(3) requires a debtor-tenant to timely perform (pay) its commercial lease obligations until the debtor decides whether to formally assume or reject the lease. Section 365(d)(3) also provides that a bankruptcy court may extend, "for cause," the time for performance for lease obligations arising within the first 60 days after the petition date, but not

[9] *See* 11 U.S.C. § 365(g); *see also* 11 U.S.C. § 365(h), which further governs landlord lease rejections, including rejection of a shopping center leases.
[10] Jordan Valinsky, *Lord & Taylor is closing all of its stores after 194 years in business*, (CNN Business Aug. 27, 2020) (available at https://www.cnn.com/2020/08/27/business/lord-and-taylor-store-closures-bankruptcy/index.html) (last visited Aug. 30, 2020).
[11] *See* discussion *infra* re Consolidated Appropriations Act whereby, for example, 11 U.S.C. § 365(d)(3) has been temporarily amended as to certain debtor types.

beyond the 60-day period. Budgets in the average retail tenant case traditionally have included a line item for go-forward rental payments, and, unless the case was dead-on-arrival, rent payments would begin roughly 30- to 45-days into a case, on average.

For instance, struggling to keep its bankruptcy afloat in the early days of the COVID-19 pandemic, J. C. Penney Company, Inc. recited in its initial bankruptcy filings [filed on or about May 15, 2020]:

> The Debtors did not pay the majority of May rent on account of temporary store closures. *These difficult but necessary measures not only shielded the Debtors from immediate danger, but enabled the Debtors to enter chapter 11 with sufficient liquidity to responsibly operate and maintain their businesses for the first few weeks of the cases*.[12]

As an example of the relative speed and the varying outcomes of recent cases involving commercial rental space, compare the J. Crew (In re Chinos Holdings) and Ann Taylor (Ascena Retail Group) cases, which both filed in the Eastern District of Virginia in May and July of 2020, respectively. In J. Crew, the filing was the culmination of a multi-year effort to restructure the balance sheet. Due to the onslaught of the pandemic, the company toggled to bankruptcy. The J. Crew debtors leased all retail locations from roughly 140 landlords and were party to approximately 500 leases located in almost every state. Real estate-related motions were filed on the first day of the case, including complex lease rejection procedures, which were summarily granted. The debtors' 365(d)(3) extension motion was granted a few weeks after the filing (on May 26 at the second-day hearing).[13] In *Ann Taylor*, the debtors filed their rent deferral motion 38 days after the July petition date and requested a hearing 20 days later (still only 58 days after the petition date). The hearing was continued by the debtors twice, and ultimately was never held because the debtors and Unsecured Creditor's Committee struck a global deal agreeing to defer rent through and including September 18, 2020 (just shy of the 60-day mark). Checks for all unpaid post-petition rent were to be cut on the same day.[14]

The longer the deferment, the greater the landlord struggle, as deferment both deepens the risk to the landlord of administrative insolvency of the debtor-tenant and creates disruption of the landlord's own cashflow.

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[12] *See* Dkt. No. 38 at para. 3, *In re J. C. Penney Co*., Case No. 20-20182 (Bankr. S.D. Tex. May 16, 2020) (JC Penney and its affiliates had nearly $500 million in cash on hand as of the filing date); *see also In re 24 Hour Fitness Worldwide, Inc*., Case No. 20-11558 (Bankr. D. Del.), whereby, despite having ceased all rent payments for months leading into its June 2020 petition, the debtors sought and received a two-month post-bankruptcy extension to begin rent payments, even while the debtors had DIP-bankruptcy financing to begin making rent payments in July. *See* Dkt. No. 132 (Rent Deferral Mtn filed June 16, 2020), Dkt. 262 (representative landlord objection) at paras. 6-12, and Dkt. No. 407 (Order Granting Relief).

[13] *See* Dkt. No. 323, *In re Chinos Holdings, Inc., et al.*, Case No. 20–32181 (Bankr. E.D. Virginia May 26, 2020) (granting the motion filed at docket 23).

[14] *See* Dkt. Nos. 158 (relevant extension motion), 585 (confirmation of announcement of withdrawal of motion), and 587 at Annex 6 (Global Settlement attached to Final Order Authorizing Cash Collateral Use), *In re Ascena Retail Group, Inc., et al.*, Case No. 20-33113 (Bankr. E.D. Virginia).

b. **"Gap" or "stub" period rent**.

