



# Shopping Center Legal Update

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## In Depth

Adding a 'Supercenter' to a Project Is Not Comparable to Fueling It With Kryptonite	2
Bankruptcy: Real Estate Issues	4
The New Wave of Cyber-Crime Facing Retailers	7
<i>Dukes v. Wal-Mart Stores: En Banc</i> Ninth Circuit Lowers the Bar for Class Certification and Creates Circuit Court Split	11
Landlord's Actions Speak Louder Than Lease Words: A Landlord's Conduct May Result in a Waiver of Its Right to Object to a Lease Assignment	14
About the Rent . . . § 365, Stub Rent, and the Billing Date and Proration Rules	17
MJP, UPL and Commercial Leasing Lawyers	19
<i>Cases</i>	22
Co-Tenancy Provision	22
Indemnity/Insurance Provision	22
Reduced Rent	23
Repair/Replacement Obligation	23

## From Canada

Precision Drafting—Making the Clauses Reflect Intent	24
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# About the Rent . . . § 365, Stub Rent, and the Billing Date and Proration Rules

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## Introduction

The premise is simple. A retailer is a tenant under an unexpired non-residential real property lease with a shopping center landlord. The tenant files a voluntary bankruptcy petition and becomes a debtor under Title 11 of the United States Code. Once the bankruptcy is filed, the debtor must pay the shopping center landlord rent (i.e., minimum rent and all additional rent under the lease) for its use and occupancy of the premises under § 365 of the Bankruptcy Code (11 U.S.C. § 101, *et seq.*) until the lease is assumed or rejected.

There is little disagreement on *whether* the debtor must pay the post-petition rent. However, the issue of *when* a debtor must pay the post-petition rent to the shopping center landlord has produced two divergent schools of thought: the “proration (or accrual) rule” and the “billing date (or performance)” rule. The debate is usually joined in the early stages of a bankruptcy case, and more often than not focuses on the “stub rent” (i.e., the rent and charges attributable to the remainder of the month in which the bankruptcy petition is filed).<sup>1</sup> Proponents of each rule argue that the plain meaning of § 365 supports their interpretation of the statute and that theirs is the only proper reading of congressional intent. As the courts have in the past, and will continue to do so in the future unless § 365 is amended or the Supreme Court grants *certiorari*, the language of the statute, much like the premise stated here, is fairly straightforward.

## The Statute

The relevant portion of § 365(d)(3) of the Bankruptcy Code is less than 50 words long:

The trustee shall timely perform all of the obligations of the debtor, except those specified in section 365(b)(2), arising from and after the order for relief under any unexpired lease of nonresidential real property, until such lease is assumed or rejected, notwithstanding section 503(b)(1) of this title. 11 U.S.C. § 365(d)(3).

The first clause of § 365(d)(3) makes it fairly clear that the trustee (and by statute, a Chapter 11 debtor-in-possession; see 11 U.S.C. § 1107) must timely perform all obligations under the lease. See, e.g., *In re New Almacs, Inc.*, 196 B.R. 244, 248 (Bankr. N.D.N.Y. 1996); *Towers v. Chickering & Gregory (In re Pacific-Atlantic Trading Co.)*, 27 F.3d 401 (9th Cir. 1994); *Cukierman v. Uecker (In re Cukierman)*, 265 F.3d 846, 851 (9th Cir. 2001). Courts analyzing the legislative history of § 365 have concluded that the statute was intended to relieve the burden placed upon shopping center landlords during the period between the tenant’s bankruptcy petition and assumption or rejection of the lease. See, e.g., *Omni Partners, L.P. v. Pudgie’s Dev. of NY, Inc. (In re Pudgie’s Dev. of NY, Inc.)*, 239 B.R. 688, 692 (S.D.N.Y. 1999), quoting 130 Cong. Rec. S8894-95 (daily ed. June 29, 1994) (statements of Sen. Hatch). Indeed, even courts that have reached opposite conclusions on the billing date and proration rules seem to agree that the legislative history of § 365 demonstrates the dual needs of ensuring that landlords receive immediate payment for lease obligations, and preventing the injustice of landlords being forced to provide uncompensated services to debtors. See *Centerpoint Properties v. Montgomery Ward Holding Corp. (In re Montgomery Ward Holding Corp.)*, 268 F.3d 205, 211 (3rd Cir. 2001) and *In re Cukierman*, 265 F.3d at 851.

