Recent Developments Regarding Unexpired Leases In Bankruptcy Cases

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I. What is an Executory Contract?

A. Importance. This question informs the application of the special treatment of executory contracts under Section 365 of the Bankruptcy Code in contrast to other claims, such as (i) the debtor’s right to cure defaults, assume and assign an executory lease notwithstanding a “nonassignment” clause, (ii) the debtor’s ability to require post-petition performance by the non-debtor party pending assumption or rejection by the debtor without curing pre-petition defaults, (iii) the non-debtor-party’s right to demand post-petition performance without establishing all of the bases of an administrative priority claim, (iv) the non-debtor-party’s right to demand cure of all monetary defaults and adequate assurance of future performance, (v) the non-debtor-tenant’s right to remain in possession during the balance of the term (including renewals) of a rejected lease, (vi) the non-debtor-party’s right to require assumption no later than 120 days (extendable by an additional 90 days) after the petition date, and (vii) the debtor’s right to cap the rejection damages for “rent”.

B. Case Law Definition. While the Bankruptcy Code does not define an “executory contract,” the “Countryman Definition” remains predominant — “a contract under which the obligation of both the bankrupt and the other party to the contract are so far underperformed that the failure of either to complete performance would constitute a material breach excusing performance of the other.” V. Countryman, Executory Contracts in Bankruptcy: Part I, 57 MINN. L. REV. 460 (1973); e.g., In re Baird, 567 F.2d 1207 (10th Cir. 2009); In re Columbia Gas Sys., Inc., 50 F.3d 233 (4th Cir. 1995); In re Streets & Beard Farm P’ship, 882 F.2d 233 (7th Cir. 1989); Lubrizol Enters., Inc. v. Richmond Metal Finishers, Inc. (In re Richmond Metal Finishers), 756 F.2d 1043 (4th Cir. 1985); In re Select-A-Seat Corp, 625 F.2d 290 (9th Cir. 1980).


2. Functional Alternative. Some courts have adopted a “functional” alternative to the countryman definition:

   a. Under the functional approach, the court works “backward from an examination of the purposes to be accomplished by rejection, and if they have already been accomplished then the contract cannot be executory.” In re Magness, 972 F.2d 689, 693 (6th Cir. 1992). There is no threshold standard of executoriness that the debtor
must meet to assume or reject; rather, the question is whether assumption or rejection would create a benefit for the bankruptcy estate and its creditors. *Id.*

3. **Prepaid Leases.** Another controversy that may be important is whether to treat prepaid oil and gas leases as interests in real estate or executory contracts. *See, e.g., Powell v. Anadarko E&P Co. L.P. (In re Powell),* 482 B.R. 873 (Bankr. M.D. Pa. 2012) (discusses conflicting case law, but finds oil and gas lease to be executory prior to discovery of minerals).

4. **Part of the Estate?** Courts are split as to when an executory contract becomes property of the estate:

a. One view, the exclusionary analysis, holds that the contract does not become part of the estate until it is assumed by the debtor. Andrew, *Executory Contracts In Bankruptcy: Understanding Rejection,* 59 U. Colo. L. Rev. 845 (1988); *In re Drexel Burnham Lambert Group, Inc.,* 138 B.R. 687, 701 (Bankr. S.D.N.Y 1992). If a contract is not property of the estate, it is not subject to the automatic stay. 11 U.S.C. § 362(a).


**C. Leases as Part of a Larger Transaction.**

1. **Integrated Transactions.** Whether an unexpired lease is “integrated” with other agreements (e.g., IP licenses, asset purchase agreements, and franchise agreements) may determine whether the more restrictive lease assumption deadlines apply.

a. Applicable non-bankruptcy law determines the question based on the parties’ intent. *E.g., In re Hawker Beechcraft, Inc.,* 2013 BL 156513 (Bankr. S.D.N.Y. June 13, 2013); *In re Contract Research Solutions, Inc.,* 2013 BL 117998 (Bankr. D. Del. May 1, 2013); *In re Buffets Holdings, Inc.,* 387 B.R. 115 (Bankr. D. Del. 2008). *See also In re Exide Technologies,* 607 F.3d 957 (3d Cir. 2010) (protects trademark licensees in a substantially performed integrated transaction on equitable grounds) and *Lewis Bros. Bakeries Inc. v. Interstate Brands Corp. (In re Interstate Bakeries Corp.),* 751 F.3d 955 (8th Cir. 2014) (*en banc*) (applying New York and Illinois law, respectively, to determine that trademark licenses
granted as part of a sale of assets are integrated and substantially performed when the sale closed).


c. If a lease is so closely bound to a franchise agreement, the longer deadline of plan confirmation under Section 365(d)(2), rather than the shorter deadline of Section 365(d)(4), applies. In re FPSDA I, LLC, 450 B.R. 391 (E.D.N.Y. 2011), leave to appeal denied, 470 B.R. 257 (E.D.N.Y. 2012) (applying Section 365(d)(4) in integrated transaction would allow leverage over lease rejection and a "superior power to determine the course and outcome of such debtor's bankruptcy case than intended"); In re Harrison, 117 B.R. 570 (Bank. C.D. Cal. 1990).

d. In re A&F Enters., Inc. II, 2013 BL 279511, *2 (N.D. Ill. Oct. 8, 2013), rev'd, 2014 BL 34222 (7th Cir. Feb. 7, 2014) exemplifies the issue. In A&F Enterprises, Inc., the Seventh Circuit stayed the decisions of the bankruptcy court and district court that franchise agreements and equipment leases to the debtor-franchisee expired when certain building leases were automatically rejected and the franchise agreement expired after the debtor's failure to assume or reject leases for 17 locations within the 120-day period under Section 365(d)(4). The Seventh Circuit found that the entire package of agreements would be worthless unless the agreements were all assumed together, due to the purpose and terms of the individual contracts, including various usage restrictions and cross-default provisions. While it did not rule on the merits, it found that the balance of equities favored the debtor and the law was sufficiently unsettled to allow the debtor to remain in control of the franchises pending resolution of the appeal.

D. Pre-Petition Termination of the Lease

1. Pre-Petition Termination. Leases terminated by the non-debtor party prior to the petition date are not executory and subject to assumption or

2. **State Law Governs.** State law determines the efficacy of termination. *In re Lakes Region Donuts, LLC* (landlord’s notice to pay or quit possession did not terminate lease in accordance with its terms, but termination occurred by operation of law when writ of possession was issued and affirmed on appeal).

