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Landlords Without Borders

Challenges in Canadian/U.S. Cross-Border Retail Restructurings



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As with its neighbor to the south, Canada faced an influx of retail insolvencies during the midst of the COVID-19 pandemic. For example, in 2020, Canadian-based clothing retailers such as the Aldo Group and Groupe Dynamite filed applications under the Canadian Companies' Creditors Arrangement Act (CCAA), Canada's equivalent to a chapter 11 case, and commenced chapter 15 proceedings in the U.S.² In 2021, the real estate segment of Sarku Japan, a Japanese quick-service restaurant chain, commenced a CCAA case and a chapter 15 proceeding, even though none of the debtors' 226 restaurants are located in Canada.³

A CCAA cross-border restructuring presents unique challenges for landlords in both the plenary CCAA case and the ancillary chapter 15 case. When a retailer chooses to restructure under the CCAA rather than chapter 11, a glaring problem for landlords is the lack of many of the unique rights and protections afforded to landlords, and in particular shopping center landlords, under § 365 of the Bankruptcy Code. However, the CCAA is not without protections for landlords.

No reported decision exists where a landlord has sought to invoke § 365 in a chapter 15 case to compensate for the comparative lack of rights in the plenary CCAA case. Section 365 does not apply in a chapter 15 case, and when a foreign representative seeks to apply certain provisions of § 365 in the restructuring, the purpose is to impair landlords' rights. However, landlords do not need to accept the *status quo*.

As illustrated in this article, landlords can optimize the rights available to them in a U.S./

Canadian cross-border restructuring by leveraging the rights and protections present in both jurisdictions. Moreover, the *Qimonda* decision of the Fourth Circuit concerning the impact of § 365(n) in a chapter 15 case demonstrates how a landlord can bootstrap the landlord protections of § 365 into a chapter 15 case.⁴

The Intersection of Chapter 15 and § 365: The *Status Quo*

Section 365 appears nowhere in chapter 15 of the Bankruptcy Code, but § 1520 enumerates certain relief that becomes automatic upon recognition of a foreign main proceeding.⁵ Moreover, § 1521(a) provides courts with the discretion to grant the foreign representative "appropriate relief," whether in a foreign main or foreign non-main proceeding, "where necessary to effectuate the purpose of this chapter and to protect the assets of the debtor or the interests of the creditors."⁶ Under § 1521(a)(7), a court may grant "any additional relief that may be available to the trustee" that is not specifically enumerated in § 1521(a)(1)-(6), other than the trustee's avoidance powers.⁷

Foreign representatives often use the catch-all provision of § 1521(a)(7) to seek, without objection, the applicability of § 365(e) to the foreign proceeding. Pursuant to § 365(e)(1), clauses in unexpired leases that provide for a default upon a party's commencement of a bankruptcy action (*i.e.*, *ipso facto* clauses) are unenforceable. In the only published decision addressing the application of § 365(e) to a chapter 15 case, the court, in *dicta*, criticized the selective application of § 365(e) to the exclusion of the rest

¹ The authors represented numerous landlords in the U.S./Canadian cross-border restructurings of the Aldo Group, Groupe Dynamite and the Yatsen Group of Companies (Sarku Japan).

² *In re The Aldo Grp. Inc., et al.*, No. 20-11062 (JKO) (Bankr. D. Del.); *In re Groupe Dynamite Inc., et al.*, No. 20-12085 (CSS) (Bankr. D. Del.).

³ *In re Yatsen Group of Cos. Inc., et al.*, No. 21-10073 (BLS) (Bankr. D. Del.).

⁴ *Jaffé v. Samsung Elecs. Co. Ltd.*, 737 F.3d 14, 26 (4th Cir. 2013).

⁵ 11 U.S.C. § 1520(a).

⁶ 11 U.S.C. § 1521(a).

⁷ 11 U.S.C. § 1521(a)(7).

of § 365.⁸ Section 365(e) is of limited utility to foreign debtors generally because landlords are generally prohibited from terminating a lease without obtaining relief from the automatic stay,⁹ and especially to CCAA debtors because *ipso facto* clauses are generally unenforceable under the CCAA.¹⁰

Thus, foreign representatives freely cherry-pick a portion of § 365 that protects the foreign debtor at the expense of landlords. As explained herein, the creditor protections in chapter 15 provide a gateway for landlords to obtain § 365 rights and protections.