The debates focus on the “arising from and after the order for relief” and the “notwithstanding section 503(b)(1)” language of § 365(d)(3).

## The Billing Date (or Performance) Rule

Under the billing date rule, the debtor must immediately pay rent under a lease that becomes due after the order for relief is entered (i.e., the date the voluntary petition is filed), even if the rent due is attributable to a time period prior to the order for relief. The case most often cited for the billing date rule is *In re Montgomery Ward Holding Corp.*, 268 F.3d at 208-209 (3rd Cir. 2001). In *Montgomery Ward*, property taxes for several pre-petition periods were invoiced to the debtor post-petition, and the Third Circuit held that under § 365(d)(3) the landlord was entitled to immediate payment. Courts in other circuits and districts have also adopted the billing date rule, both before and after the Third Circuit’s 2001 decision in *Montgomery Ward*: See *In re Appletree Markets, Inc.*, 139 B.R. 417, 420 (Bankr. S.D. Tex. 1992); *In re F&M Distributors, Inc.*, 197 B.R. 829, 831 (Bankr. E.D. Mich. 1995); *In re Krystal Co.*, 194 B.R. 161, 164 (Bankr. E.D. Tenn. 1996); *In re DeCicco of Montvale, Inc.*, 239 B.R. 475 (Bankr. D. N.J. 1999); *In re HQ Global Holdings, Inc.*, 282 B.R. 169 (Bankr. D. Del 2002); *In re CCI Wireless, LLC*, 279 B.R. 590, 594 (Bankr. D. Colo. 2002); and *In re Comdisco, Inc.*, 272 B.R. 671, 675 (Bankr. N.D. III. 2002).

If the lease requires payment of rent in full and in advance on the first day of the month (as most shopping center leases do), and if the tenant files bankruptcy after the first calendar day of the month, proponents of the billing date rule argue that *all* of the rent was due and payable on the first day of the month (i.e., pre-petition), and thus the stub rent cannot be ordered immediately paid under § 365(d)(3). Landlords have then been required to seek payment of the stub rent under § 503(b)(1) of the Bankruptcy Code, which does not require immediate payment by the debtor. See *In re HQ Global Holdings, Inc.*, *supra*, and *In re Goody's Family Clothing, Inc.*, 401 B.R. 656 (D. Del. 2009) (currently on appeal to the Third Circuit).

The billing date rule poses risks for debtors for the month in which the lease is rejected. In 2000, the Sixth Circuit was faced with a scenario where the debtor elected to conduct store closing sales (also known as going-out-of-business or GOB sales) and rejected one lease on the second day of the month. In *Koenig Sporting Goods, Inc. v. Morse Road Co. (In re Koenig Sporting Goods, Inc.)*, 203 F.3d 986 (6th Cir. 2000), the debtor was required to pay the rent for the entire month, even though the lease was rejected on the second day of the month because all rent was due and payable on the first calendar day of the month. The debtor argued that policy considerations, equity and common sense compelled adoption of the proration rule, and that adopting the billing date rule would provide the landlord with a windfall. The Sixth Circuit disagreed, noting that the debtor alone was in the position to control whether the landlord would be entitled to the payment of the full month's rent because it could have rejected the lease before the end of the prior month.