3. **Impact on Post-Petition Cure Rights.** Whether the debtor has a right to cure defaults on the petition date (as opposed to mere notice until the effective date of a termination notice) determines whether the debtor can benefit from the statutory 60-day extension of cure rights under Section 108(b). *Amoco v. Moody*, 734 F.2d 1200 (7th Cir 1984).

II. **Twilight Zone Before Assumption or Rejection under Section 365(d)(3).**

A. **Post-Petition Obligations of Non-Debtor-Party.** Pending assumption or rejection, the non-debtor party must continue to perform its obligations under the lease or executory contract. *In re Nat’l Steel Corp.*, 316 B.R. 287, 305 (Bankr. N.D. Ill. 2004).

1. **Statutory Protection.** Section 365(d)(3) is supposed to protect the non-debtor landlord by requiring commensurate post-petition performance by the debtor. Rent due between the petition date and the date of rejection of a lease of non-residential real property must be paid immediately by the debtor. No benefit to the estate is required. *In re Pudgie’s Dev. of NY, Inc.*, 239 B.R. 688 (S.D.N.Y. 2000); *In re MHI, Inc.*, 61 B.R. 69 (Bankr. D. Md. 1986).

a. Given the confusion immediately following a bankruptcy filing, the non-debtor party typically must move the bankruptcy court to compel performance by the debtor, often in combination with a request to set a deadline to assume or reject. See, e.g., *In re Pudgie’s Dev. of NY, Inc.*, 239 B.R. 688 (S.D.N.Y. 2000).

b. The non-debtor landlord should take care before requesting payment of an administrative claim for post-petition rent, because it would be undertaking a burden to meet the requirements of Section 503(b) that are expressly excused under Section 365(d)(3). See Section II.B below.

2. **ABI Proposed Amendment.** The ABI Report confirms this approach and would amend the Bankruptcy Code to expressly require a non-debtor party to an executory contract or unexpired lease to continue to perform after the petition date. *ABI Report Section V.A.2*. Courts justify the continued
one-sided performance by emphasizing the importance of the breathing spell created by the automatic stay for the debtor in possession. *In re Cont’l Energy Assocs. Ltd. P’ship*, 178 B.R. 405, 408 (Bankr. M.D. Pa. 1995).

a. However, the ABI Report would amend the Bankruptcy Code to clarify that, subject to Section 365(d)(3), the debtor does not have an obligation to perform, or to cure any defaults, under such contract or lease prior to the assumption of that contract or lease under 365(a). ABI Report, Section V.A.2.

b. The ABI Report acknowledged that the BAPCPA Amendments to the Bankruptcy Code clarified the issue for real property leases, and recommended that a debtor in possession should not be required to cure nonmonetary defaults occurring prior to assumption.

3. **Pre-Petition Breach.** Similar to a post-petition breach, a debtor cannot compel a non-debtor-party’s performance when the non-debtor party has withheld performance due to a pre-petition breach by the debtor. *In re Lucre*, 339 B.R. 648, 657 (Bankr. W.D. Mich. 2006). (“The mere commencement of the bankruptcy case and attended imposition of the automatic stay do not by themselves empower a debtor to compel from the other party to an executory contract performance the day after the commencement of the bankruptcy case when the debtor had no right to compel the performance the day before.”). However, when the non-debtor has performed pre-petition, such as a lessor who has delivered possession to the debtor, the non-debtor is subject to the automatic stay. *In re Sturgis Iron & Metal Co., Inc.*, 420 B.R. 716, 724 (Bankr. W.D. Mich. 2009).

4. **Post-Petition Breach by Debtor.** A post-petition breach by the debtor would generally excuse further performance by the non-debtor party, but it would likely have to seek a court order modifying the automatic stay to terminate the lease or repossess the leased premises. 11 U.S.C. §§ 362(a)(3), 365(d).

5. **Post-Petition Breach by Non-Debtor.** If the non-debtor party to a lease breaches it, the application of normal contract law principles allows the debtor to exercise any rights or remedies it may have under the lease or applicable non-bankruptcy law. *In re Feyline Presents, Inc.*, 81 B.R. 623 (Bankr. D. Colo. 1988). If the non-debtor-party’s breach is an attempted termination or anticipatory repudiation because the debtor is in bankruptcy or for failure of the debtor to pay or perform its pre-petition obligations, debtors sometime seek injunctive relief in the bankruptcy court due to a violation of the stay. *Matter of Whitcomb & Keller Mortgage Co., Inc.*, 715 F.2d 375, 378 (7th Cir. 1983). (“The Bankruptcy Code provides a
sufficient legal basis for a bankruptcy court to issue an injunction or restraining order in appropriate situations. Section 105(a) empowers a bankruptcy court to issue any order that is necessary or appropriate to carry out the provisions of the Code.”).

B. Post-Petition Obligations of Debtor. Section 365(d)(3) governs the debtor’s “obligations” under an unexpired lease of non residential real property: “The Trustee shall timely perform all 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 502(b)(1) of this title.” (emphasis added)

1. What is an “Obligation”? Some courts have held that the term “obligation” includes virtually all lease obligations, whether related to “rent” or not, including attorneys’ fees. In re Cukierman, 265 F.3d 846, 847 (9th Cir. 2001). Other courts follow a narrow rule that defines obligation as including only those obligations that have a contractually determined time frame, and thus would exclude legal fees. In re Pudgie’s Dev. of NY, Inc., 202 B.R. 832 (Bankr. S.D.N.Y. 1996).

2. Better Than an Administrative Claim. The right to payment under Section 365(d)(3) is independent of any duty to establish the elements of an administrative claim under Section 503(b) such as the “necessity” of the leased space or the quantum of benefit to the debtor. See, e.g., Child World, Inc. v. Campbell/Mass. Trust (In re Child World, Inc.), 161 B.R. 571, 576 (S.D.N.Y. 1993); In re C.Q., LLC, 343 B.R. 915, 917 (Bankr. W.D. Wis. 2005) (holding that rent under Section 365(d)(3) is not an administrative expense under Section 503 because such rent is “payable, whether necessary or not, for the protection of landlords. It is not, nor is it intended to be, measured in any way by benefit to the debtor or the estate”. This right frequently is not covered by subordination arrangements for DIP financing that only prime administrative priority claims.


