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"Stub Rent" Considered Administrative Expense Obligation by Delaware District Court

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The United States District Court for the District of Delaware, in *Goody's Family Clothing, Inc. et al. v. Mountaineer Prop. Co. II, LLC, et al.* (In re *Goody's Family Clothing, Inc. et al.*), 2009 WL 903370 (D. Del. March 31, 2009), held that "stub" rent owed to commercial landlords should be accorded administrative expense priority under Section 503(b)(1) of the Bankruptcy Code. "Stub" rent is a bankruptcy term of art that means rent due for the period from the date the bankruptcy case is commenced through the end of the month in which the case was filed. In so ruling, the District Court swiftly distinguished the Third Circuit's decision in *In re Montgomery Ward Holding Corp.*, 268 F.3d 205, 209 (3d Cir. 2001), and ruled that Section 365 of the Bankruptcy Code is not the exclusive remedy for commercial landlords to obtain payment of "stub" rent. The Goody's Court ruled, however, that while the "stub" rent obligation constituted an administrative expense claim, payment did not have to be made immediately. That is, payment could be made pursuant to a confirmed Chapter 11 plan.

Section 365(d)(3) of the Bankruptcy Code provides that a debtor-in-possession must timely perform all the obligations of the debtor under an unexpired commercial real property lease arising after the order for relief is entered until such lease is assumed or rejected, notwithstanding section 503(b)(1) of the Bankruptcy Code. As to payment of "stub" rent, there is a split of authority whether such obligation should be deemed a pre-petition or post-petition obligation of the debtor-tenant. Some courts have adopted the "billing date" approach based on their view that an

obligation to pay rent arises on the day that rent is due, while others have adopted the “accrual date” approach based on the days the tenant occupies the leased premises. In *Montgomery Ward*, the Third Circuit adopted the “billing date” approach when confronted with the issue of whether real estate taxes billed to the tenant under an unexpired lease after the bankruptcy filing had to be paid in full, even though a portion of the taxes were attributable to the pre-petition period. The Third Circuit required payment of the entire real estate tax bill because it was “billed” after the bankruptcy filing.

Technically, under *Montgomery Ward*’s “billing date” approach, the “stub” rent in *Goody’s* would have constituted a pre-petition claim. However, the *Goody’s* Court relied on Section 503(b) of the Bankruptcy Code to grant the commercial landlords an administrative expense claim for their “stub” rent. That statute provides that an administrative claim should be allowed for the “actual, necessary costs and expenses of preserving the estate.” The *Goody’s* Court held that because the debtors were occupying leased commercial premises after the bankruptcy filings and were using them to conduct “profitable” store closing sales, Section 503(b) entitled them to an administrative expense claim for the “stub” rent. This is a significant victory for commercial landlords, and one debtors’ counsel should consider when determining the date on which a bankruptcy filing should be commenced.

On April 27, 2009, the Debtors filed a notice of appeal in the District Court, invoking their right to have the Third Circuit review the Delaware District Court’s decision. The Third Circuit case number is 09-2168.

Cole, Schotz, Meisel, Forman & Leonard, P.A.

Court Plaza North
25 Main Street
Hackensack, NJ 07601
Phone:
(201) 489-3000

900 Third Avenue
16th Floor
New York, NY 10022
Phone:
(212) 752-8000

500 Delaware Avenue
Suite 1410
Wilmington, DE 19801
Phone:
(302) 652-3131

300 East Lombard Street Suite 2000
Baltimore, MD 21202
Phone:
(410) 230-0660