### The Proration (or Accrual) Rule

Under the proration rule, rent must be timely paid as it accrues for every day the debtor occupies the property. See *In re Handy Andy Home Improvement Centers, Inc.*, 144 F.3d 1127-1128 (7th Cir. 1998) and *In re NETtel Corp., Inc.*, 289 B.R. 486, 490-491 (Bankr. D. D.C. 2002). Advocates of the proration rule point to the equitable nature of the approach as well as the ease of calculating the stub rent—one simply takes the *per diem* rent and multiplies it by the number of days remaining in the month (including the day the petition was filed) to determine the amount payable under § 365(d)(3). Since the Third Circuit's decision in *Montgomery Ward*, courts have generally recognized that the proration rule holds a slight majority. See *In re Furr's Supermarkets, Inc.*, 283 B.R. 60, 68 (Bankr. 10th Cir. 2002) and *In re National Refractories & Minerals Corp.*, 297 B.R. 614, 619 (Bankr. N.D. Cal. 2003).

Indeed, courts throughout the country adopted the proration rule both before and after *Montgomery Ward*: See *In re Child World, Inc.*, 161 B.R. 571, 575-576 (S.D.N.Y. 1993); *In re All For A Dollar, Inc.*, 174 B.R. 358, 361-362 (Bankr. D.Mass. 1994); *In re William Schneider, Inc.*, 175 B.R. 769, 772 (S.D. Fla. 1994); *In re Warehouse Club, Inc.*, 184 B.R. 316, 318 (Bankr. N.D. Ill. 1995); *In re Best Products Co., Inc.*, 206 B.R. 407 (Bankr. E.D. Va. 1997); *In re McCrory Corp.*, 210 B.R. 934, 940 (S.D.N.Y. 1997); *In re Handy Andy Home Improvement Ctrs., Inc.*, 144 F.3d 1125 (7th Cir. 1998); *In re Learningsmith, Inc.*, 253 B.R. 131, 133-134 (Bankr. D. Mass. 2000); *In re Trak Auto Corp.*, 277 B.R. 655, 663 (Bankr. E.D. Va. 2002); *In re NETel Corp., Inc.*, *supra*; *In re Ames Dep't Stores*, 306 B.R. 43, 64 (Bankr. S.D.N.Y. 2004); *In re Treesource Industries, Inc.*, 363 F.3d 994, 998 (9th Cir. 2004) (rent and tax liabilities accrue over time); *Heathcon Holdings, LLC v. Dunn Industries, LLC (In re Dunn Industries, LLC)*, 320 B.R. 86 (Bankr. D. Md. 2005); and *In re Stone Barn Manhattan LLC, f/k/a Steve & Barry's LLC*, 398 B.R. 359 (Bankr. S.D.N.Y. 2008) (stub rent payable).

### Legislative Change?

Despite the many changes made by the 2005 amendments to the Bankruptcy Code, no effort was made to solve the stub rent issue legislatively, nor firmly establish the billing date rule, nor the proration rule; perhaps that is as it should be. Prior to the time the Sixth Circuit decided *Koenig Sporting Goods*, the Third Circuit opined in *Montgomery Ward* and the 2005 amendments to the Bankruptcy Code went effective, the lines of engagement were not yet firmly established between the billing date and proration proponents. Both sides would likely agree that some certainty on the stub rent issue would benefit debtor/tenants and landlord alike, but the issues then become how and when that certainty is realized.

Although the *Goody's* case is on appeal to the Third Circuit, it remains to be seen whether the losing party would seek (or the Supreme Court would grant) *certiorari* based on the split between the various circuits that have opined on the stub rent issue. The seed of a legislative solution may already have been planted, but in a form that is anathema to one provision of § 365(d), for which shopping center landlords lobbied (and obtained) in the 2005 amendments.

A portion of H.R. 1942, which was introduced in April 2009, seeks to eliminate the amendment that provides debtors a maximum period of 210 days (without landlord consent) to assume, assume and assign, or reject non-residential real property leases, so the solution of the stub rent issue lies with Congress. As of June 2010, H.R. 1942 has not moved beyond a referral to the House Judiciary Subcommittee on Commercial and Administrative Law. Whether with the judiciary or the legislative branch, it does not appear that the stub rent issue will be settled any time soon, but at least the premise is simple.

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<sup>1</sup>Other circumstances that fuel the debate include billings for year-end adjustments, reconciliation for triple-net charges (e.g., property taxes, common area maintenance fees) and when the debtor rejects the lease after the first calendar day of a month.