C. Determining Whether Obligations are Pre-Petition or Post-Petition has been controversial in several contexts.

1. Billing Date vs. Accrual Methodologies. When the rental period spans the petition date, courts are split on the methodology of allocating rent between pre-petition (paid only under a plan or “cure” in connection with assumption) or “stub rent” that will be paid sooner.
a. Under the “billing date” methodology, the Third, Sixth, Seventh and Eighth Circuits interpret Section 365(d)(3) to require the trustee to perform the lease according to its terms, including terms that determine both the nature of the obligation and when it arises. *CenterPoint Properties Trust v. Montgomery Ward Holding Corp.*, 268 F.3d 205 (3d Cir. 2001) (tax reimbursement payment is post-petition obligation if so billed, regardless of accrual date of underlying taxes); *In re Koenig Sporting Goods, Inc.*, 203 F.3d 986, 989 (6th Cir. 2000); *In re Burival*, 406 B.R. 548, 553 (B.A.P. 8th Cir. 2009); see also *Ha-Lo Industries Inc. v. CenterPoint Properties Trust*, 342 F.3d 794 (7th Cir. 2003) (applies billing date methodology to hold that an entire month’s rent owed under Section 365(d)(3) where the debtor rejected the lease on the third day of the month. To conserve cash flow, large retail debtors may delay bankruptcy until immediately after receiving a bill for real estate taxes, or on the second day of a month, rendering the tax and rent obligations “pre-petition” under 365(d)(3).

b. Under the “proration” rule, the obligation is allocated proportionally to the time period covered by the obligation before and after the petition date. *In re Handy Andy Home Improvement Ctrs. Inc.*, 144 F.3d 1125 (7th Cir. 1998). This rule prevents a landlord from waiting until after the petition to bill the debtor for an obligation. *Id.* (applies accrual methodology to tax reimbursement obligation billed post-petition). The ABI Report recommends amending the Bankruptcy Code to implement this approach. ABI Report Section V.A.6

2. **Stub Rent Issues.**

a. “Stub Rent” is the portion of the rent that is due for the period beginning on the petition date through the end of the first post-petition month.

   (i) Even though it is supposed to be automatically due under Section 365(d)(3), landlords typically must file a motion to get paid because that is the practice generally applicable to administrative expenses under Section 503. That is because some courts in “accrual” jurisdictions hold that, in a mid-month filing, the time for performance has passed pre-petition. *In re UAL Corp.*, 291 B.R. 121 (Bankr. N.D. Ill. 2003); *In re HQ Global Holdings Inc.*, 282 B.R. 169 (Bankr. D. Del. 2002).

   (ii) A landlord may be entitled to administrative stub rent in a billing date jurisdiction where the rental obligation arose
pre-petition. In re Goody’s Family Clothing, Inc., 401, B.R. 656 (D. Del. 2009), aff’d sub nom, In re Goody’s Family Clothing, Inc., 610 F.3d 812 (3d Cir. 2010) (bankruptcy filed 8 days after rent was due did not bar landlord from seeking payment of remaining 21 days’ rent under Section 503); In re ZB Co., Inc., 302 B.R. 316 (D. Del. 2003) (holding that the landlord was entitled to stub rent for the use and occupancy of the premises from the petition date despite classifying the stub rent as a pre-petition obligation under Section 365(d)(3)). But see In re Oreck Corp., 2014 WL 92964 (Bankr. M.D. Tenn., March 10, 2014) (holding that the billing date rule precluded a finding of stub rent for the post-petition use and occupancy of the premises).

III. Rejection.

A. Debtor’s Business Judgment. The decision to reject a lease is based on the debtor’s business judgment and will be granted on a minimal showing that is very difficult to rebut. In re Orion Pictures Corp., 4 F.3d 1095, 1099 (2d Cir. 1993).

B. Termination of Post-Petition “Obligation.” Section 365(d)(3) no longer applies to obligations arising after rejection of a lease. In re Ames Dep’t Stores, 306 B.R. 43, 52 (Bankr. S.D.N.Y. 2004) (refuses to allow non-debtor party to compel performance of any provisions of a rejected lease); but see In re Ground Round, Inc., 335 B.R. 253 (1st Cir. BAP 2005) (allows landlord to specifically enforce provisions of a lease against debtor after rejection because specific performance is permitted under applicable state law)

C. Consequences of Rejection of Lease. While it is not entirely resolved, most circuit courts have concluded that rejection by the debtor does not automatically terminate a lease or executory contract, but merely breaches the lease by anticipatory repudiation. Midway Motor Lodge of Elk Grove v. Inkeepers’ Telemangement & Equipment Corp., 54 F.3d 406 (7th Cir. 1995); Eastover Bank for Savings v. Sowashee Venture (In re Austin Development Company), 19 F.3d 1077 (5th Cir. 1994); In re Modern Textile, Inc., 900 F.2d 1184, 1191 (8th Cir. 1990); Leasing Service Corp. v. First Tennessee Bank, Nat’l Ass’n, 826, F.2d 434, 436-37 (6th Cir. 1987); John Hilsman Inv., LLC v. Quality Properties, LLC, 500 B.R. 105 (N.D. Ala. 2013), aff’d, 13-14754 (11th Cir. 2014).

1. State Law Remedies for Landlord Breach. Under state law, a breach does not cause the real property interest of the tenant to be extinguished, and the tenant remains obligated to continue to pay rent for the life of the lease. A termination ends the leasehold estate and gives the landlord a claim for contractual damages only, not rent. A landlord has a duty to mitigate those damages, but not mitigate an obligation to pay rent.
2. **Rejection is Breach.** Under Section 365(g), rejection “constitutes a breach of such contract or lease.” Most courts agree that a non-debtor party may not seek specific performance against a debtor following rejection of a contract. However, a controversy exists concerning whether the non-debtor party may continue to exercise its non-monetary rights following rejection, or whether the non-debtor party must forego such non-monetary rights and convert the value of such rights to a monetary claim against the estate.

a. The dispute is well documented in the highly publicized intellectual property cases of *Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc. (In re Richmond Metal Finishers, Inc.),* 756 F.2d 1043 (4th Cir. 1985) (holding that a non-debtor licensee could only seek monetary damages as a result of the debtor-licensor’s rejection, but could not continue to use the licensed intellectual property), and *Sunbeam Products, Inc. v. Chicago American Manufacturing, LLC,* 686 F.3d 372 (7th Cir. 2012) (holding that a non-debtor licensee of a trademark may continue to use the trademark despite rejection because the non-debtor would be permitted to do so under state law in the event of a breach by the debtor).

b. The ABI Report would amend the Bankruptcy Code to expressly state that the trustee’s or debtor’s rejection of an executory contract should not entitle the non-breaching, non-debtor party to a right to specific performance or to retain possession or use of any property of the estate, unless specifically authorized by the Bankruptcy Code such as Section 365(h) or (n). ABI Report, Section V.A.3.

