



Shopping Center Legal Update

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What Must a Retail Debtor Do to Timely Assume a Shopping Center Lease Under Bankruptcy Code § 365(d)(4)?

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Introduction

The *Bankruptcy Abuse Prevention and Consumer Protection Act of 2005* (the “2005 Act”) brought significant changes to a number of sections of the United States Bankruptcy Code. Among many of the sections of the Bankruptcy Code, Congress focused on eliminating past abuses relating to the period of time within which a debtor/tenant may assume, assume and assign, or reject a lease of non-residential real property under 11 U.S.C. § 365(d)(4).¹ Prior to passage of the 2005 Act, as long as a retail debtor could establish “cause” (a term not defined by the Bankruptcy Code) for an extension of time under § 365(d)(4), bankruptcy courts granted multiple extensions of time that, in some cases, stretched on for years. Following prolonged debate, Congress mandated a maximum period of 210 days after an order for relief is entered following a bankruptcy petition for a debtor/tenant to assume a non-residential real property lease. But what, exactly, must a retail debtor do to assume a shopping center lease? Despite the plain language of the statute, two schools of thought have emerged: (1) that a debtor need only file its motion to assume before the 210th day of the case; (2) that the bankruptcy court’s lease assumption order must be entered by the 210th day of the case. An analysis of the legislative history of the 2005 Act, the language of § 365(d)(4), and several related sections of the Bankruptcy Code and the Federal Rules of Bankruptcy Procedure support the conclusion that the debtor needs to have a lease assumption order in hand (or on the docket) to avoid having the lease deemed rejected and being forced to surrender possession to the landlord.

The Statute

The 2005 Act substantially revised § 365(d)(4) “to reduce the time in which a trustee [or debtor-in-possession] may assume or reject a real property lease and to give greater rights to real property lessors.”²

Section 365(d)(4) currently reads as follows:

(A) Subject to subparagraph (B), an unexpired lease of nonresidential real property under which the debtor is the lessee shall be deemed rejected, and the trustee shall immediately surrender that nonresidential real property to the lessor, if the trustee does not assume or reject the unexpired lease by the earlier of—

- (i) the date that is 120 days after the date of the order for relief; or
- (ii) the date of the entry of an order confirming a plan.

(B)(i) The court may extend the period determined under subparagraph (A), prior to the expiration of the 120-day period, for 90 days on the motion of the trustee or lessor for cause.

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- (ii) If the court grants an extension under clause (i), the court may grant a subsequent extension only upon prior written consent of the lessor in each instance. § 365(d)(4).

The 210-Day Deadline—It’s a Bright Line, Not Just a Suggestion

The intent of, and the purpose behind, the current version of § 365(d)(4) was set out very clearly by Congress before the 2005 Act became law.

Sec. 404. Executory and Contracts and Unexpired Leases. Subsection (a) of section 404 of the Act amends section 365(d)(4) of the Bankruptcy Code **to establish a firm, bright line deadline by which an unexpired lease of non-residential real property must be assumed or rejected. If such lease is not assumed or rejected by such deadline, then such lease shall be deemed rejected, and the trustee shall immediately surrender such property to the lessor.** Section 404(a) permits a bankruptcy trustee to assume or reject a lease on a date which is the earlier of the date of confirmation of a plan or the date which is 120 days after the date of the order for relief. An extension of time may be granted, within the 120 day period, for an additional 90 days, for cause, upon motion of the trustee or lessor. Any subsequent extension can only be granted by the judge upon the prior written consent of the lessor either by the lessor’s motion for an extension or on motion of the trustee, provided that the trustee has the prior written approval of the lessor. **This provision is designed to remove the bankruptcy judge’s discretion to grant extensions of the time for the retail debtor to decide whether to assume or reject a lease after a maximum possible period of 210 days from the time of entry of the order of relief. Beyond that maximum period, the judge has no authority to grant further time unless the lessor has agreed in writing to the extension.** H.R.Rep. No. 109-31(I), at 8687 (2005) (emphasis added).

Prior to the 2005 Act, and consistent with the absence of a bright line test for when a lease must be assumed (or assumed and assigned), courts in some jurisdictions held that merely filing a motion to assume (or assume and assign) a lease satisfied the requirement that a lease be “assumed” for purposes of § 365(d)(4). However, since the 2005 Act became law, that rationale no longer withstands scrutiny.

