



*Case Law Update:
Landlord/Tenant Issues in
Bankruptcy*

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Non Residential Lease and Executory Contracts (§ 365)

- ▶ Commercial landlords are entitled to current cash payments of rent (subject to a suspension of up to 60 days from the filing).
- ▶ A debtor also must assume or reject a lease of nonresidential real property within 120 days of filing, subject to only one extension of up to 90 days.
- ▶ If assumed, any prepetition default must be cured and “adequate assurance of future performance” must be provided.
- ▶ If contract or lease is effectively terminated pre-petition, then it cannot be assumed.
- ▶ If property owner desires to evict the debtor and lease the property to someone else. If the property owner believes that the lease is a benefit

Pandemic Rent Deferral

- ▶ A debtor in bankruptcy has the right to "assume" or "reject" unexpired leases of non-residential real property under section 365 of the Bankruptcy Code.
- ▶ A debtor has a limited amount of time to make this decision, and until that point, must continue to timely perform its post-petition lease obligations, including paying rent.
- ▶ The global pandemic has caused debtors to get creative.
- ▶ Recent cases in which courts from various jurisdictions have allowed deferral or cessation of rent payments and in some cases, operations entirely.

In re Pier 1 Imports, Inc., et al., Case No. 20-30805.

- ▶ Filed for chapter 11 bankruptcy in the Eastern District of Virginia on February 17, 2020.
- ▶ Debtors filed a motion to, among other things, temporarily stop making or delay all payments not contemplated by a proposed budget, including rent payments to landlords who had not voluntarily consented to a rent deferral.
- ▶ The Court granted the requested relief relying on its broad equitable powers under section 105 of the Bankruptcy Code.
- ▶ The Court clarified that the specific relief requested was not to abolish the Debtors' obligation to pay rent, but instead to delay such payment during the 'limited operations period' in the Motion and all unpaid rent would continue to accrue and would need to be paid before the Debtors could confirm a plan, in accordance with the Code's administrative claim requirements.

In re Modell's Sporting Goods, Inc., et. al., Case No. 20-14179

- ▶ On March 23, 2020, the Debtors filed a motion requesting temporary suspension of all deadlines and activities in their chapter 11 cases, including suspending all operations and a deferral of all expense payments other than those that were absolutely essential. The Debtor had a proposed budget which contemplated all stores closing, and the going out of business sales (in store and on line) suspended.
- ▶ The Court relied on sections 105 and 305 of the Bankruptcy Code, and authorized the requested suspension until April 30, and then again, until May 31, 2020, without prejudice to requests for further extensions.

In re Craftworks Parent, LLC, et al., Case No. 20-10475

- ▶ On March 27, 2020, the debtors filed a request for additional DIP financing in the amount of \$4 million, and attached a proposed six-week budget through the week ending May 10, 2020.
- ▶ The Debtor did not include rent payments to the landlords in its proposed budget.
- ▶ The landlords objected that the motion did not request authority to defer lease obligations, but instead, in effect, sought an indefinite, de facto extension of lease obligations until some point in time beyond May 10, 2020—at least 68 days after the bankruptcy filing
- ▶ Over landlord objections, the Court approved the requested funding on April 2, 2020.

In re J. Crew Virginia, Inc., et al, Case No. 20-32180

- ▶ First major American retailer to file Chapter 11 amid the coronavirus pandemic. Debt load of \$1.7 billion and had been struggling for a number of years.
- ▶ As of May 27th only 7 of its 500 stores had reopened.
- ▶ Debtor asked to defer rent, with one basis that its \$400 million DIP financing package did not include rent for at least the first 60 days of the case.
- ▶ Over the objections of certain landlords, including Simon Property Group, who argued that stores that reopen should pay rent, Judge Phillips allowed the Debtor to defer all rent for 60 days.
- ▶ Judge Phillips noted that the Debtors plan provides that the deferred rent will be paid when(if) the Debtors plan is confirmed.

In re FoodFirst, et al, Case No.

- ▶ Cases were filed on April 10, 2020. In the Petition Date, Debtors operated 102 restaurants under the brand name Brio and Bravo.
- ▶ Debtors filed an emergency motion to reject 43 leases in April 14, 2020 (see *In re Florida Lifestyle Apparel*, 221 BR 897, a Judge Jennemann decision regarding administrative rent)
- ▶ Debtors filed a motion to delay all rent payments for 60 days based upon the impact of COVID-19 as cause under Section 365(d)(3).
- ▶ More than 30 landlords filed objections to the deferral motion.
- ▶ The Debtor also filed a motion to sell substantially all assets and to assume and assign the remaining leases. The Debtors requested a sale hearing on day 60.