3. **Non-Debtor Tenant’s Right to Remain in Possession.** Following rejection, Section 365(h) allows the non-debtor tenant to elect whether to (i) treat the lease as terminated or, (ii) if the lease term has commenced, the tenant can stay in possession for the balance of the term and any renewal or extension term and retain its other rights under the lease (such as the amount and timing of rent, rights of use and possession, quiet enjoyment, subletting, assignment or hypothecation) and offset against any rent owed its damages caused by the landlord’s failure to perform after rejection. 11 U.S.C. § 365(h).

a. The best practice is for the non-debtor tenant to file with the bankruptcy court a notice of its election to remain in possession.

b. If the non-debtor tenant remains in possession, it cannot compel the debtor-landlord to provide any ongoing services. *Id.*
c. The non-debtor tenant owes an obligation to pay rent under the lease for the post-rejection period of possession, but can offset against that obligation its damages arising from the debtor-landlord’s failure to provide ongoing services. *Id.*

d. If the property containing the premises subject to Section 365(h) rights has been sold, the buyer likely will be entitled to the future rents payable by a tenant that elects to remain in possession. As a matter of real property law and without regard to the contractual aspect of a lease, the fee owner of real estate is entitled to the rents and profits thereof and the obligation of a tenant to pay rent arises independently from the landlord’s obligations. 1 *Friedman On Leases* §§ 1:2.2, 5:1.1. However, the buyer should be careful in its purchase agreement to acquire, and certainly not exclude from the purchased assets, any right of the debtor to payments by the tenant under Section 365(h).

e. Particularly in the case of a multi-tenant property, the tenant in possession under Section 365(h) and the new owner of the property would be well advised to negotiate a new lease that incorporates the rent from the rejected lease, but also covers the other services required by the tenant from the landlord.

D. **Rejection Date.**

1. **Date of Order.** Rejection normally occurs when the order approving the rejection is entered on the docket. *In re Fleming Cos.*, 304 B.R. 85, 96 (Bankr. D. Del. 2003).

2. **Retroactive Rejection.** Some courts allow “retroactive rejection,” whereby the effective date predates the order authorizing the rejection. This typically occurs when the debtor has vacated the premises and given informal notification to the landlord that it wishes to vacate prior to seeking authority of the bankruptcy court. If rejection is retroactive to the petition date, it would eliminate all of the landlord’s claims for administrative priority under Section 503 and for payment of post-petition obligations under Section 365(d)(3).

a. The First Circuit ruled that retroactive rejection was not precluded by the Bankruptcy Code. *In re Thinking Machines*, 67 F.3d 1021, 1028 (1st Cir. 1995). Rejection under Section 365(a) does not take effect until judicial approval is secured, but the approving court has the equitable power, in suitable cases, to order a rejection to operate retroactively. *Id.* at 1029. Accord *In re Adelphia Bus. Solutions, Inc.*, 482 F.3d 602 (2d Cir. 2007) (permitted retroactive rejection, but declined to rule on the issue because the parties


c. In certain cases, especially where the debtor has vacated prepetition, the Court has made the date of rejection retroactive to the petition date. E.g., In re Musicland Holding Corp., No. 06-10064 (Bankr. S.D.N.Y); In re Amber’s Stores, Inc., 193 B.R. 819, 827 (Bankr. N.D. Tex. 1996).

d. Retroactive rejection can cause the landlord to lose substantial rent and reimbursement for pass-through expenses otherwise recoverable under Section 365(d)(3). Landlord’s counsel should be very vigilant in reviewing orders that may appear to cover rejection procedures, bidding procedures or sales. In In re Copelands Enterprises, Inc., No. 06-10853 (Bankr. D. Del. 2006), the debtor filed a motion to approve procedures for rejection of executory contracts. In the motion, the debtor sought to establish a procedure whereby the debtor provides notice of rejection to the landlord and the landlord would have seven days to object. If the landlord did not object, the rejection date would be effective on the later of the date the rejection notice was sent or the date on which the debtor vacated the premises. Thus, if the landlord objected to rejection and lost, the date of rejection would be the date of the notice or the debtor vacating the premises.

3. **Advance Rejection.** A debtor should not be permitted to ask a court to authorize the rejection of a contract at some point in the future, upon the debtor’s discretion. In re U.S. Airways Group, Inc., 287 B.R. 643, 646 (Bankr. E.D. Va. 2002) (“there is no way by which the court can make a meaningful determination on whether the debtor has exercised sound business judgment in seeking to abandon a lease when the debtor has not selected which leases are to be rejected”)

E. **Duty to Mitigate.** State law will determine whether the landlord has a duty to mitigate its loss following breach by the tenant.


2. Some States Excuse Mitigation for Abandoned Premises. Other cases only excuse mitigation if the tenant abandoned the premises. Crowder v. Virginian Bank of Commerce, 127 Va. 299, 103 S.E. 578, 579 (1920). See also tenBraak v. Waffle Shops, Inc., 542 F.2d 919, 924 (4th Cir. 1976) (upon tenant's abandonment, landlord is entitled to remaining rents that accrue under the lease).

3. Some States Require Mitigation If Landlord Terminates Lease. A duty to mitigate may arise when a lease is rejected under Section 365 and a damage claim arises when the landlord treats the lease as terminated. D.H. Overmyer Co., Inc. (Ohio) v. Irving Trust Co., 60 B.R. 391, 394 n.5 (S.D.N.Y. 1986) (New York law); Matter of Parkview-Gem, Inc., 465 F. Supp. 629, 636 (W.D. Mo. 1979) (Missouri and Tennessee law); In re Bob’s Sea Ray Boats, Inc., 143 B.R. 229 (Bankr. D.N.D. 1992) (“as with any claim for damages arising out of the breach of a lease, claim for damages under [S]ection 502(b)(6) is subject to mitigation including an obligation on the part of the landlord to attempt the reletting of the premises.”).

4. Federal Mitigation. There is a split of authority.


b. However, at least one court held that a debtor-guarantor could not assert a duty to mitigate defense based on the lack of any duty of a landlord to mitigate. In re Episode USA, Inc., 202 B.R. 691 (Bankr. S.D.N.Y 1996).
IV. Rejection Damages.

