

## Client Advisory

April 2005

# Amendments to Bankruptcy Code Benefit Commercial Landlords

On April 20, 2005, President Bush signed into law legislation which is commonly known as the Bankruptcy Reform Act of 2005 (the "Act"). Although widely reported as a consumer bankruptcy reform bill, the Act also improves two protections commercial landlords already enjoy under Section 365 of the Bankruptcy Code (the "Code").

## I. Tenant's Ability to Extend Time to Assume or Reject Leases Limited to Seven Months

### Summary

The Act materially limits a debtor's ability to extend the time to assume, assume and assign, or reject nonresidential real property leases under Section 365(d)(4) of the Code beyond seven months. In contrast to prior law, where bankruptcy courts could (and did) grant further extensions for "cause," now commercial landlords *must* consent to *any* extension beyond the first 210 days of the bankruptcy case.

### History

Prior to the Act, Section 365(d)(4) afforded a debtor-tenant under a nonresidential real property lease an initial 60-day period to determine whether it would assume, assume and assign, or reject its leases. A debtor could obtain an extension of the 60-day period by demonstrating "cause" in a motion filed with the bankruptcy court. Because Section 365(d)(4) did not define "cause" and did not specifically limit either the length or the number of extensions a debtor could obtain, attempts by commercial landlords to restrict a debtor's time to assume, assume and assign, or reject leases met with varying degrees of success. As a result, bankruptcy courts regularly granted multiple extensions, spanning periods of months or years.

### New Procedures

The Act amends Section 365(d)(4) to require a debtor to assume, assume and assign, or reject a nonresidential real property lease by the earlier of 120 days (previously 60 days) after entry of an order for relief (usually the date the bankruptcy petition is filed), or the date an order confirming a plan of reorganization is entered. If the debtor does not meet that initial deadline, the lease is deemed rejected, and the premises immediately surrendered to the landlord, unless the debtor obtains an extension of the initial 120-day period. The bankruptcy court may grant the debtor a single 90-day extension beyond the initial 120-day period, provided the debtor demonstrates cause. Thereafter, unless the landlord gives prior written consent, the bankruptcy court cannot grant a further extension to the debtor.

While the Act doubles the debtor's initial period to assume, assume and assign, or reject leases to 120 days, the practical effect of this change is minimal in light of bankruptcy courts' routine granting of extensions under the prior statute. The Act does not change a debtor's burden to remain current on all post-petition lease obligations, and a landlord may still seek affirmative relief from the bankruptcy court within the initial 120-day period if the debtor fails to perform under the lease.

If bankruptcy judges follow the law, the Act provides a commercial landlord with greater certainty and control over its leases. The limitation to a single 90-day extension without landlord consent provides leverage to commercial landlords to: (i) require the debtor to assume, assume and assign, or reject their leases within the first 210 days of the bankruptcy case; or (ii) obtain adequate protection from the debtor in exchange for a further extension. As amended, Section 365(d)(4) provides commercial landlords significantly greater control over their leases after the first 210 days of a bankruptcy case.

## **II. Shopping Center Landlord's Control Over Tenant Use, Mix, and Balance Reinforced**

### **Summary**

The Act also limits a debtor's ability to assign a shopping center lease, and reinforces the fact that such assignments under Section 365(f)(1) are subject to *all* the special protections afforded landlords under Section 365(b). Under prior law, there was some confusion among bankruptcy courts concerning whether the landlord protections found in Section 365(b) which require an assignee take a lease subject to all its terms and exclusivity provisions of other shopping center leases overrode the debtor's general ability to assign an unexpired lease under Section 365(f)(1).

### **History**

Section 365(b) affords shopping center leases special protections. Among other things, a debtor may not assign a shopping center lease unless: (i) the assignment is subject to existing lease provisions (including but not limited to those concerning radius, location, use and exclusivity); and (ii) the assignment will not disrupt the tenant mix and balance in the shopping center. Prior to the Act, Section 365(f)(1) generally allowed a debtor to assign a lease notwithstanding any lease provision which limits or prohibits assignments. The confusion inherent in these competing sections led some bankruptcy courts to ignore the vital landlord protections found in Section 365(b)(3) in favor of the debtor's general ability to assign its leases under Section 365(f)(1), even where the assignment violated specific terms of the shopping center leases.

### **New Provision**

The Acts amends Section 365(f)(1) to specify that it is subject to Section 365(b). The Act is consistent with a recent Fourth Circuit Court of Appeals ruling addressing the relative priority of Sections 365(b) and 365(f)(1). *In re Trak Auto Corp.*, 367 F.3d 237 (4<sup>th</sup> Cir. 2004). KMZ Rosenman filed an *amicus brief* on behalf of its client the International Council of Shopping Centers supporting the shopping center landlord's argument that the specific protection of Section 365(b) given to the use clause of a shopping center lease overrode the general provision of Section 365(f)(1) rendering anti-assignment clauses unenforceable. The Fourth Circuit agreed with the landlord. Indicative of the legislative intent behind the amendment to Section 365(f)(1), Senator Orrin Hatch referenced the Fourth Circuit's *Trak Auto* opinion in his comments in support of the Senate version of the Act. While a shopping center landlord may forego the protections of Section 365(b) as part of a consensual lease assignment, the Act, if followed by the bankruptcy courts, will prevent a bankruptcy court from overstepping its authority and repeating the errors made by the lower courts in *Trak Auto* — using Section 365(f)(1) to override the special protections of Section 365(b).

### III. Effective Date of the Act

The Act is effective on October 17, 2005 (the “Effective Date”). The provisions of the Act will not apply to cases filed before the Effective Date. Thus, the limitations on a debtor’s ability to extend the time to assume, assume and assign, or reject a nonresidential real property lease (discussed in Part I of this Client Advisory) will apply only to those cases filed on or after the Effective Date. The Effective Date has less bearing on a shopping center landlord’s ability to control tenant use, mix, and balance in a contested lease assignment (discussed in Part II of this Client Advisory) because the Act is declaratory of existing law.

### We Can Help

For further information regarding the Act and its various amendments, or further advice relating to landlord rights in bankruptcy cases, please contact one of the members of the Shopping Center and Retail Law Practice.

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