Landlord Rights and Protections Under § 365

Section 365 contains various protections for landlords. One of the most fundamental protections is that the debtor is required to assume or reject a nonresidential real property lease within the earlier of 210 days following the petition date, unless extended for 90 days for cause, and the confirmation of the plan.¹¹ As a condition to assumption, the debtor must cure any default under the lease.¹² In addition, upon assumption, the debtor must provide adequate assurance of its future performance,¹³ or if the debtor assigns the lease, provide adequate assurance of the proposed assignee's future performance.¹⁴ Moreover, upon the assignment of a lease, a landlord may require a deposit or other security under the lease the same as would have been required by the landlord upon the initial leasing to a similar tenant.¹⁵

Shopping center landlords enjoy “extraordinary protections” under the Bankruptcy Code.¹⁶ Where the leased premises are in a shopping center, the debtor must meet the heightened definition of “adequate assurance.”¹⁷ Generally speaking, this standard requires adequate assurance that the (1) source of rent due under the lease, and in the case of an assignment, the financial and operating performance of the proposed assignee, is similar to that of the debtor at the time the lease was executed; (2) percentage rent will not substantially decline; (3) the assignment of such lease is subject to all of its provisions; and (4) the assignment will not disrupt any tenant mix or balance.¹⁸

The Monitor in CCAA Cases

An American bankruptcy lawyer cannot effectively navigate a CCAA cross-border case without understanding the monitor's unique role, as it is usually the for-

eign representative in the chapter 15 case. The monitor is a restructuring advisory firm or large accounting firm appointed by the court to supervise the debtor, periodically report to the court and stakeholders on the debtor's business, and assist with the restructuring.¹⁹ The monitor's specific statutory duties primarily include filing reports throughout a case on the company's business and financial affairs, providing an opinion on important issues such as a proposed sale of the debtors' assets, plan of arrangement and assignment of leases, and investigating and seeking to avoid certain pre-filing transfers.²⁰ In practice, a monitor's rights and responsibilities are much broader and difficult to define, as they are often expanded by court order and custom.²¹

What is clear is that the monitor is an important player in a CCAA case and exercises broad powers.²² For example, as an independent officer of the court, judges defer to a monitor's advice and viewpoint on the restructuring.²³ As the court's “eyes and ears,” the monitor is not considered an adversary and generally avoids taking positions in a litigation.²⁴ The monitor is also viewed as an advisor to the debtor company and a representative of the creditors.²⁵

Although court-appointed, the monitor is selected and paid by the debtor. This creates an unavoidable tension between the monitor's independence and the monitor's ties to debtor's counsel, who may hold the keys to future engagements. This dynamic must be managed in CCAA cases and, when appropriate, leveraged to advance the landlord's interests.

Landlords in CCAA Cases

The landlord protections of § 365 are almost entirely absent in the CCAA. Under Canadian law, a debtor does not affirmatively assume a lease.²⁶ A debtor may “disclaim” a lease, which is the functional equivalent of a rejection.²⁷ The monitor must approve the disclaimer.²⁸ If a debtor never disclaims a lease, it continues in effect.²⁹ The debtor is not required to cure any default as a condition to retaining a lease, nor establish adequate assurance of the debtor's future performance. Any pre-petition claim arising under a retained lease is treated as a general unsecured claim under the debtor's plan of arrangement, meaning the landlord's claim does not have to be paid in full.

However, the CCAA favors landlords in several ways. Like in the U.S., a CCAA debtor may assign a lease with an anti-assignment clause, but as a condition to the assign-

8 *In re Bluberi Gaming Techs. Inc.*, 554 B.R. 841, 845 (Bankr. N.D. Ill. 2016).

9 *See In re Mirant Corp.*, 440 F.3d 238, 252-53 (5th Cir. 2006).

10 CCAA, R.S.C. 1985, c. C-36, § 34.

11 11 U.S.C. § 365(d)(4). The Coronavirus Aid, Relief and Economic Security Act (CARES Act), Pub. L. 116-136, increased the initial time period within which to assume or assign a commercial lease from 120 days to 210 days. This change will sunset on Dec. 27, 2022, but will continue to apply to subchapter V small business chapter 11 cases commenced before that date. *See* Ben Feder, “Commercial Landlords Take Note — COVID Relief Bill Contains Important Bankruptcy Code Amendments,” Kelley Drye & Warren LLP (Jan. 12, 2021), *available at* bankruptcy.lawinsights.com/2021/01/commercial-landlords-take-note-covid-relief-bill-contains-important-bankruptcy-code-amendments (unless otherwise specified, all links in this article were last visited on Dec. 23, 2021).

12 11 U.S.C. § 365(b).

13 11 U.S.C. § 365(b)(C).

14 11 U.S.C. § 365(f)(2)(B).

15 11 U.S.C. § 365(i).