A related issue to the rent deferral and abatement requests involves debtors challenging whether and when they should be required to pay "stub" or "gap period" rent—that being the rent for periods falling just after the bankruptcy filing but before the first (full) rent payment. Various circuits take different approaches. Some courts take the "Billing Date" approach, holding that 11 U.S.C. § 365(d)(3) requires an examination of when "rent" becomes due and payable under the lease. *See, e.g., In re Simbaki, Ltd*., No. 13-36878, 2015 WL 1593888, at *5 (Bankr. S.D. Tex. Apr. 3, 2015). Under the Billing Date approach, if the due date for the rent was pre-bankruptcy (e.g., the debtor filed in the middle of a rental period), the "stub" rent due through the close of that initial period is a pre-bankruptcy, unsecured claim that is not entitled to payment under section 365.

Other courts have adopted the "Proration" approach over the "Billing Date" approach, holding 11 U.S.C. § 365(d)(3) requires a debtor to prorate rent for the month straddling the bankruptcy filing into pre- and post-bankruptcy buckets, with the post-bankruptcy portion due as part of the debtor's section 365 obligations. *See, e.g., In re Stone Barn Manhattan LLC*, 398 B.R. 359, 365 (Bankr. S.D.N.Y. 2008). Nuances to the analysis include consideration of such matters as when tax or insurance payments "accrue" such that those amounts enjoy either administrative priority or pre-bankruptcy, unsecured status.

The range of impact of the application of either approach is dependent on each debtor's situation.[15] To be sure, in cases such as those being filed amidst the pandemic, where rent payments have been withheld for months leading into the bankruptcy and where the future of the retailer's business is anything but certain, the availability of the largest possible administrative rent claim is a critical opportunity for landlords to enjoy at least some priority of payment.

Whether the balance of the stub or "gap period" rent for the month of the initial filing is considered a post-petition claim, the timing for payment of such stub rent is another strategy debtors use in managing their cash in the post-COVID era. For instance, debtors may delay payment of such gap or stub rent until on or after plan confirmation as a cure payment for assumed leases or as an administrative claim for rejected leases. Still other debtors have paid the stub rent over the course of their bankruptcy cases.

In the Men's Wearhouse (Tailored Brands, Inc.) case, the debtors agreed in their final DIP financing order to pay stub rent to landlords for "go forward" stores as follows: 20% within thirty days of entry of the final financing order, 20% within 60 days of entry of the financing order, 25% upon confirmation and 35% upon the effective date of the confirmed plan. Landlords with rejected leases were paid stub rent within sixty days after entry of the final financing order.[16]

Under either the Billing Date or Proration approach, the debtor is technically permitted to delay payment (not receive debt forgiveness). However, debtor-tenants in the current cycle have

[15] Note that debtors in cases involving requests for rent deferral or abatement (like 24 Hour Fitness) have sought to extend the analysis re "gap period" (pre- and post-bankruptcy rent) to pre- and post-deferral rent amounts.
[16] *See* Final Financing Order, Dkt. No. 512 (entered 9/2/2020) at pp. 33-34. *In re Tailored Brands, Inc., et al.,* Case No. 20-33900 (Bankr. S.D. Texas).

frequently requested landlord agreement to waive the stub rent as part of lease amendment negotiations (which also generally demand additional rent concessions).

In the event a tenant has withheld significant rent leading into the bankruptcy only to (a) delay starting rental payments until several months post-petition or (b) delay payment of at least some post-petition payments until confirmation, significant monetary obligations and practical challenges may arise for a landlord (such as paying taxes, dealing with property damage, appeasing remaining tenants, meeting their own loan covenants, etc.).

c. **Express or implied contract provisions**.