A. Section 502(b)(6) Cap on Rejection Damages.Damages resulting from termination are capped based on a complicated formula that must be carefully unpacked and computed:

"(b) Except as provided in subsections (e)(2), (f), (g), (h) and (i) of this section, if such objection to a claim is made, the court, after notice and a hearing, shall determine the amount of such claim in lawful currency of the United States as of the date of the filing of the petition, and shall allow such claim in such amount, except to the extent that —

* * *

(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 reposessed, or the lessee surrendered, the leased property; plus

(B) any unpaid rent due under such lease, without acceleration, on the earlier of such dates."


B. What is “Rent” under the Section 502(b)(6) Cap? Three interpretations have emerged in the cases.

1. Capped Rent or No Claim. Some cases hold that the landlord’s claim for future rent must meet a strict three-part test and other damages are not allowed at all. The three-part test that must be met for a lease charge to constitute rent reserved: (1) the charge must be (a) designated as “rent” or “additional rent” in the lease, or (b) provided as the tenant’s/lessee’s obligation in the lease; (2) the charge must be related to the value of the property or lease thereon; and (3) the charge must be properly classifiable as rent because it is a fixed, regular or periodic charge. In re McSheridan, 184 B.R. 91 (B.A.P. 9th Cir. 1995); but see In re El Toro Materials, Inc., 504 F.3d 978, 982 (9th Cir. 2007) (overrules McSheridan to the extent it creates a limitation on tort claims, as opposed to “rent like claims”).
2. **Only Rent is Capped.** Other cases hold that items that are not “rent reserved” are not subject to any cap, i.e., repair and maintenance damages. Section 502 was only meant to limit prospective future rent, not to limit ordinary contract claims, and therefore, deferred maintenance and repairs are not subject to the cap of Section 502(b)(6). *In re Best Prods. Co.*, 229 B.R. 673 (Bankr. E.D. Va. 1998) (expressly rejecting the *McSheridan* test).

3. **All Rent and Non-Rent Claims are Capped.** Still other cases hold that all damages, whether rent or not, are counted, but capped. If the dollar amount of future rent was nominal and if the non-rent claim was very large, the cap would still be based on 15% or one year of rent, and not based on 15% of the dollar value of the non-rent claims. *In re Foamex Int’l, Inc.*, 368 B.R. 383 (Bankr. D. Del. 2007) (following *McSheridan*).

C. **What is the “Remaining Term”?** Two interpretations have emerged in the cases.


2. **Term Measurement.** Other courts follow the “term measurement” method which applies the 15 % limitation to the time left on the lease, not to the dollars that remain unpaid. *In re Heller Ehrman LLP*, 2011 WL 635224, *6* (N.D. Cal. 2011); *In re Allegheny Int’l, Inc.*, 145 B.R. 823 (W.D. Pa. 1992). The rationale behind this approach is to avoid acceleration, which arguably would occur if a landlord was given 15 percent of all remaining rent.

D. **Uncapped Claims in the Lease.** The landlord may have substantial claims that are not typically thought of as an occupancy charge and may not be capped.

1. **Unpaid Pre-Petition Rent Due Under the Lease.** Several courts expand “rent” beyond occupancy charges. *E.g., In re Clements*, 185 B.R. 895 (Bankr. M.D. Fla. 1995) (uncapped rent includes the taxes, maintenance, insurance and attorneys’ fees termed “additional rent” under a “triple net” lease); *In re Q-Masters, Inc.*, 135 B.R. 157 (Bankr. S.D. Fla. 1991) (same, but no reliance on “additional rent” term). But see cases limiting prepetition claim by reference to “rent reserved” analysis under the future rent cap in Section 502(b)(6) and the test in *McSheridan* (See Section IV.B.1 above); *Smith v. Sprayberry Square Holdings, Inc. (In re Smith)*, 249 B.R. 328 (S.D. Ga. 2000) (disallows claim for “excused” contingent.
rent that is due only on default as a penalty, unamortized building allowance, interest, late charges and attorneys’ fees).

2. **Removal, Environmental and Repair Obligations.** Courts are split as to whether a tenant’s failure to remove waste and hazardous materials constitute damage claims that arise during the pre-rejection period, and hence, should be entitled to administrative priority (In re Nat’l Refractories & Minerals Corp., 297 B.R. 614 (Bankr. N.D. 2003)), or arise upon termination and are subject to the cap. In re Teleglobe Commc’ns Corp., 304 B.R. 79 (D. Del. 2004), In re Ames Dep’t Stores, Inc., 306 B.R. 43, 52 (Bankr. S.D.N.Y. 2004).

3. **Indemnification.** A claim arising from an indemnification provision in a non-residential commercial lease in the twilight zone between the petition date and the rejection date was entitled to administrative priority pursuant to Section 365(d)(3). In re Mervyn’s Holdings, LLC, 08-11586 (Bankr. D. Del. 2013).

**E. Rejection after Assumption.** One exception to the generally landlord-friendly 2005 Amendments to the Bankruptcy Code is the limitation to two years’ rent of the amount of damages that have administrative priority if the tenant rejects and, hence, breaches a lease after assumption. Section 365(g) makes the rejection after assumption on a post-petition breach. However, Section 503(b)(7) provides:

“(b) After notice and a hearing, there shall be allowed administrative expenses, other than claims allowed under section 502(f) of this title, including—

** * * *

(7) with respect to a nonresidential real property lease previously assumed under Section 365, and subsequently rejected, a sum equal to all monetary obligations due, excluding those arising from or relating to a failure to operate or a penalty provision, for the period of 2 years following the later of the rejection date or the date of actual turnover of the premises, without reduction or setoff for any reason whatsoever except for sums actually received or to be received from an entity other than the debtor, and the claim for remaining sums due for the balance of the term of the lease shall be a claim under section 502(b)(6).


1. **Future Rent Cap Applicable.** The reference to Section 502(b)(6) makes the rejection damage claim subject to the future rent cap under that Section.
2. **Subordination Following Conversion.** Note that, if a case is converted to Chapter 7, rejection damages for a previously assumed lease are subordinated to Chapter 7 administrative expenses pursuant to Section 365(g)(2)(B).

