

PRESENT

Slumlords and Deadbeats: Issues in Landlord/Tenant Bankruptcy

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Non-residential Real Property Leases as Part of the Bankruptcy Estate

- Estate includes "all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541(a)(1). This provision includes any rights that the debtor may hold in an unexpired lease as of the date of the bankruptcy filing.
- If the term of the lease has terminated prior or during the bankruptcy case, then such is not property of the estate.
- However, if the primary term of the lease has terminated by its own terms but the tenant has not vacated the premises, a holdover tenancy could be in existence, and the automatic stay likely would prevent the landlord from attempting to collect lease obligations that arose prior to the date of the bankruptcy filing .
 - Holdover per the terms of the lease (month-to-month provisions)
 - Holdover by operation of law (tenancy at sufferance - tenant is a trespasser or holdover tenant, at landlord's election)

A Debtor-Tenant's Obligations and a Landlord's Protections Under § 365(d)(3)

- Under § 365(d)(3), a debtor-tenant is required to perform all of the obligations with respect to leases of non-residential real property in a timely fashion, except, for cause, during the first 60 days post-petition, pending the decision to assume or reject.
- Where the debtor is the tenant, the lease is deemed rejected if not assumed by the earlier of (i) 120 days post-petition or (ii) the date a plan is confirmed. Before the 120 days expire, the court may extend the time period for 90 days (on motion and for cause), or for longer with the lessor's written consent. 11 U.S.C. §§ 365(d)(4).
 - In the Fifth Circuit, several short extensions are favored over long extensions. *In re American Healthcare Management, Inc.*, 900 F.2d 827 (5th Cir. 1990). This is not the case in all Circuits.

A Debtor-Tenant's Obligations and a Landlord's Protections Under § 365(d)(3)

- The trustee shall **timely perform all the obligations of the debtor, . . . , arising from and after the order for relief under any unexpired lease of non-residential real property**, until the lease is assumed or rejected, **notwithstanding § 503(b)(1) of this title.**

11 U.S.C. § 365(d)(3).

- § 503(b)(1) calls for administrative priority for claims of the actual, necessary costs and expenses of preserving the estate including -- [wages, salaries, professional fees etc.].
- 3 key issues in interpreting the interplay of this statutory language:
 - 1) what obligations "arise from" and are "under" the lease?
 - 2) when is "timely" performance? and what does "notwithstanding §503(b)(1)" mean? These are tied together to answer the question . . . when does the landlord get paid?
 - 3) what is the date of rejection?

"Obligations" Arising From and Under the Lease

- Rent
- Common Area Maintenance ("CAM")
- Fees (non-penalty fees)
- Prorated *ad valorem* taxes
- Repair costs
- Attorney's fees (if called for under the lease)
- specifically excludes § 365(b)(2) incl. *ipso facto* clauses and penalty rates and provisions.

"Obligations" Under the Lease – Stub Rent

- Stub rent is the rent owed by a debtor-tenant to the landlord for the period from the petition date until the rent is due the next month.
- Ex. Rent is due on the 1st of every month by 5p. Petition date is on the morning of the 10th. Tenant did not pay rent starting with the 1st. Stub rent 10th - 1st of the next month.
- Is stub rent an "obligation" that must be timely paid? Two theories - *proration method* and the *billing method*.
- Proration: Rent accrues daily. Prorated stub rent, for days 10-1st of the next month is a § 365(d)(3) obligation.
- Billing: A rent obligation "arises" when it is due under the lease. Rent for days 10-1st of the next month is either a § 503(b)(1)(A) admin. claim, if proven to be an "actual and necessary" cost, or an unsecured claim.

"Timely" performance? When does the landlord get paid?

- 4 options:
 - 1) § 365(d)(3) super priority status (i.e. immediately, as due),
 - 2) § 503(b)(1)(A) administrative claim (*pro rata* w/ other administrative claims),
 - 3) § 503(b) *Midway/Imperial Beverage* administrative claim (paid like an admin. claim, but no "actual or necessary" requirement) or
 - 4) general unsecured claim.