For rent deferrals beyond the 60-day period, debtors have looked to clauses in the contract, such as force majeure, or related doctrines such as frustration of purpose or impossibility and have sought bankruptcy court relief using the court's general equitable powers under 11 U.S.C. §§ 105(a) and/or 305(a) (essentially, "because, COVID"). In essence, they argue the concepts should be applied due to the pandemic and/or weather-related events to receive the rent relief they seek.[17]

Judge Marvin Isgur recently rejected Chuck E. Cheese's request to further defer—based on force majeure language in specific leases and a frustration of purpose argument—certain rental obligations past the initial extended period of sixty days for locations the company could not open or were open on a limited basis due to COVID-19 operating restrictions in certain states. Judge Isgur found that the Bankruptcy Code did not provide any authority to defer rent beyond the initial 60-day period and any additional rent deferral would rest on non-bankruptcy law.[18] After considering the language in each of the leases at issue, the court determined (i) there was no basis for deferral based on force majeure and (ii) the frustration of purpose doctrine was not applicable either having been superseded by the force majeure clause or having not been triggered because the lease's purpose had not been entirely frustrated.[19]

The approach of bankruptcy courts in analyzing these express or implied contract provisions to effect further rent deferral has varied widely across the country. At bottom, however, the inquiries tend to be fact-intensive, with courts taking the same approach Judge Isgur employed, i.e., reviewing each lease and considering the general circumstances of the debtor-tenant, albeit with differing outcomes.

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[17] *See, e.g.*, David J. Marmins and Michael F Holbein, *Illinois Bankruptcy Court Grants Force Majeure Relief to Restaurant* (ABA Practice Points) (June 29, 2020) (available athttps://www.americanbar.org/groups/litigation/committees/real-estate-condemnation-trust/practice/2020/illinois-bankruptcy-court-force-majeure-restaurant/) (last visited Aug. 30, 2020); *see also, e.g., In re J. C. Penney Co. Inc.,* No. 20-20182 (Bankr. S.D. Tex. June 11, 2020); *In re Craftworks Parent LLC*, No. 20-10475 (Bankr. D. Del. May 21, 2020); *In re Bread & Butter Concepts, LLC*, No. 19-22400 (Bankr. D. Kan. May 15, 2020); *In re Pier 1 Imports, Inc*., 2020 WL 2374539 (Bankr. E.D. Va. May 10, 2020); *In re Modell's Sporting Goods, Inc*., No. 20-14179 (Bankr. D. N.J. Mar. 27, 2020).

[18] *In re CEC Enter., Inc., et al*., No. 20-33162, 2020 WL 7356380, at *3-4 (Bankr. S.D. Tex. Dec. 14, 2020).

[19] *Id*. at *3.

d. **Initial takeaways and perspective**.

For many post-COVID-19 debtor cases (like JC Penney and 24 Hour Fitness), the bankruptcy was materially funded from unpaid rents. At the same time, bankruptcy courts have shown there are limits to the relief that may be granted, depending on the facts and circumstances of each case and, more particularly, to the language of particular leases implicated by the bankruptcy filing.

Bankruptcy jurisprudence in previously cycles developed at the point where creativity met desire in order to adjust to the practical realities debtors and their various creditor constituencies faced (such as critical vendor motions). Similarly, motions to defer rent and seeking related relief during COVID-19 have an uncertain and evolving legal and statutory justification that will need to be monitored closely as it evolves.

2. Impact of Certain COVID-19 Relief.

The mega cases that typified the commercial filings for 2020 may be the tip of iceberg, as they say nothing of the small- to moderate-size businesses that, for a variety of reasons, including greater access to government assistance early in the pandemic, may be part of the next (or continued) wave of bankruptcy filings. Those small-to-midsize companies frequently form the tenant mix at retail centers, owe lenders of their own, and their leases are also part of landlord's collateral packages in respect of the landlord's lenders.

a. **Consolidated Appropriations Act**.

The Consolidated Appropriations Act of 2021 (the "Act") was signed into law on December 27, 2020. It provides roughly $900 billion in pandemic relief and includes provisions that (at least temporarily) have the potential to impact the landlord/tenant relationship in the instance of bankruptcy by amending certain Bankruptcy Code sections:[20] (1) allowing PPP loan eligibility (albeit with a heavy caveat) with an amendment to 11 U.S.C. § 364; (2) temporarily reducing preference exposure for landlords with an amendment to 11 U.S.C. § 547; (3) temporarily increasing the time chapter 11 debtors have to determine whether to assume or reject non-residential real property leases under 11 U.S.C. § 365; and (4) temporarily increasing the available time for rent deferral for Subchapter V debtors under 11 U.S.C. § 365(d)(3).

i. *PPP eligibility*.