F. **Plan Voting.** A plan that pays, in cash, the full capped claim under Section 502(b)(6) does not impair the claim of the landlord under Section 1125 of the Bankruptcy Code and entitle it to vote on a plan because the legal and equitable rights of the landlord are unaltered by the plan. *In re PPI Enters. (U.S.), Inc.*, 324 F.3d 197 (3d Cir. 2003).

V. **Assumption and Assignment.**

A. **Debtor’s Business Judgment.** The decision to assume a lease is based on the debtor’s business judgment and will be granted on a minimal showing that is very difficult to rebut. *In re Orion Pictures Corp.*, 4 F.3d 1095, 1099 (2d Cir. 1993).

B. **“Actual” v. “Hypothetical” Tests for Assumption.** There is a split among the circuit courts regarding how to apply Section 365(c)(1) to an executory contract or lease assumption by the debtor in possession. Section 365(c)(1) provides:

> “The trustee may not assume or assign any executory contract or unexpired lease of the debtor, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties, if —

> (1)(A) applicable law excuses a party, other than the debtor, to such contract or lease from accepting performance from or rendering performance to an entity other than the debtor or the debtor in possession, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties; and

> (B) such party does not consent to such assumption or assignment; [. . .]


1. **“Actual” Test.** Under the actual test adopted in the First and Fifth Circuits, assumption is permitted by the debtor and Section 365(c)(1) only bars assignment to a non-debtor if its circumstances excuse the non-debtor party to the lease from accepting performance by the non-debtor. *Summit Inv. & Dev. Corp. v. Leroux*, 69 F.3d 608, 614 (1st Cir. 1995); *In re Mirant Corp.*, 440 F.3d 238 (5th Cir. 2006).

2. **“Hypothetical” Test.** The reorganized debtor itself may be blocked from assuming its own pre-petition contracts under the “hypothetical test” adopted by courts in the Third, Fourth, Sixth, and Ninth Circuits for the
application of Section 365(c)(1): “[A] debtor in possession may not assume an executory contract over the non-debtor's objection if applicable law would bar assignment to a hypothetical third party, even where the debtor in possession has no intention of assigning the contract in question to any such third party. In re Catapult Entm't, Inc., 165 F.3d 747, 753 (9th Cir. 1999). See also See Clincola v. Scharffenberger, 248 F.2d 110, 121 (3d Cir. 2001); In re Sunterra Corp., 361 F.3d 257 (4th Cir. 2004); In re Kazi Foods of MI, Inc., 473 B.R. 887 (Bankr. E.D. Mich. 2011). Those courts applying the “hypothetical” test read the word “or” literally, concluding that unless applicable law permits assignment, the trustee may not assume the contract.

3. **ABI Would Enact the Actual Test.** The ABI Commission rejects the "hypothetical" approach and proposes the codification of the "actual" approach. The Commissioners recognized that application of the hypothetical test results in artificial barriers to the reorganization of the debtor in possession — an outcome that directly undercuts a fundamental policy underlying the Bankruptcy Code.

C. **Assignment Not Subject to Section 365(d)(4) Deadline.** A commercial lease timely assumed under Section 365(d)(4) may be assigned after the expiration of the 210-day deadline. In re Eastman Kodak Co., 495 B.R. 618 (Bankr. S.D.N.Y. 2013).

D. **Which Defaults Must Be Cured on Assumption**

1. **General Rule.** Under Section 365(b)(1) & (2), the debtor must, at the time of assumption or within a reasonable time thereafter set by the bankruptcy court:

   a. Cure all defaults other than “ipso facto” defaults relating to the insolvency or financial condition of the debtor or the commencement of the bankruptcy or a receivership;

   b. Compensate, or provide adequate assurance that it will compensate, the non-debtor party for any actual pecuniary loss suffered as a result of the debtor's defaults; and

   c. Provide adequate assurance of future performance after assumption.

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1 The Eleventh Circuit has also applied the hypothetical test in the context of determining whether franchisor consent was required for a franchisee to assume a franchise agreement, but ultimately concluded that applicable non-bankruptcy law did not excuse the franchisor from accepting performance from a third party, so Section 365(c) did not apply regardless. See City of Jamestown v. James Cable Partners, L.P. (In re James Cable Partners, L.P.), 27 F.3d 534, 537 (11th Cir. 1994).
If the lease is being assigned, the assignee frequently must fund the monetary cure costs and provide adequate assurance of its future performance, although the ultimate economic burden of the cure costs may fall on the debtor and its creditors due to reduction in the consideration they receive from the assignee.

2. **Exception for Some Nonmonetary Defaults.** In the 2005 BAPCPA Amendments, Congress amended former Section 365(b)(1)(A) by explicitly providing that tenants under real property leases may assume leases without having to cure nonmonetary defaults if cure cannot be made "by performing non-monetary acts at and after the time of assumption." In the case of leases of nonresidential real property, performance of nonmonetary covenants after assumption is deemed to be a cure so long as the pecuniary losses of the non-debtor party for prior breaches are compensated.

E. **What Restrictions on Assignment are Enforceable?**

1. **General Rule.** Except for those few leases for which applicable non-bankruptcy law would excuse performance to the assignee by the non-debtor party to the lease, Section 365(f) overrides provisions in the lease that bar assignment without the non-debtor party's consent or alter the terms of the lease. Bankruptcy courts routinely override clever attempts to disguise non-assignment clauses as use restrictions or fees. *E.g.*, *In re U.L. Radio Corp.*, 19 B.R. 537 (Bankr. S.D.N.Y. 1982) (permits appliance store to small bistro); *In re Peterson's Ltd., Inc.*, 31 B.R. 524 (Bankr. S.D.N.Y. 1983); *In re Evelyn Byrnes, Inc.*, 32 B.R. 825 (Bankr. S.D.N.Y. 1983) (permits elegant dress shop to "Labels for Less" discounter); but see *In re Black Enters., Inc.*, 39 B.R. 253 (Bankr. D. Guam 1982) (enforces a restriction to plastics manufacturing).

2. **Special Restrictions on Assignment of "Shopping Center" Leases.** The Bankruptcy Code provides special protections to landlords at shopping centers by specifically defining the considerations for determining "adequate assurance of future performance" for a shopping center to include adequate assurance of similar financial condition of the prospective tenant, (A) no substantial decline in percentage rent, (B) continued compliance with provisions concerning radius, location, use or exclusivity, (C) no breach of other leases or master agreements, and (D) no disruption of "any tenant mix or balance in such shopping center." 11 U.S.C. § 365(b)(3). The term "shopping center" is not defined in the Bankruptcy Code. Bankruptcy cases have identified certain factors to determine whether a property is a shopping center, including: common ownership of contiguous property; anchor tenants; joint off-street parking; the presence of a master lease; fixed hours of operation; common areas;
and joint advertising. In re Joshua Slocum Ltd., 922 F.2d 1081 (3d Cir. 1990); In re Goldblatt Bros., Inc., 766 F.2d 1136 (7th Cir. 1985).

