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Bankruptcy Act aids landlords

By Paul Van Hoomissen

After several failed attempts and extensive lobbying efforts by the banking and credit card industries, the *Bankruptcy Abuse Prevention and Consumer Protection Act of 2005* (“*the Act*”) was signed into law last April. With the exception of certain provisions, the Act became effective in bankruptcy cases which are filed on or after October 17, 2005. The Act has been characterized as the largest overhaul of the Bankruptcy Code since it was enacted in 1978, and purportedly intends to restore personal responsibility and integrity in the bankruptcy system. While much of the press coverage of the Act focused on its effects on consumer bankruptcy, the Act also has provisions affecting corporate restructurings under Chapter 11.

One such provision involves the deadline by which a debtor must assume or reject a nonresidential real property lease. Many commercial property managers and owners have been frustrated by a debtor-tenant’s seeming ability to endlessly delay its decision to either assume a lease (and cure almost every default as a condition thereof) or reject a lease (and allow the landlord to market the space for a replacement tenant). Under the former code, a debtor-tenant was required to assume or reject a lease within 60 days after filing for bankruptcy protection, but this deadline was routinely extended by the courts. Many extensions lasted several months, or even years, and prevented landlords from exercising their rights.

Under the Act, a nonresidential real estate lease is *automatically* rejected if the debtor-tenant does not assume the lease. An election to assume must be made within 120

days after filing the bankruptcy petition. Importantly, this deadline can be extended only 90 days by a court upon a debtor-tenant’s motion. Any subsequent extension by a court is permitted “only upon prior written consent of the lessor” (11 U.S.C.A. § 365(d)(4).) With this new provision, a landlord can require a debtor-tenant to assume or reject a nonresidential lease no later than 210 days after bankruptcy is initiated.

This new provision will force many debtor-tenants to err on the side of caution and assume a lease, only to later breach it. To address this, the Act caps the landlord’s administrative claim -- a very high priority claim -- for damages caused by the ultimate breach to two years’ rent and other monetary damages after the tenant turns over the premises or ultimately rejects the lease, whichever is later. The remainder of the damages caused by the breach becomes an unsecured claim limited by other sections of the bankruptcy code. (11 U.S.C.A. §§ 502 and 503.)

In the end, the Act has increased a nonresidential landlord’s control and leverage when a tenant declares Chapter 11 bankruptcy. Critics of this newfound power complain landlords will use this leverage to extract substantial concessions or payments in exchange for consent to extend the assumption/rejection deadline. Landlords counter the Act simply provides a reasonable time limit on how long their property can hang in limbo during a debtor-tenant’s bankruptcy.

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