The Small Business Administration (SBA) began administering PPP loans as part of Congress's initial response to the COVID-19 pandemic in early 2020. Both the SBA and bankruptcy courts almost immediately began grappling with how PPP loans factored into various

[20] The Act also impacts the following Bankruptcy Code provisions (only some of which are discussed in this paper): 11 U.S.C. § 366 (limiting utilities' ability to terminate services to debtors); 11 U.S.C. § 525 (protecting against discriminatory treatment of debtors); 11 U.S.C. § 541 (excepting pandemic relief payments from being considered property of the estate).

bankruptcy analyses, and essentially found debtors in bankruptcy ineligible to apply for the PPP based on SBA guidance.[21]

Those companies that have received funds through the PPP and/or other federal, state, or local programs outside of bankruptcy in the early months of the pandemic, and yet still experiencing distress have in some ways been disincentivized to file bankruptcy based on (a) the perceived or actual ability with the cash infusion to get further down the road toward business as usual or (b) the uncertainty of how parameters around receipt, spending, or payback of the government funds work from both a practical and technical standpoint.

For the second round of PPP, Congress attempted to resolve some of the uncertainty around a debtor's PPP eligibility by amending Bankruptcy Code section 364 to provide that, upon notice and a hearing, certain debtors (such as small business debtors) *are* permitted to obtain PPP loans if they are otherwise eligible; provided, however, the Act includes a major caveat in that regard. This amendment to section 364 will only take effect if the SBA determines debtors are generally eligible for PPP loans. There is no deadline for the SBA to make any such determination, leaving the actual ability of debtors to obtain PPP loans in limbo.

ii. *Reduced preference exposure*.

Landlords that receive a pre-bankruptcy payment on account of late rent payments within the 90 days before a bankruptcy filing would typically be exposed to avoidance risk under a preference theory pursuant to 11 U.S.C. § 547. A creditor, however, may avoid preference liability by asserting a statutory defense enumerated under Section 547(c). The Act temporarily amends Section 547 by adding a new defense under a new subsection 547(j), which, among other things, provides some comfort to landlords[22] negotiating with distressed businesses during COVID.

Section 547(j) expands the preference defense to transfers made toward "rental arrearages"[23] where: (a) there is an amendment to an existing, nonresidential lease for the deferral of rent, (b) the amendment occurs on or after March 13, 2020, and (c) the amount of deferred rent does "not exceed the amount of rental and other periodic charges agreed to" under the existing lease." The last requirement expressly excludes any fees, penalties, or interest in an amount greater than those the debtor would owe if the debtor had made every payment due under the nonresidential lease on time and in full before March 13, 2020. *See* 11 U.S.C. § 547(j)(1)(A)(iii). This amendment expires on December 27, 2022, but will continue to apply to cases filed prior to the expiration date.

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[21] The SBA has made its position known re PPP loans and bankruptcy: debtors in bankruptcy are ineligible to receive PPP loans. See 13 CFR Parts 113, 120 and 121, available at PPP -- IFR -- Paycheck Protection Program as Amended by Economic Aid Act (1.6.2021).pdf (sba.gov) (last visited March 31, 2021) ("reserving funds for businesses in operation is necessary because only businesses that are still in operation will retain employees, which is a primary purposes of the PPP.").

[22] The Act also extends preference protection to suppliers of goods or services.

[23] Relatedly, a payment of supplier arrearages under the new 547(j) means a payment made "in connection with an agreement or an arrangement between a debtor and a supplier of goods or services to defer or postpone the payment of amounts due under an executory contract for goods or services" and the agreement or arrangement is made on or after March 13, 2020.

iii. *Extended lease assumption or rejection deadline*.

The Act also amends 11 U.S.C. § 365(d)(4) to provide trustees or debtors in possession in all chapter 11 cases with an initial 210 days from the initiation of the bankruptcy case to assume or reject nonresidential real property leases, instead of the previous 120-day deadline. This amendment, in effect, allows a debtor up to 300 days to decide whether to assume or reject a lease when combined with the 90-day extension already allowed "for cause" under 11 U.S.C. § 365(d)(4)(B)(i). Unlike the amendment to Section 365(d)(3), the new 210-day deadline to assume or reject a lease does not have a pandemic hardship requirement. This extended deadline will also expire on December 27, 2022.

iv. *Increased rent deferral for Subchapter V debtors*.