VI. Protecting Non-Debtor in a 363 Sale.

A. Sale free and clear of a leasehold. In re Qualitech Steel Corp., 327 F.3rd 537 (7th Cir. 2003) showed how a leasehold can be wiped out if a tenant is not vigilant. In that case, the Seventh Circuit upheld a bankruptcy court’s sale of assets that was "free and clear" of the interests of the debtor’s lessee to possess and use the leasehold property sold to a third party. Even though Section 365(h)(1)(A) of the Bankruptcy Code protects a tenant’s possessory right, this Section had narrow application to the rejection of a lease, while Section 363 could more broadly extinguish leasehold and other "interests" in a sale pursuant to Section 363(f). The protection of a good faith purchaser under Section 363(m) from the reversal of a sale order on appeal requires that objections be timely made and effectively presented.

B. Section 365(h) Prevails over Section 363(f). In re Zota Petroleums, LLC, 482 B.R. 154 (Bankr. E.D. Va. 2012) and In re Haskell L.P., 321 B.R. 1 (Bankr. D. Mass. 2005) rejected the approach of Qualitech Steel because they read the legislative history of Section 365(h) to protect tenants broadly by stating “the tenant will not be deprived of his estate for the term for which he bargained.” S. Rep. No. 95-989 at 90 (1978). They also relied on the rule of statutory construction that the broad “free and clear” approach of Section 363(f) should not trump the more narrow protections of Section 365(h).

C. Omnibus Assumption Motions. Sales are often accompanied by omnibus provisions to deal with the related leases and executory contracts relating to the assets being sold. These often have tricks and traps, including lengthy and illegible schedules, the assertion of “zero dollar” cure amounts, short response dates and maddening flexibility for the buyer to change its mind up to the last minute regarding whether to assume the lease or cause the debtor to keep or reject it. Vigilance in reviewing pleadings and timely responding is essential, because a landlord that sleeps on its rights will lose them.

VII. Enforcing Credit Support.


B. Automatic Stay.
1. **Security Deposit.** The automatic stay applies to a landlord’s offset of a security deposit posted by a debtor-tenant following bankruptcy. 11 U.S.C. §§ 362(a)(3) & (7).

2. **Letter of Credit.** No stay applies to drawing on a well-drafted standby letter of credit, which generally requires no collection activity against the primary obligor as a condition to payment. *In re Page*, 18 B.R. 713, 715-16 (D.D.C. 1982) (“In issuing the letter of credit, the Bank entered into an independent contractual obligation to pay WCC out of its own assets. Although cashing the letter will immediately give rise to a claim by the Bank against the debtors pursuant to the latter’s indemnification obligations, that claim will not divest the debtors of any property since any attempt to enforce that claim would be subject to an automatic stay pursuant to Section 362(a)(4).”)

   a. In some cases, debtors have sought injunctive relief against collection against such credit support, but have had more success in the case of guaranties by the principal of the debtor (who may be “distracted” from reorganization activities by the collection suit) than letters of credit (which are governed by the so-called "independence principle" under UCC § 5-103, which treats letters of credit as being independent of the guaranteed obligations). *In re M.J.H. Leasing, Inc.*, 328 B.R. 363 (Bankr. Mass. 2005).

3. **Guaranties.**

   a. Guaranties of payment are clearly exempted from the stay because they expressly excuse any collection activity against the debtor.

   b. Even in the case of a guaranty of collection, the beneficiary is excused from enforcement against the bankrupt debtor before seeking enforcement against the guarantor. See *Restatement (Third) of Suretyship and Guaranty* § 15(b). An exception exists where the parties have negotiated at the outset that the insolvency or bankruptcy of the primary obligor does not relieve the beneficiary from first seeking recovery from the primary obligor. See *Restatement (Third) of Suretyship and Guaranty* § 6 (“Each rule in this Restatement stating the effect of suretyship status may be varied by contract between the parties to it”); *Data Sales Co., Inc. v. Diamond Z Mfg.*, 205 Ariz. 594, 74 P.3d 268, 273–74 (Ct. App. Div. 1 2003) (affirming the “general policy that parties may contractually waive defenses,” but noting that “[t]his does not mean, however, that all rights may be waived,” citing unconscionability, good faith and fair dealing and the statute of frauds as limits to the freedom of contract law).
4. **Avoid Obligations to Collect.** It is important that the conditions to enforcing the guaranty or drawing on the letter of credit do not require any statement or other action by the primary obligor, which would be stayed. For example, a guaranty or letter of credit should not require presentment of an invoice or demand to the debtor as a condition to drawing on the letter of creditor or enforcing the guaranty.

C. **Application of the Future Rent “Cap” under Section 502(b)(6).**

1. **Security Deposits.**

   a. The Section 502(b)(6) cap limits the landlord’s recourse to a security deposit posted by the debtor-tenant. See *In re Mayan Networks Corp.*, 306 B.R. 295 (B.A.P. 9th Cir. 2004).

   b. The legislative history of Section 502(b) states that the landlord cannot avoid the application of the cap by offsetting higher actual damages against his security deposit and then claiming the balance under Section 502. S.REP. NO. 989, 95th CONG., 2nd Sess. 63 (1978) ("to the extent that a landlord has a security deposit in excess of the amount of his claim allowed under Section [502(b)(6)], the excess comes into the [bankruptcy] estate.")

2. **Letters of Credit.** There is a split of authority regarding the application of the rent cap to letters of credit.

   a. Some courts have interpreted a letter of credit posted by the debtor-tenant to operate the same way as a security deposit and hold that a letter of credit posted by the debtor-tenant can only be used up to the amount of the statutory cap, and that any amount over the cap cannot be drawn. *In re PPI Enters. (U.S.), Inc.*, 324 F.3d 197 (3d Cir. 2003).

   b. Other courts rely on the independence principle under UCC § 5-103 and hold that a landlord can draw upon the full letter of credit and retain the excess over the cap, but only if the landlord has not filed a proof of claim. *In re Stonebridge Techs., Inc.*, 430 F.3d 260 (5th Cir. 2005) (*per curiam*).

   c. Still other courts hold that a landlord can draw upon the full letter of credit where the letter of credit is obtained by a third party posting collateral, but not where the collateral is property of the estate. *In re Mayan Networks Corp.*, 306 B.R. 295 (B.A.P. 9th Cir. 2004) (J. Klein concurring).