16 *In re Rickel Home Ctrs. Inc.*, 209 F.3d 291, 298 (3d Cir. 2000).

17 *Id.* at 299 (citation omitted).

18 11 U.S.C. § 363(b)(3).

19 *See* “Chapter 11 and CCAA: A Cross-Border Comparison,” Blake, Cassels & Graydon LLP (February 2020), pp. 1-16, *available at* blakes.com/getmedia/58907e69-1854-49ed-a768-9ff949831a4/Chapter-11-CCAA-Comparison_Oct-2021.pdf.aspx.

20 *See* Denis Ferland & Christian Lachance, “The Role of the Monitor and Its Impact on U.S. Restructurings,” December 2014, pp. 38-41, *available at* dwpv.com/-/media/Files/PDF_EN/2014-2007/2014-12-01-Article-The-Role-of-the-Monitor-and-its-impact-on-US-Restructurings.ashx.

21 *See id.*

22 *Id.* at 38.

23 *Id.* at 40.

24 *Id.* at 39.

25 *Id.*

26 *See* Linc Rogers & Aryo Shalviri, “Retail Insolvencies in Canada Series, #1: Landlord Perspectives,” Blake, Cassels & Graydon LLP (July 2017), pp. 1-5, *available at* blakes.com/getmedia/6E537852-D203-47A9-BED0-DEB7E8CA9B99/Retail_Insolvency_Series_Landlord_Perspectives.aspx.

27 *See* Brian D. Huben, “North vs. South: How Certain Canadian and American Insolvency Laws Affect Shopping Center Landlords,” Int'l Council of Shopping Ctrs. Inc. (Summer 2008), *available at* katten.com/files/21077_Huben%20-%20Shopping%20Center%20Legal%20-%20North%20v%20South.pdf.

28 *See* Rogers & Shalviri, *supra* n.26, p. 2.

29 *Id.* at 2.

ment, the debtor must cure monetary defaults.³⁰ In addition, the court will consider the proposed assignee's ability to perform the obligations under the lease.³¹

Moreover, in a precedent-setting decision in the *Groupe Dynamite* case, the court rejected the debtors' request to defer paying rent for leases in Ontario and Manitoba during the pendency of COVID-19 restrictions in those provinces.³² On the other hand, during the pandemic, U.S. bankruptcy judges have been generally receptive to motions to defer a debtor's obligation to timely pay rent under § 365(d)(3)³³ and under various state law theories.³⁴

The CCAA also does not include a limitation on damages arising from a disclaimer of a commercial lease (referred to as a "restructuring" claim in Canada) similar to the cap found in § 502(b)(6) of the Bankruptcy Code on lease-rejection damages.³⁵ CCAA debtors and monitors routinely seek to impose a cap on restructuring claims. Monitors usually demand a cap equal to 12 to 16 months of rent, arguing that a landlord should mitigate most of its damages within that time frame. This view does not comport with the reduced demand for brick-and-mortar stores caused by the retail industry's shift to online sales, nor the costs of attracting new tenants and repurposing the premises. Landlord-specific facts can be used to oppose a monitor's *de facto* cap on restructuring claims.

Lastly, there is no cramdown or similar concept in Canada. To approve a plan of arrangement, at least two-thirds in value of voting claims and a majority in number of voting creditors in a class must vote in favor of a plan.³⁶ Unlike in chapter 11 cases, it is typical for CCAA debtors to lobby landlords with significant restructuring claims to support the plan. This provides landlords with added leverage when, for example, negotiating a resolution of a disputed restructuring claim which the monitor seeks to reduce or when negotiating a lease amendment with the debtor.

Changing the Status Quo for Landlords in Chapter 15 Cases

Landlords can seek § 365 protections in a cross-border restructuring pursuant to § 1522(a), which provides, in pertinent part, that the "court may grant relief under section ... 1521, or may modify or terminate relief [granted under section 1521], only if the interests of the creditors ... are sufficiently protected."³⁷ Section 1522 provides bankruptcy courts "broad latitude to mold relief to meet specific circumstances, including appropriate responses if it is shown that the foreign proceeding is seriously and unjustifiably injuring [U.S.] creditors."³⁸

As illustrated by the decision of the Fourth Circuit Court of Appeals in *Qimonda*, the statutory framework exists to

apply the landlord protections of § 365 to a CCAA cross-border restructuring. In *Qimonda*, the German insolvency administrator declared that the cross-license agreements between Qimonda and its licensees were no longer enforceable under German law.³⁹ As the foreign representative, he filed a motion in the chapter 15 case to restrict the licensees' rights under § 365(n).⁴⁰ To protect licensees, § 365(n) limits the debtor's ability to unilaterally reject licenses to the debtor's intellectual property, reserving to the licensees the option to elect to retain their rights under the licenses.