The Act also temporarily amends 11 U.S.C. § 365(d)(3) to allow Subchapter V debtors experiencing coronavirus-related financial hardship to defer their rent payments to the earlier of 120 days post-petition or until the debtor's assumption or rejection of the lease. *See* Consolidated Appropriations Act of 2021 § 1001(f), 11 U.S.C. § 365(d)(3). Any deferred rent under Section 365(d)(3) "shall be treated as an administrative expense described in section 507(a)(2)." In other words, Subchapter V debtors have more flexibility on the timing of post-bankruptcy rent payments, thereby forcing landlords to consider bringing early motion practice against the Subchapter V debtor-tenant or accept an involuntary extension of credit. With many cases in the COVID-era experiencing uncertain post-bankruptcy revenue generation and/or other access to capital, the portion of the Act affirming the administrative status of landlord claims for post-bankruptcy rent may or may not provide some assurances to landlords. This amendment is set to expire on December 27, 2022, but will continue to apply to Subchapter V cases filed before this date.

b. **Continued Expansion of Subchapter V Debt Ceiling.**

In late 2019, Congress passed the Small Business Reorganization Action of 2019 (the SBRA), representing a material attempt to streamline the process for small business reorganizations. In particular, the SBRA created a new Subchapter V of Chapter 11, which took effect toward the end of February 2020. *See* 11 U.S.C. §§ 1181 to 1195. Importantly, the new Subchapter V did not replace a small business debtor's option to proceed as a small business case under Chapter 11, but rather provides a different option for small business reorganizations.[24]

As practitioners and courts were just beginning to explore the new subchapter, the COVID-19 pandemic took center stage, and the CARES Act quickly provided further modification to Subchapter V. Among other things, Section 1113 of the CARES Act expanded the permissible debt ceiling under Subchapter V.[25] The expanded debt ceiling under the CARES Act was set to expire one year from enactment, or March 27, 2021.

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[24] *See, e.g.*, 11 U.S.C. §§ 101(51C) (defining "small business case" to exclude an election under Subchapter V), 101(51D) (defining "small business debtor" with a debt ceiling of $2,725,625), and 1116 (setting out the duties of a small business debtor).

[25] *See* 11 U.S.C. § 1182, which defines a Subchapter V "Debtor" as "a person engaged in commercial or business activities (including any affiliate of such person that is also a debtor under this title and excluding a person whose primary activity is the business of owning single asset real estate) that has aggregate noncontingent liquidated secured and unsecured debts as of the date of the filing of the petition or the date of the order for relief in an amount not more

As the impact of the COVID-19 pandemic creeped into 2021, Congress was lobbied to continue the expanded debt ceiling under Subchapter V.[26] On March 27, 2021, President Biden signed the COVID-19 Bankruptcy Relief Extension Act of 2021 (H.R. 1651) into law, which extended the key provisions of the COVID-19 Bankruptcy Relief Act (enacted as part of the CARES Act) for another year (until March 27, 2022). Thus, more small businesses will be able to take advantage of the "cheaper and faster" bankruptcy process Subchapter V offers.[27]

Whether and to what extent this continued expansion will impact the landlord/tenant relationship is presently unknown given the relative newness of Subchapter V in general. However, because (1) practitioners have had more than a year to explore the benefits and burdens of the new Subchapter V in general, and (2) there is an expectation that more small- and mid-size companies will be forced to consider bankruptcy as the economy continues to rebalance, it is logical that debtor-tenants, individual guarantors, and even some landlords[28] may look to Subchapter V to provide them a bankruptcy breathing space, as opposed to a traditional chapter 11, a small business case, or even a chapter 7 liquidation.

3. Lease Assumption and Rejection Principles.

As more commercial tenants look to chapter 11 for relief due in part to continued impacts of the COVID-19 pandemic and recent weather events nation-wide, the threat of a ripple effect across the real estate market becomes more of a reality. Bloomberg quotes a former bankruptcy judge's warning, "If this becomes a tsunami of retailers rejecting their leases, it's going to trigger another part of the sea change – the mortgages held by landlords."[29] Accordingly, a refresher on some general considerations regarding lease assumption and rejection is appropriate.

a. Lease assumption.

Though a tenant's decision of whether to assume or reject a lease is outside the landlord's control, there are ways that a landlord can influence this decision. But first, a landlord should determine whether it is in the best interest of the landlord and their property for the subject lease to remain in place—and at what cost. Among the questions a landlord might ask itself are:

- Are the terms of the lease above or below market?
- What are the practical chances of reletting the space in the current COVID-19 pandemic environment?
- What is the acquisition cost of getting a new tenant in terms of commission to brokers and any tenant improvements?

