

What to Expect When You're Expecting a Bankruptcy

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Whether by the time this is published General Growth Properties has filed for bankruptcy or is still pleading with its lenders for more time, retailers are likely to experience landlord bankruptcies for the foreseeable future. From the perspective of the retailer, here are some things to think about as they brace for the hard times to come.

First, let's start with the good news about the bad news. The good news is that the Bankruptcy Code, which was extensively re-written in 1978 in part to protect shopping center owners, does a great deal to protect shopping center tenants. Thus, it's important to become familiar with those provisions of the Code that most directly impact the retailer.

The first thing to know about the Code is that it virtually does away with any language you might have in your lease that talks about bankruptcy, insolvency, and transfers for the benefit of creditors. (And if your lease was written like most, the drafters were thinking about your insolvency, not the landlord's.) One might speculate that the only reason this language is inserted into leases is in anticipation that the Code may change. Nevertheless, there is little, if anything, that drafters can insert into leases that will permit them to avoid the provisions of the Bankruptcy Code.

A retailer is likely to have three main concerns when learning that its landlord may file or has just filed for bankruptcy: What immediately must I do?; What will happen to my store and the shopping center while the bankruptcy is pending?; and what will happen to my store if my lease is assigned (sold) or rejected?

If a retailer suspects that its landlord is about to file for bankruptcy—and when “bankruptcy” is used here, it is a Chapter 11 reorganization, not a Chapter 7 liquidation—it needs to make sure that it is tracking developments and will be notified as soon as possible following any filing. Unfortunately, tenants—who are generally not creditors in the strict sense of the word—may not be immediately notified of a landlord's bankruptcy filing either by the debtor (the landlord) or the court (usually, a trustee). Moreover, notice of filing may be sent to the location where rent is paid, not necessarily to the tenant's administrative or legal offices. If the tenant is concerned that it may be left in the dark, it can follow the landlord's status through online search engines such as Google, using search terms such as the landlord's name and “Chapter 11” and “bankruptcy.” Once the landlord has filed its petition in bankruptcy, a tenant can follow all of the proceedings, obtain notice of important events and motions, and file any claims using the U.S. government's “PACER” system. PACER provides access to all federal courts, including bankruptcy courts, through an online database that can be accessed by anyone.



For better or worse, there is not much a tenant can do immediately upon the landlord's filing—nor should there be much need for immediate action. As we'll get to shortly, if everything happens as the drafters of the Code intended, the retailer's business should continue through bankruptcy pretty much as it normally would. That is, if anything these days can be considered normal.

The exception to the foregoing is if the tenant has a significant and pressing need that cannot get the landlord's attention and cannot wait until

the bankruptcy runs its course. Examples would include: repairs that are necessary for safety or to continue store operations; the payment of a significant tenant allowance, particularly one that is required for a store expansion, renovation or relocation; or execution of an option. In such cases, it may be in the retailer's interest either to obtain a First Day Order (FDO) or file papers with the court and trustee as soon as possible after the landlord has commenced its bankruptcy. Generally, the FDO is for those with the largest interest in the operation of the debtor's business. However, even if the tenant does not seek an FDO, it may still wish to appear as soon as possible after the bankruptcy filing if it is faced with a significant, immediate issue that affects the operation of the landlord's business. Such a tenant should contact a bankruptcy attorney as soon as it suspects a filing may be imminent.



The other step that retailers can take immediately is to seek out other retailers at the same property or properties and consider hiring common bankruptcy counsel. Given the number of general questions retailers may have and their common interest in the maintenance of the landlord's properties, it would seem prudent to share the cost of good counsel.

As for the status of the lease during the course of the bankruptcy, the Code provides a number of assurances. First, as the bankruptcy proceeds, the tenant-landlord relationship should remain the same. Both sides need to perform. Rent and additional rent need to be paid—although where and to whom payment is sent may change—and the landlord's obligations

remain the same. If the lease is "assumed," meaning the landlord agrees that it will recognize the lease and remain bound to it—or whoever purchases the lease remains bound to it—then its terms and conditions, including options, renewals, rights of assignment, etc., remain the same. In addition, in order to "assume" a lease, the landlord or acquirer must agree to "future performance," in other words agree that all duties, including obligations and debts (for example, for overcharges) existing prior to the bankruptcy, be performed or paid.

In the unlikely event that the lease is rejected—unlikely because the lease is the landlord's source of income—the tenant is still entitled to remain in possession and remains entitled to virtually all of the covenants of the lease, including any right to options (so long as the options can be unilaterally triggered by the tenant) or assignment. Perhaps most significantly, if the lease is rejected, the Code provides rights that may not exist in the lease, such as the right to set-off.

One area of concern to tenants that may not be adequately addressed by the Code is the maintenance and preservation of the common areas. While one might assume that the landlord and its creditors are aware of its importance, insuring that the common areas are properly funded throughout a long bankruptcy process is by no means assured. Aggravating this concern is the fact that many shopping center owners have gone from separate common-area charges to gross rent. As a result, it may not be easy to allocate income to the debtor that should be set aside to maintain the common areas. One way to insure that the common areas are properly maintained and secured is to establish a separate bankruptcy committee representing the retailers. They, along with the creditors' committee and the trustee, should work to insure that the shopping center remains attractive to the most important person in this process: the shopper.

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