

Legislative Update: Commercial Leases under the New Bankruptcy Code

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As you probably know, on October 17, 2005, the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the “Act”), which overhauled the Bankruptcy Code, went into effect. Much ado was made in the media and by commentators about the Act’s effect on individual consumers; however, the Act also included changes to other areas of bankruptcy law, including Commercial Leases. Prior to the Act, a four part article was published by the authors titled “Bankruptcy, a Landlord’s Perspective”, copies of which are located in the Paraclete Archives on the Bar’s website, which focused on provisions of the old Bankruptcy Code that effect commercial landlords. Several of those Bankruptcy Code provisions were amended under the Act and a few new provisions were added. The purpose of this Article is to provide a summary of those provisions.

Revised 11 U.S.C. § 365(b)(1)(A)

Prior to assuming a lease under the old Bankruptcy Code, a debtor had to cure, or provide adequate assurance of a cure, all defaults under the lease prior to assumption. Revised 11 U.S.C. § 365(b)(1)(A) states that if a default is related to the failure to abide by the non-monetary terms of the lease, the default must be cured at *and after* the time of assumption in order for the debtor to assume the lease and pecuniary losses associated with the default must be paid as part of the cure. Extending the time to cure defaults makes it easier for a debtor to assume and assign its commercial leases if the debtor cures the defaults post-assumption.

Revised 11 U.S.C. § 365(d)(4)

Under the old Bankruptcy Code, the debtor was required to assume or reject its leases within sixty (60) days of the filing, unless the debtor obtained an order granting it an extension of time to do so. During this time, the debtor was required to continue to pay rent and additional

expenses, however landlords were frequently frustrated by repeated orders granting debtors an extension of time to decide what to assume or reject. The Act provides some relief to landlords by establishing an initial one hundred twenty (120) window for the debtor to assume or reject, followed by a one time extension of up to ninety (90) days. Thereafter, “the court may grant a subsequent extension only upon prior written consent of the lessor...”. Thus, after two hundred ten (210) days from the filing, the landlord has control over deciding whether to stick it out in the bankruptcy or to force the debtor’s hand on the lease.

New 11 U.S.C. § 503(b)(7)

11 U.S.C. § 502(b)(6) caps the damages a landlord may recover if its lease is rejected by a debtor. Prior to the enactment of the Act, a landlord’s claim for a lease which was assumed by a debtor, but later rejected, was not subject to the 502(b)(6) cap. In re Klein Sleep Products, Inc., 78 F.3d 18 (2d Cir. 1996). However, under the Act, a new section was added, 11 U.S.C. § 503(b)(7), which allows the claim of a such a landlord as an administrative expense (and thus paid as a priority higher to a claim under 502(b)(6)), but caps that amount of the claim at equal to the amount due for two (2) years after rejection or turnover of the property, whichever is later, with the remainder of the claim paid as an unsecured claim under and subject to the limitations of 502(b)(6). The effect of this provision is to limit the potential damage to a debtor’s plan of reorganization by capping the priority claims that arise when a debtor initially decides to assume a lease but later discovers that the lease should be rejected, particularly under the new time crunch of 11 U.S.C. § 365(d)(4) for debtors to assume or reject.

Revised 11 U.S.C. § 365(f)(1)

A minor change was added to 11 U.S.C. § 365(f)(1) under the Act which benefits owners of shopping center leases. Section 365(b)(3) provides that when a debtor assumes or assigns a

shopping center lease, provisions in the lease concerning use, radius, location and exclusivity may not be breached by said assumption or assignment. Under the old Bankruptcy Code, Section 365(f)(1), which voids anti-assignment provisions in a lease, was not specifically applicable to Section (b)(3), resulting in a split of authority on the issue of whether overly-restrictive use provisions in a lease could constitute *de facto* anti-assignment clauses and therefore void under (f)(1). Section 365(f)(1), as amended, specifically includes Section 365(b) in its totality as an exception to the section to the benefit of owners of shopping center leases who seek enforcement of more restrictive use provisions in their leases.

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