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than $7,500,000 (excluding debts owed to 1 or more affiliates or insiders) not less than 50 percent of which arose from the commercial or business activities of the debtor.

[26] Note that the Consolidated Appropriates Act did not address the Subchapter V debt ceiling limit issue.

[27] Leslie A. Pappas, *Biden Signs Law Extending Debt Cap for Small Business Bankruptcy*, (BLOOMBERG LAW) (March 29, 2021) (available at https://news.bloomberglaw.com/bankruptcy-law/biden-signs-law-extending-debt-cap-for-small-business-bankruptcy) (last visited April 1, 2021).

[28] Subchapter V defines the debtors eligible to elect to reorganize under the subchapter, and expressly excludes as eligible debtors those that are single asset real estate debtors. *See* 11 U.S.C. § 1182(1)(A).

[29] *See* Doherty, Katherine and Hill, Jeremy, *Busted Retailers Use Bankruptcy to Break Leases by the Thousands* (last visited Aug. 30, 2020) (quoting Melanie Cyganowski, former bankruptcy judge for the Eastern District of New York).

- ❖ Are there co-tenancy triggers for other tenants if the debtor-tenant vacates their premises?
- ❖ Is there a risk that an assignment (to a different operator or for a different use) could affect the character of the property or have implications for existing exclusives, recorded restrictions, or even zoning compliance relating to parking and density?
- ❖ Are the tenant's proposed modified terms of the lease (e.g., dramatically reduced rent, waived rights) worth accommodating in order to keep the tenant in place and have the lease assumed?
- ❖ Will and, if so, how, will the landlord will be impacted by the Bankruptcy Code amendments described above.

These questions help bankruptcy practitioners on both sides of the negotiations consider what's at stake in the short- and the longer-term. There are, of course, factors that make assumption unlikely, regardless of a landlord's cooperation—such as, a short remaining lease term, above-market rent rates, or a more successful nearby location.

Bankruptcy court approval of a tenant's lease assumption requires the debtor to reaffirm the lease, promptly cure all defaults, and provide adequate assurance that it will be able to perform its obligations in the future. However, a debtor does not need to actually cure defaults at the time of assumption so long as the debtor provides adequate assurance it will promptly act to cure the default and provide compensation. *See, e.g., In re Embers 86th Street, Inc*., 184 B.R. 892 (Bankr. S.D.N.Y. 1995) ("[a]dequate assurance of a prompt cure requires that there be a firm commitment to make all payments and at least a reasonably demonstrable capability to do so"). Accordingly, the issue of adequate assurance on assumption is frequently subject to dispute in debtor-tenant cases. Where the lease being assumed is a commercial lease in a shopping center, special provisions govern what constitutes "adequate assurance" of future performance. 11 U.S.C. § 365(b)(3)(A)-(D).

In terms of assignment of assumed leases, while bankruptcy courts tend to permit broad assignment, debtors should be ready to meet their burden regarding demonstrating the assignee's future performance in general and in particular where a landlord challenges the assignee's ability. For instance, a landlord may contest assignments to certain operators, or for certain uses, that would negatively impact shopping centers or could cause the landlord to run afoul of exclusive use rights, prohibited uses, local zoning ordinances and other similar restrictions.

b. Lease rejection.

When a lease is on the rejection chopping block, various issues come into play. Debtors have become savvy over the years at (1) seeking retro-active rejection (despite holdover) and (2) setting deadlines and rejection processes that are often challenging for even the most experienced bankruptcy counsel to follow. Practitioners must be on guard for early and rapid developments impacting landlord rights, such as (a) the "omnibus" lease rejection motion—always check the exhibits and consider the multiple ways a debtor might reference a particular leasehold[30]; (b) lease rejection procedures motions—these often have broad implications and may come at a time when

[30] For example, a lease may be referred to in a rejection motion by location address, P.O. Box for rent checks, registered agent of the landlord, common name for shopping center at which the retail space is located, etc.

a committee has not yet been appointed and/or is just getting going, so practitioners should not presume a committee and/or the court will scrutinize the requested procedures on behalf of impacted creditors; (c) the potential practical or legal implications of rent deferral vis-à-vis an on-going liquidation, sale, and/or lease rejection process; and (d) limited, but varying, time for filing lease rejection claims.