As a preliminary matter, § 365(d)(4) speaks to the consequences of a debtor (or trustee’s) failure to “assume” the lease. A non-residential real property lease cannot be assumed unless a debtor moves to assume the lease under § 365, and the bankruptcy court grants the motion and enters an order. See § 365, and Fed.R.Bankr.Proc. 6006, 9013, and 9014. Many courts have held that assumption under § 365 cannot be accomplished by implication or the unilateral acts of the debtor. See, e.g., *In re Enron*, 300 B.R. 201, 214 (Bankr. S.D.N.Y. 2003) and *In re Kelly Lyn Franchise Co.*, 26 B.R. 441, 445 (Bankr. M.D. Tenn. 1983) (rejecting the notion that assumption could be implied from the debtor’s conduct). Indeed, assumption under § 365 requires the express approval of the court. See *Lindsey v. Dept. of Labor (In re Harris Management Co., Inc.)*, 791 F.2d 1412, 1414 (9th Cir. 1986), and *In re Whitcomb & Keller Mortgage Co.*, 715 F.2d 375, 380 (7th Cir. 1983). See also, *In re House of Deals of Broward, Inc.*, 67 B.R. 23, 25 (Bankr. E.D.N.Y. 1986) (the term “assumption” contemplates not only the debtor in possession making a motion to assume, but also the court granting such a motion). The filing of a lease assumption motion on or before the 210th day of the case, with a hearing on the lease assumption motion coming after the 210th day of the case, is merely an artifice to extend the time to assume a lease beyond the 210-day deadline without the landlord’s consent—a practice the 2005 Act was clearly designed to stop.

In those instances where a retail debtor wants or needs more than 210 days to decide whether it will assume or assume and assign its nonresidential real property leases, § 365(d)(4) provides the debtor with a mechanism to obtain a further extension with the prior written consent of the landlord. See § 365(d)(4)(B)(ii). In a number of large Chapter 11 retail bankruptcy cases since 2005 (e.g., Mervyn’s, Circuit City, Blockbuster, Borders), the retail debtors approached shopping center landlords early in the reorganization process to negotiate an extension of time to assume leases beyond the 210-day deadline. Not surprisingly, those debtors did not rely upon the filing of a lease assumption motion to obtain a *de facto* extension beyond the 210th day of their cases. In those cases, clearly such a strategy would not have been worth the risk. Indeed, all of the deadlines imposed by the former and current versions of § 365 were designed by Congress to be punitive. See *Debartolo Properties Management, Inc. v. Devan*, 194 B.R. 46, 52 (Bankr. D. Md. 1996) (§ 365(d)(4) encourages debtors to make a prompt decision about their leases and punishes debtors who fail to timely act). In *In re Tubular Technologies, LLC*, 348 B.R. 699 (Bankr. D. S.C. 2006), the Chapter 11 debtor filed a motion to extend the time to assume or reject a non-residential real property lease on the 112th day of the case, but a hearing was not held until the 144th day of the case. The bankruptcy court denied the debtor’s motion, noting that the unambiguous language of § 365(d)(4) “clearly provides that if any extension is desired, Debtor must obtain the extension by an order entered within the 120 day period proscribed.” *In re Tubular Technologies, LLC*, 348 B.R. at 708.

It seems unlikely that Congress intended to treat a retail debtor's failure to obtain a lease assumption order prior to the 210-day deadline any less severely than a retail debtor's failure to comply with the 120-day deadline to obtain the single 90-day extension of time under § 365(d)(4)(b)(i).

Congress was also keenly aware of the hardship that the 210-day deadline could create for a retail debtor. Before the 2005 Act, early assumption of a shopping center lease followed by a subsequent "rejection" created a potentially crippling liability for the debtor—all of the rent due under the lease for the remainder of the term was elevated to the level of an administrative priority claim, essentially moving the landlord close to the front of the proverbial line of creditors and positioning the claim for payment in full. *See Nostas Assocs. v. Costich (In re Klein Sleep Products Inc.)*, 78 F.3d 18 (2nd Cir. 1996) (rejection of assumed lease gave rise to debt entitled to administrative priority because the entire liability resulting from the breach of an assumed lease was deemed a cost of administering the estate). While § 365(d)(4) imposes the hard 210-day deadline for assumption of a shopping center lease, another part of the 2005 Act limits the debtor's liability in the event a lease is assumed and later rejected. In such a scenario, the debtor's liability is capped under § 503(b)(7) to two years' worth of rent and charges under the lease.

Summary

At this point, the 2005 Act has been in effect for less than six years. Some bankruptcy courts may have already opined on whether a debtor must have its lease assumption order entered before the 210-day deadline in order to avoid automatic rejection of a shopping center lease, but the Bankruptcy Appellate Panels and Circuit Courts have yet to provide any guidance on the issue. Time will no doubt yield clarity on the matter; until then, debtors and their counsel are likely best served by toeing the bright line drawn by Congress in the 2005 Act.

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¹Unless otherwise noted, subsequent references to a "Section" are to the United States Bankruptcy Code, 11 U.S.C. §§ 101, *et seq.*

²*Collier on Bankruptcy* (15th ed. Rev. 2009) § 365.LH[2][g] at pp. 365–112.