Super Priority Status

- **Super priority:** § 365(d)(3) claims exist "notwithstanding" § 503(b)(1), § 503 dealing with administrative claims.
- Courts take the view that "notwithstanding" means that the § 365(d)(3) obligation is expressly independent of standards for administrative expense claims, so § 365(d)(3) claims are more akin to payments in the ordinary course, which are paid when due.
- Several cases in the country hold for super priority status but **only 1 case in 5th Cir. so holds** – *In re Compuadd Corp.*, 166 B.R. 862 (Bankr. W.D. Tex. 1994) (Judge Monroe)).
 - Basis: No ambiguity in the language. "So, what do we call this right to payment? Is it an administrative claim? How could it be? The clear language makes the administrative claim provisions of § 503(b)(1) inapplicable. Is it a super priority claim? Although not denoted as such by Congress, § 365(d)(3) certainly seems to have that effect. However, what we call this type of claim is less important than giving due effect to the statute." *In re Compuadd Corp.*, 166 B.R. at 865.

ADMINISTRATIVE

Administrative Expense Claim § 503(b)(1)

- *pro rata* with other administrative claims
- must show actual & necessary cost and expense or a benefit to the estate
- In W.D. Tex., *Mr. Gatti's* case (164 B.R. 929, Bankr. W.D. Tex. – Austin 1994):
 - "notwithstanding" means that it does not matter whether the claim is admin. or non-admin., a court must order its payment pending assumption or rejection, and does not mean that § 503(b)(1)(A) requirements have been abrogated.
 - Once "actual and necessary" test is met, the claim is based on the payment calculated per the lease, not FMV.
 - § 365 is akin to Congress granting landlords right to seek adequate protection (§ 362(f) and 363(c)), and moving to compel assumption or rejection, moving to dismiss or appoint trustee for cause.

"Mid-Way" View – Administrative Expense Claim § 503(b)

- *In re Midway Airlines*, 406 F.3d 229, 234 (4th Cir. 2005), adopted by Judge Houser in *In re: Imperial Beverage Group, LLC*, 457 B.R. 490 (Bankr. N.D. Tex. 2011).
- Paid Like an Administrative Claim, but no requirement to show such are actual or necessary costs, or that the landlord conferred a benefit to the estate.
- Why does this "mid-way" position make sense to Judge Houser? 2 issues:
 - 1. in construing as a § 503(b)(1) claim, § 365(d)(3) claims are notably absent from the list of administrative expense claims under § 503(b), and
 - 2. in construing as entirely independent of § 503 = illogical result when a case is converted from a chapter 11 to a 7.
 - post-petition, pre-conversion claims lose priority status (i.e. are unsecured) except those under § 503(b). 11 U.S.C. § 348(d).

General Unsecured Claim

- If stub rent is calculated under the Billing Method, any rental obligation paid before it “arises” under the terms of the lease, if it is not an actual and necessary cost to preserve the estate, is a general unsecured claim.

DATE

Date of Rejection

- If not deemed rejected by statute, what is the date of rejection?
- When a landlord has knowledge of debtor's intent to reject or when order is entered?
- Majority view: upon entry of the order.
 - Why? Must read with FRBP 6006 and 9014, requiring a motion, notice, opportunity to object in a contested proceeding, and an order before rejection. *See, e.g., In re Amber's Stores*, 193 B.R. 819, 826 (Bankr. N.D. Tex. 1996) (Judge Abramson).
 - But, Court can approve the trustee's rejection of a non-residential real property lease retroactively to an earlier date if the equities of the case require. (Logic is - why should a debtor have to pay for the time the court spends to issue an order?) *Id.*

DATE

Date of Rejection

- Minority view: upon unequivocal notice of intent of the debtor to reject and any subsequent court approval automatically relates back to the date of the decision.
 - Logic is - The plain language of § 365(a) does not expressly require prior court authorization to assume or reject an executory contract or unexpired lease.
- and
- Rejecting a lease has been recognized as being effective on the day of notifying the lessor of such intent. (e.g. leases are deemed rejected without a court order).



Cap on Rejection Damages

Cap on Rejection Damages

- Section 502(b)(6) caps a landlord's claim for termination damages as follows:
 - (6) if such claim is the claim of a lessor for damages resulting from the **termination** of a lease of real property, such claim exceeds—
 - (A) the rent reserved by such lease, without acceleration, for the greater of one year, or 15 percent, not to exceed three years, of the remaining term of such lease, following the earlier of—
 - (i) the date of the filing of the petition; and
 - (ii) the date on which such lessor repossessed, or the lessee surrendered, the leased property; plus
 - (B) any unpaid rent due under such lease, without acceleration, on the earlier of such dates.