Once a lease is rejected, there are multiple considerations for preparing a proof of claim for the resulting damages. Bankruptcy Code section 502 "caps" certain damages landlords might otherwise claim when their lease is rejected. There are little controlling circuit decisions to guide practitioners in preparing rejection damages claims and district and bankruptcy courts take disparate approaches to these calculations. Accordingly, practitioners should leave sufficient time to prepare a rejection damages claim in advance of the deadline set for filing the same.

Despite the lack of controlling authority at the circuit level, the "time" approach (as opposed to the "rent" approach) is arguably the prevailing approach as of this writing to calculate the Section 502(b)(6) cap on lease rejection damages, as outlined in *In re Filene's Basement, LLC*, No. 11-13511, 2015 WL 1806347, at *4 (D. Del. Apr. 16, 2015). The *Filene's Basement* court explained, "The Third Circuit has not ruled on this question, although in dicta the Court has explained that under the § 502(b)(6)(A) cap, 'a landlord-creditor is entitled to rent reserved from the greater of (1) one lease year or (2) fifteen percent, not to exceed three years, of the remaining lease term.'"[31] The *Filenes* case clarified the proper method for calculating the term "15 percent" of any "rent reserved" in Bankruptcy Code Section 502(b)(6)(A).[32]

Ultimately, *Filene's* established that determining whether a charge is allowable under 11 U.S.C. § 502(b)(6) depends on whether the charge is a "termination charge." To analyze whether something is a "termination charge," the court's first inquiry is: **did the claim arise from *terminating* (as opposed to rejecting) the lease**? If yes, the second question is whether the charge is considered "rent reserved." If yes, then the amount is subject to the cap. If no, then the charge is arguably not allowable. Delaware bankruptcy courts have concluded the following are allowable charges as "rent reserved" that are subject to the 502(b)(6)(A) cap: (1) Base rent; (2) CAM charges; (3) Insurance premiums; (4) Property taxes, depending on the language of the lease. The following

[31] *In re Filene's Basement, LLC*, No. 11-13511, 2015 WL 1806347, at *4 (citing *In re PPI Enters. (U.S.), Inc.*, 324 F.3d 197, 207 (3d Cir. 2003)).

[32] Specifically, the rent cap is calculated under the *Filenes* approach as follows:

> Step 1: Determine the reference date, or the date from which the calculations in Section 502(b)(6) are measured. This date will be the earlier of either (i) the petition date or (ii) the date on which the landlord repossessed or the debtor surrendered the property.
> Step 2: Starting from the reference date, determine the number of months remaining on the lease term. Take the number of months and multiply it by 15% (0.15). If the result is less than three years (36 months), then this is the term. If the result is greater than 36 months, then the term is deemed to be 36 months.
> Step 3: The greater term will be the larger of (i) one year or (ii) the term calculated in Step 2.
> Step 4: Calculate the rent reserved for the "greater term" calculated in Step 3. The result will be the rejection damages cap.

are charges courts have held are not considered "rent" under 502(b)(6): (a) maintenance and repair fees[33]; (b) attorneys' fees[34]; (c) late fees.[35]

While courts appear to be trending toward the "time approach" outlined above,[36] other courts use the "rent" approach when calculating the damages cap.[37] Under the "rent" approach, the damages are capped at "15 percent of the total rents due under the lease, through the expiration date of the lease."[38] In other words, the fifteen percent quantifies the aggregate *rent* remaining under the lease, as opposed to the *time* remaining. One court has commented in applying the rent approach, "Although not a model of clarity, this appears to be the most natural interpretation of the statutory language."[39]

Like the other circuits, the Fifth Circuit has not weighed in on its interpretation of the 502(b)(6) cap. Some courts in the Fifth Circuit have included "all aspects of the relationship related to the lease" when determining what qualifies as "rent reserved."[40] For instance, such items "including, but not limited to **rent, taxes, insurance, change orders as an aspect of rent and, indeed any miscellaneous 'non-rent' claims such as repair and maintenance, attorney's fees, and utilities**" may be considered "rent reserved."[41] The date on which the charge arose is also examined in considering what charges are subject to the cap.[42]

While there is an array of authority regarding whether the "rent" approach or the "time" approach is the correct interpretation of Section 502(b)(6), the American Bankruptcy Institute Commission to Study the Reform of Chapter 11 suggested in its final report and recommendation,

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[33] *See, e.g.*, *In re Foamex Int'l, Inc.*, 368 B.R. 383, 392 (Bankr. D. Del. 2007) ("The application of the *McSheridan* factors for determining whether or not a tenant's lease obligation is "rent" for purposes of Section 502(b)(6) leads to only one conclusion: the maintenance and repair obligations are not rent. All three of the factors must be present for the Court to deem an obligation to be "rent" and only one of the requirements is met in this case.").