3. **Guarantees.**
a. Courts have consistently ruled that the Section 502(b)(6) cap does not limit claims against a non-debtor guarantor of a lease to a debtor-tenant. *In re Danrik, Ltd.*, 92 B.R. 964 (Bankr. N.D. Ga. 1988).

b. The contribution claim of a non-debtor guarantor against the debtor-tenant likely will be capped under Section 502(b)(6). *In re Leslie Fay Companies, Inc.*, 166 B.R. 802 (Bankr. S.D.N.Y. 1994).


d. Some cases even allowed a debtor-guarantor to assert the Section 502(b)(6) cap in the case of the default by a non-debtor tenant. *In re Farley, Inc.*, 146 B.R. 739 (N.D. Ill. 1992) (no policy difference in applying the shield to protect other creditor from dilution by enormous future rent liability if the tenant or the guarantor is in bankruptcy); see also *Arden v. Motel Partners* (*In re Arden*), 176 F.3d 1226 (9th Cir. 1999); *In re Episode USA, Inc.*, 202 B.R. 691 (Bankr. S.D.N.Y 1996); *In re Thompson*, 116 B.R. 610 (Bankr. S.D. Ohio. 1990).

VIII. Strategic Points.

A. The outcome may depend on state law and holdings of the relevant circuit court. Strategy will depend on knowing the precise way that state law will define the relationship on the petition date and the way that the bankruptcy court will apply Sections 365 and 502. Be aware of state procedures for termination of tenancy as a companion to remedies under the lease itself.

B. Some drafting ideas.

- Make sure that all indemnification and reimbursement claims are "additional rent".
- The lease should allow the landlord, not the tenant, to determine the form of credit assurance or collateral security (e.g., letter of credit or security deposit). Use guaranties of payment, rather than collection.
- Keep standby letters of credit as clean as possible.
• Carefully draft assignment clauses to explain any particularized performance due from a tenant that the landlord wants a bankruptcy court to protect when considering “adequate assurance” of future performance by the debtor or an assignee.

• Provide notice of termination, but not cure periods following default and permit fax notice to give the greatest possibility of effecting a clear pre-petition termination of a lease in default.

• In an integrated transaction, include appropriate recitals, cross-default and automatic termination provisions that terminate a lease or other license rights based on the default or rejection of any of them.

• A buyer of real estate subject to leases to be rejected should explicitly take an assignment of any payments made by a tenant that elects to remain in possession under Section 365(h).

C. **Be vigilant at the first sign of financial distress.** Section 363 sales or “zero dollar” cure amounts in associated bulk assumptions can wipe out the rights of a non-debtor party to a lease who receives notice but sleeps on its rights by failing to object and request adequate protection recourse. Watch out for first-day and “omnibus” motions to set rules on lease rejection and resulting claims. Watch out for bar dates on administrative claims even though Section 365(d)(3) may provide an alternative ground for immediate payment of post-petition rent “obligations”. Tenants and sublessees with a landlord or sublessor in bankruptcy must closely monitor the case for attempts to use Sections 363 or 365 to wipe out their lease on a theory that the failure to object, after notice, equals to “implied consent”.

D. **Timing is everything in billing date jurisdictions.** Debtors in billing date jurisdictions need to be careful about the timing, vis-à-vis, of the date when rent is due on major leases, of the filing of a bankruptcy petition or the rejection of a major lease. Landlords must be aggressive and seek collection of “stub rent” and should make sure that they take full advantage of Section 365(d)(3) when they consider the timing of bills (and hence, the debtor’s “obligation” to pay attorneys’ fees, pass-through expenses and indemnification liability, (particularly in connection with a lease that is likely to be rejected). Debtors who delay rejection can take a risk of administrative liability for indemnification claims billed before rejection.

E. **Show me the money.** Be vigilant about the performance of the financially distressed tenant, including imposing tax and insurance escrows, terminating rent deferrals upon default and delay in paying “stub rent” or other post-petition rent.

F. **Mind the “Cap.”** Be alert to the application of the Section 502(b)(6) cap on claims in negotiations regarding modification of a lease to effect its assumption (as opposed to rejection). The different approaches to dealing with rent
concessions, escalations and acceleration can affect the landlord’s claim for rejection damages. Debtors may wait until after confirmation of a plan to object to a claim; it often is better for the landlord to smoke out objections prior to confirmation so that it can use the leverage of its vote to settle the claim.

**G. Cash may be “king”, but a letter of credit is faster.** Letters of credit offer advantages in terms of the automatic stay and, in some cases, the Section 502(b)(6) cap on claims. Be careful to avoid limitations on drawing such as characterization of unpaid “rent” or the requirement of any action by the debtor. Filing a proof of claim may make the cap applicable to the letter of credit proceeds in some jurisdictions.

**H. Guaranties can help on more than payment.** A personal guaranty can motivate assumption and assignment, and add value beyond the pure ability to collect.

**I. Take advantage of the whole relationship.** Since the lease may be part of an integrated transaction, develop a strategy and take advantage of the fact that certain agreements may give greater rights to either the landlord or the tenant.

**J. Make a careful election after rejection.** After rejection, a landlord should carefully review applicable bankruptcy and non-bankruptcy law before electing to terminate the lease, since rejection does not cause automatic termination and the decision may trigger a duty to mitigate and a broader application of the Section 506(b)(6) cap on future damage claims for rent. On the other hand, failure to terminate prior to locating a replacement tenant may eliminate the damage claim in a few jurisdictions.

**K. Retroactive Rejection is a powerful tool.** Be aware if courts in the jurisdiction apply it. Even if it is not applied, substantial support exists to expand the doctrine and landlords should be prepared to oppose it based on the substantial contrary authority. Since vacating the premises is not “rejection” or “abandonment,” the landlord should not rely on getting post-petition rent (which can be wiped out by a retroactive rejection) and consider a motion to lift the bankruptcy stay or compel abandonment to repossess the leased premises.

**L. The ABI Report is just a recommendation.** Since the landlord lobby is much stronger than the lobby of the ABI, bankrupt companies or their advisors, don’t hold your breath that the amendments proposed by the ABI Report will be enacted.