

PUBLICATION

Landlords Beware: Potential Post-Holiday Bankruptcy Filings By Retail Tenants

Authors: John David Folds

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The holiday shopping season has long been the most important time of the year for many retailers. In the past, it has been common for troubled retailers to file for bankruptcy protection in the months following the holiday season. The difficult retail environment in 2015 was reflected in bankruptcy filings by prominent retailers such as Radio Shack, American Apparel, Cache and Quiksilver, and by numerous shopping mall closures. Many commentators anticipate that one or more significant retailers will file for bankruptcy in early 2016. Recognizing these risks, commercial and retail landlords should consider taking measures to help minimize disruption and losses from troubled tenants and potential bankruptcy filings.

A bankruptcy filing creates an automatic stay of any enforcement action against the tenant outside of the bankruptcy court and imposes penalties for violating this stay. In addition, once a retail tenant files for chapter 11 bankruptcy, the tenant gains a series of statutory protections and rights, including certain rights that supersede lease provisions. Despite these enhanced tenant rights, a landlord can take several steps to protect its interests and limit potential losses associated with the bankruptcy.

Before a tenant files for bankruptcy, a retail landlord can enhance its position by taking proactive steps to enforce lease provisions promptly after a tenant defaults under its lease. For instance, if the lease authorizes the landlord to draw on a security deposit, terminate renewal rights or take other enforcement measures, these steps can improve the landlord's position if the tenant subsequently files for bankruptcy. By closely monitoring tenants' performance, and understanding and enforcing its own contractual rights, a landlord may be able to terminate a lease, obtain possession of its space and avoid the bankruptcy process altogether.

After a commercial tenant files for chapter 11 bankruptcy, the tenant still is required to pay rent under the lease until it rejects the lease and surrenders the premises. If the tenant fails to comply with this obligation, the landlord should demand the rent from the lessee and, if necessary, seek an order from the bankruptcy court compelling payment. Retail companies frequently fail to pay the advance rent due for the month in which they will be filing for bankruptcy. Depending on the jurisdiction in which the tenant files for bankruptcy, the landlord may be entitled to diem or "stub" rent for the remaining days in the month after the bankruptcy filing. Frequently, large retailers will seek authority to conduct going-out-of-business sales at some or all locations, and ask the bankruptcy court to authorize them to approve procedures – such as hanging banners or placing sandwich board walkers in common areas – that may violate lease terms and/or local ordinances. Landlords who wish to challenge these types of terms should promptly raise their objections before the deadline imposed by the bankruptcy court. Frequently, the landlord can reach an agreement with the tenant's bankruptcy counsel or the proposed liquidator to minimize inconvenience to the landlord and its other tenants.

A bankruptcy filing also provides a retail tenant with the statutory right to assume a lease (even if it is in default) and to assign the lease to a third party. In order to exercise these rights, the tenant must satisfy certain statutory requirements, such as curing existing monetary defaults. Although a retail landlord may not be able to prevent its tenant from assuming a lease after filing for bankruptcy, by making timely and assertive filings in the bankruptcy case the landlord can require that prior defaults be cured. When a tenant seeks to invoke the

bankruptcy rules to allow it to assign a lease to a new tenant, the landlord may be able to obtain an additional security deposit or third party guaranty to provide additional security.

Finally, a commercial landlord also should timely file a proof of claim in the bankruptcy case to assert all amounts owed from the tenant due under the lease, such as unpaid pre-bankruptcy rent. In addition, if the tenant rejects the lease and surrenders the premises during the bankruptcy case, the landlord is entitled to assert its damages for the breach of the lease. The claim for these damages may be capped by the bankruptcy code which, in essence, limits the claim to the greater of (i) rent/additional rent for one year, or (ii) rent for 15% of the remaining term of the lease, not to exceed three years.

A bankruptcy filing by a commercial or retail tenant triggers a series of rights, obligations and deadlines. When a tenant files for chapter 11, a landlord should monitor the case carefully, review the bankruptcy filings closely and be prepared to assert these rights in the bankruptcy court in a timely manner.