[34] *See, e.g.*, *In re PPI Enters. (U.S.), Inc.*, 228 B.R. 339, 349 (Bankr. D. Del. 1998) ("Because attorneys' fees are neither related to the leasehold's value nor constitute a fixed, regular, or periodic charge, courts applying the *McSheridan* test to the question of whether attorneys' fees are allowable as 'rent reserved' under Section 502(b)(6) have held that such fees are not allowable.").

[35] *See id.* at 350 ("Thus, because the Lease's late fees fail the second and third prongs of the *McSheridan* test, they are not properly included as rent reserved under § 502(b)(6).").

[36] *But see In re Filene's Basement*, No. 11-135112015, WL 1806347, at *4, n.9 ("The 'rent' approach is sometimes referred to as the 'majority' view, but a review of the case law reveals that courts appear to be evenly split. There is no clear majority of decisions favoring either the 'rent' approach or the 'time' approach.").

[37] *See, e.g.*, *In re Andover Togs, Inc.*, 231 B.R. 521, 540–41 (Bankr. S.D.N.Y. 1999); *In re Gantos, Inc.*, 176 B.R. 793, 795–96 (Bankr. W.D. Mich. 1995); *In re Rock & Republic Enterprises, Inc*., No. 10-11728, 2011 WL 2471000, *20 (Bankr. S.D.N.Y. June 20, 2011) (expressly rejecting the "time" approach: the "Court declines to depart from the long-standing authority adopted in this jurisdiction, and holds that the damages calculation is subject to the 'total rent approach.'").

[38] *In re Andover Togs*, 231 B.R. at 547.

[39] *In re Gantos, Inc.*, 176 B.R. at 796.

[40] *See, e.g.*, *In re Metals USA, Inc*., No. 01-42530-H4-11, 2004 WL 771096 (Bankr. S.D. Tex. Jan. 15, 2004).

[41] *Id.* at *6 (emphasis added).

[42] *See In re Dronebarger*, No. 10-10889-HCM, 2011 WL 350479, at *11 (Bankr. W.D. Tex. Jan. 31, 2011) ("According to the plain language and meaning of § 502(b)(6), the damages cap applies only to damages resulting from the 'termination' of a real property lease. Since the 'termination' … did not occur until June 1, 2003, the property damages sought … could not and did not result from 'termination' of such leases.").

in 2014 that the cap should be calculated according to the "time" approach.[43] In addition to disparate approaches to what is included in the cap, the issue of whether and to what extent damages determined not to be subject to the cap are nevertheless recoverable "outside" the cap.

With so much uncertainty as to which standard applies, a practitioner should consider both the applicable case law in the jurisdiction in which the rejection damages claim will be filed and the facts and circumstances surrounding the particular landlord's claim (including the plain language of the lease) in order to perform a good-faith calculation of damages sought (both inside and outside the cap).

E. Conclusion

Even as certain segments of the economy are showing promising signs of recovery, the sheer breadth and depth of distress for commercial tenants is naturally creeping up the chain to landlords. The 2021 round of COVID-related relief offers relief more targeted to debtor-tenants and their landlords, but only time will tell whether the pace of commercial tenant or landlord bankruptcies will continue to rise. To be sure, the wave of retail tenant bankruptcies in 2020 has shown the importance of understanding the developing trends in those cases, as well as of recalling lessons learned from prior bankruptcy cycles heavy in commercial real estate.

[43] *See 2012-2014 Final Report and Recommendations*, AM. BANKR. INST. COMM'N TO STUDY THE REFORM OF CHAPTER 11, pp. 129-30 (2014), https://abiworld.app.box.com/s/vvircv5xv83aavl4dp4h. (last visited March 31, 2021).