Cap on Rejection Damages

- "Rejection" = "Breach" = "Termination"?
- Fifth Circuit Says No.
 - *Matter of Austin Development Co.*, 19 F.3d 1077, 1082 (5th Cir. 1994).

Cap on Rejection Damages

- Special Issues: Letters of Credit
 - Not Property of the Estate. *In re Stonebridge Technologies, Inc.*, 430 F.3d 260, 268-269 (5th Cir. 2005)
 - Section 502(b)(6) cap does not apply
 - Open issue: Can cap limit landlord's claim when she files a claim for balance due after applying LOC?

Cap on Rejection Damages

- Special Issues: Repair and Other Non-Rent Obligations
 - Subject to cap. *In re Mr. Gatti's, Inc.*, 162 B.R. 1004 (Bankr. W.D.Tex.1994); *In re Metals USA, Inc.*, 2004 WL 771096, *5-6 (Bankr. S.D. Tex. 2004).
 - Not if obligation arose prior to termination. *In re Dronebarger*, 2011 WL 350479, 11 (Bankr. W.D. Tex. 2011).



Texas Assignment of Rents Act ("TARA")

Assignment of Rents Act

- Effective June 17, 2011
- Adds Chapter 64 to Tex. Prop. Code
- Applies to existing and future documents

Assignment of Rents Act

- All assignments in connection with real estate loans are "collateral" assignments, grants security interest – eliminates absolute assignments. Tex. Prop. Code Ann. § 64.051(a).
 - Exception: certain home equity loans, reverse mortgages or manufactured home loans governed by the Texas Constitution.

Assignment of Rents Act

- Overrules form and terms of existing agreements. Tex. Prop. Code Ann. § 64.051(b) ("...regardless of whether the document is in the form of an absolute assignment, an absolute assignment conditioned on default or another event, an assignment as additional security, or any other form. ")

Assignment of Rents Act

- Effective upon recordation
- Enforcement
 - Effected by notice to either the assignor or any tenant as well as by other remedies such as seeking appointment of a receiver
 - After notice to either assignor or any tenant, lender is entitled to collect all unpaid rents that accrued prior to such date and all rents that accrue on or after such date



Unique Landlord-Tenant Preference Issues

Landlord-Tenant Preference Issues

- Effect of Assumption of Lease
 - Prevents Preference Claim. *In re MMR Holding Corp.*, 203 B.R. 605, 613 (Bankr. M.D. La. 1996); *In re Kiwi Intern. Airlines, Inc.*, 344 F.3d 311, 318–19 (3d Cir. 2003); *Matter of Superior Toy & Manufacturing Co., Inc.*, 78 F.3d 1169, 1172–5 (7th Cir. 1996)

Landlord-Tenant Preference Issues

- Does Constitute New Value
 - Right to occupy premises after rental payment. *In re JS & RB, Inc.*, 446 B.R. 350, 355 -356 (Bankr. W.D. Mo. 2011); *In re General Time Corp.*, GTC, 328 B.R. 243, 246 (Bankr.N.D.Ga.2005); *Brown v. Morton* (In re Workboats Northwest, Inc.), 201 B.R. 563 (Bankr.W.D.Wash.1996); *In re Coco*, 67 B.R. 365 (Bankr.S.D.N.Y.1986); *Armstrong v. General Growth Development Corp. (In re Clothes, Inc.)*, 35 B.R. 489, 491 (Bankr.N.D.1983); *Carmack v. Zell* (In re Mindy's Inc.), 17 B.R. 177, 178–9 (Bankr.S.D.Ohio 1982)

Landlord-Tenant Preference Issues

- Does not constitute new value:
 - Reduction of rent. *In re Hencie Consulting Services, Inc.*, 2006 WL 3804991, *5-6 (Bankr. N.D. Tex. 2006)(J. Lynn)(" a settlement or release cannot constitute new value because it is not money or money's worth").
 - Re-entry of premises and avoidance of moving costs. *Hencie Consulting Services, Inc.*, 2006 WL 3804991 at *5-6 (too "speculative [a] benefit").
 - Contemporaneous right to occupancy. *In re Breaux* 2005 WL 4677825, *6 (Bankr. E.D. La. 2005).
 - Forbearance not to terminate the lease. *Charisma Investment Co., N.V. v. Airport Systems, Inc. (In re Jet Florida System, Inc.)*, 841 F.2d 1082, 1084 (11th Cir.1988).