In re FoodFirst, et al, Case No.

- ▶ Court granted rent deferral motion and sale motion and set fast track procedure to determine contested cure issues.
- ▶ Some of the key landlord issues were no additional deferral, establish a procedure to contest cure, and a mechanism to deal with property left behind at rejected locations.
- ▶ Within 60 days of the Petition Date, Judge Vaugh approved the sale of the business, assignment of at least 45 leases, cure of \$5,000,000 in past due rent, satisfaction of over \$30 million in senior secured debt and preservation of over 2,500 jobs.

In re J.C. Penney Company, Inc., et al, Case No. 20-20182(DRJ)

- ▶ JCP filed on May 15, 2020. Paid April and some May rent. Originally asked landlords to forgo rent for June, July and August.
- ▶ Filed a motion asking for rent deferral to July 14, 2020.
- ▶ Judge granted the motion in part. Judge deferred monetary obligations only under nonresidential real property leases through July 13th, provided the Debtors do not seek any further extension.
- ▶ At the end of the deferral period, Debtor must promptly pay all referred rent, unless the Debtor has reached a different agreement with a landlord.
- ▶ All pleadings seeking performance under a lease or to compel assumption/rejection were abated until after July 13th.

In re Hitz Restaurant Group, 2020 WL 2924523 (Bankr. N.D. Ill. June 3, 2020),

- ▶ Court held that a COVID-19 related shutdown order partially excused a tenant's post-petition rent obligations.
- ▶ Lease language: "Landlord and Tenant shall each be excused from performing its obligations or undertakings provided in this Lease ... so long as the performance ... is prevented by ... *laws, governmental action or inaction, orders of government or civil ... authorities....*"
- ▶ the Court arrived at the 25% rent obligation based on the Tenant's estimation that 75% of its square footage was "rendered unusable" by the Governor's Order, while 25%, "consisting of the restaurant's kitchen, could have been used for carry-out, curbside pick-up, and delivery purposes." *Id.* at *4.
- ▶ The Court noted that this was only a preliminary finding, acknowledging that it had not conducted an evidentiary hearing.

Force Majeure

- ▶ Does the lease contain a “force majeure clause?”
- ▶ Force majeure clauses excuse a party’s nonperformance when unforeseen circumstances outside the party’s control prevent it from meeting its obligations. Depending on the specific language of your lease, events like pandemics, epidemics, contagious diseases, government acts and orders, and civil emergencies or unrest may qualify. Difficult market conditions, financial difficulty, or events that could or should have been anticipated usually do not.
- ▶ Many leases that contain Force majeure clauses, the obligation to pay rent is typically excluded from relief under a force majeure clause.
- ▶ Important to comply with any and all notice requirements for claiming a force majeure event as an excuse for failure to perform any lease obligation.

Can PPP loans help landlords?

- ▶ Under current guidance from the SBA and the recently enacted PPP Flexibility Act of 2020, up to 40% of PPP loans can be used for certain non-payroll expenses, including “any payment on any covered rent obligation.”
- ▶ SBA is taking the position that a Debtor in bankruptcy is not eligible. However, the provisions of the CARE Act related to PPP loans do not include any prohibition on Debtors being eligible for PPP loans.
- ▶ Debtors are filing TROs against the Administrator of the SBA asking the Courts to enjoin the SBA Administrator from disqualifying it from participating in the PPP. Courts have decided both for and against the SBA

Can PPP loans help landlords?

continued

- ▶ Some Debtors have dismissed their case for the sole purpose of applying for a PPP loan and not having to check the bankruptcy box.
- ▶ *In re Advanced Power Technologies, LLC*, Case No. 20-13304 (S.D. of FL). Dismissed case, obtained a PPP loan and then refiled.
- ▶ For those cases where a TRO is obtained and the SBA appeals, SBA is setting aside the funds.
- ▶ *In re Gateway Radiology Consultants, P.A. v. Jovita Carranza*, in her capacity as Administrator for the U.S. SBA, et al., Adv. 20-00330-MGW. Judge Williamson issued a very well reasoned opinion in favor of the Debtor.

The domino effect

- ▶ It is estimated that over 25,000 retail stores will close their doors permanently in 2020. Other retail and hospitality will not have sufficient revenues to pay full rent under their leases.
- ▶ Will this put landlords with no alternative but to default under their mortgage obligations?
- ▶ What is the impact on lenders, both traditional and alternative.