The U.S. Bankruptcy Court for the Eastern District of Virginia granted the motion, and the licensees appealed.⁴¹ As instructed by the district court on remand, the bankruptcy court balanced the interests of Qimonda's estate with the interests of the licensees pursuant to § 1522(a). The bankruptcy court concluded that the application of § 365(n) was necessary to ensure that the licensees were "sufficiently protected" as required by § 1522(a), although its decision would result in far less value being realized by Qimonda's estate.⁴² The Fourth Circuit affirmed the bankruptcy court on direct appeal.⁴³

Qimonda can serve as a road map for landlords to advance their interests in cross-border retail reorganizations. Landlords can request that a court apply some of the protections found in § 365 to a chapter 15 case based on § 1522's command that courts consider the interests of all creditors and interested parties when evaluating whether to grant the foreign representative discretionary relief. As illustrated by *Qimonda*, a court may deny, condition or modify relief granted under § 1522 when doing so would diminish the value of the foreign debtors' principal asset. For example, a landlord may invoke the shopping center provisions to resist the unwanted assignment of a lease to an undesirable tenant, or may demand additional security from a proposed assignee pursuant to §§ 365(l) and 1522(b).⁴⁴ A court faced with a request by a landlord for protections under § 365 would be hard-pressed to decline the request without carefully weighing the interests of the creditor against the interests of the foreign debtor as the Third Circuit did in *Qimonda*.

A landlord may also combat a foreign debtor's delay in deciding which leases to keep by asking the court to impose a deadline to assume or reject leases consistent with § 365(d)(4). In Canada, debtors must file applications to extend the rights and protections conferred to them under the CCAA. The extensions (referred to as "stay periods") are usually in the range of two to six months and are rarely contested. In the *Aldo* case, in December 2021 the debtors sought their seventh request to extend the stay period. The court granted the extension to April 30, 2022, which means that the debtors could remain in the proceedings for more than two years. A motion in a chapter 15 case to impose a deadline on a foreign debtor can pressure the foreign debtor to move expeditiously toward emergence from the CCAA proceedings.

30 *Id.*

31 See Blake, Cassels & Graydon LLP, *supra* n.19, p. 8.

32 See Sébastien Guy & Géraldine Côté-Hébert, "CCAA Debtor Must Pay Post-Filing Rent for the 'Use' of Leased Premises," Blake, Cassels & Graydon LLP (Jan. 15, 2021), available at blakes.com/insights/bulletins/2021/ccaa-debtor-must-pay-post-filing-rent-for-the-use%E2%80%9D.

33 See, e.g., *In re Pier 1 Imports Inc.*, 615 B.R. 196, 202 (Bankr. E.D. Va. 2020).

34 See, e.g., *In re Cinemex USA Real Est. Holdings Inc.*, 627 B.R. 693, 695 (Bankr. S.D. Fla. 2021).

35 The Bankruptcy and Insolvency Act, a scheme designed for smaller companies, includes a formula to cap landlords' restructuring claims similar to the cap in section 502(b)(6). See Rogers & Shalviri, *supra* n.26 at 2.

36 CCAA, R.S.C. 1985, c. C-36, § 6(1).

37 11 U.S.C. § 1522(a).

38 *Jaffé v. Samsung Elecs. Co. Ltd.*, 737 F.3d 14, 26 (4th Cir. 2013) (quoting H.R. Rep. No. 109-31, pt. 1, at 116).

39 *Id.* at 20.

40 *Id.*

41 *Id.* at 20-21.

42 *Id.* at 22-23.

43 *Id.* at 32.

44 Under § 1522(b), "The court may subject relief granted under section 1519 or 1521 ... to conditions it considers appropriate, including the giving of security or the filing of a bond."

A request to apply certain provisions under § 365 can be made at any time during a chapter 15 case. Therefore, a landlord can file a cross-motion in response to a recognition motion and request that the § 365 rights be included in the recognition order. It does not need to wait the usual month or two for the court to grant the foreign representative's recognition motion on a final basis before seeking § 365 rights. Moreover, relief previously granted might be modified or terminated pursuant to § 1522(c). Thus, for example, a landlord may seek such relief in response to a foreign debtor's decision to disclaim, retain, or assign a lease in the foreign proceeding.

Conclusion

A U.S. landlord does not have to be a mere spectator in a CCAA cross-border restructuring. As demonstrated herein, the tools and strategies are at their disposal to safeguard their rights and economic interests in both the plenary CCAA case and ancillary chapter 15 case. **abi**

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