

Pillsbury's Distressed Real Estate Task Force Presents:

COVID and Commercial Lease Bankruptcies

Part of Pillsbury's Swimming Lesson Series - Surviving and Navigating  
the Choppy Waters of Distressed Real Estate

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# Speakers



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# Today's Discussion

- COVID's Impact on Commercial Leases
- Overview of the Bankruptcy Process

# COVID's Impact on Commercial Leases

- Commercial real estate has been significantly impacted by the pandemic
- Attempts at lease workouts
- Effects of real estate-secured loans
  - Lease modifications may require lender consent.
  - Failure to obtain consent could be a loan default and may trigger recourse provisions.
  - Loans that are securitized or otherwise being handled by special servicers or special asset groups may present logistical issues for consents.
  - Because a lack of rent translates into no available funds for debt service payments, lenders are facing the same situation as landlords/borrowers.
  - Anecdotally, lenders have agreed to defer payments and forbear on exercising remedies.
  - Lenders may be unwilling to take over commercial buildings during the pandemic.
  - Depressed valuations may impact decisions.

# Overview of Bankruptcy Process

- Chapter 7 – Liquidation
- Chapter 11 – Reorganization

# Automatic Stay in Bankruptcy

- What actions can and cannot be taken by the landlord?

# Assumption or Rejection of the Lease

- What happens to the lease after a tenant files for bankruptcy?
- Payment of post-bankruptcy rent
  - A non-residential tenant debtor must begin timely performance under a lease within 60 days of the commencement of its case.
  - During the COVID crisis, bankruptcy courts have excused certain retail debtors from performing under leases beyond the 60-day period.
  - Potential impact of force majeure clauses in leases – if present in a lease and worded appropriately, it may relieve a tenant of paying some or all of the rent during the pandemic.
  - Some courts have invoked section 305 of the Bankruptcy Code to suspend the bankruptcy proceedings for a period of time.

# Assumption or Rejection of the Lease (cont'd)

- How long does a tenant have to decide on whether to assume or reject the lease?
  - A non-residential tenant debtor has a limited time to decide whether to assume or reject a lease – 120 days, which can be extended up to an additional 90 days.
  - The Consolidated Appropriations Act (called the COVID relief act in the press) contains several amendments to the Bankruptcy Code, including a change to Section 365(d)(4)(A) of the Bankruptcy Code to give the debtor (or trustee) 210 days after the order for relief to assume an unexpired non-residential real property lease, thereby automatically extending the period by the additional 90 days without the need for a motion and the showing of cause. This change applies to cases under all chapters and sunsets in two years on December 27, 2022.
  - Further extensions require landlord consent.



# Assumption or Rejection of the Lease (cont'd)

- What are the requirements for a tenant's assumption of the lease?
- What happens if the lease is assumed?
  - Accrued and unpaid post-petition rent must be paid in full as an administrative expense claim if the debtor is to confirm a Chapter 11 plan of reorganization. The debtor must also demonstrate that it will be able to perform under such lease and that the plan of reorganization is feasible.
  - There is a risk that administrative expense claims accrued during Chapter 11 will not be paid in full if the debtor's case is converted to a liquidation under Chapter 7.
- Can the lease be assigned?
- What happens if the lease is rejected?

# Proof of Claim in Bankruptcy

- Requirement of filing a “Proof of Claim” in the bankruptcy case before the “Bar Date” or such other date fixed by the Bankruptcy Court – normally 30 days after rejection
- Amount of landlord’s claim if lease is rejected
  - Bankruptcy cap on amount of commercial lease claim: rent reserved under the lease for greater of 1 year or 15%, not to exceed 3 years.
  - Duty to mitigate and possible impact on claim.
  - Can a debtor tenant object to the amount of landlord’s claim? What is the process and the timing for making such objections?
  - How does the process work for a bankrupt tenant to pay a distribution to creditors on their claims?
  - When will the landlord receive a distribution on account of its claim?
  - How is the distribution amount determined?
  - Can a landlord sell its claim to a third party instead of waiting for a distribution from the bankrupt tenant?

# Proof of Claim in Bankruptcy (cont'd)

- Treatment of security deposits, letters of credit and guarantees in bankruptcy
  - Is a lease security subtracted from a landlord's capped claim or from the landlord's full damage claim?
    - Cash security deposit
    - Letter of credit
    - Guaranty
  - Can a landlord keep lease security proceeds that exceed the bankruptcy capped claim?
    - Cash security deposit
    - Letter of credit
    - Guaranty
  - When can a landlord draw down the letter of credit and for what types of damages?
  - Pros and cons of the different types of security devices

# Plan of Reorganization Process

- How a bankrupt tenant obtains approval and confirmation of a plan of reorganization
  - Anticipated duration of process
  - Concept of exclusivity
  - Can there be assumption or rejection under the plan?
  - How does this process affect a landlord of:
    - a rejected lease
    - an assumed lease

# Preference Actions

- A bankrupt tenant can recover payments it made to a landlord during the 90 days preceding bankruptcy under certain circumstances.
- Landlord considerations
  - Negotiating a pre-bankruptcy lease termination
  - Other considerations

# Pillsbury's Distressed Real Estate Practice

- We understand that clients must act *quickly and decisively* to create or preserve value, achieve stability and seize market opportunities. Pillsbury's Real Estate team is adept at working with clients to capitalize on the effects of market disruptions – whether resulting from inefficient capital structures, asset-specific difficulties or event-driven (or macroeconomic) distress situations.

## Pre-bankruptcy experience:

- debt and equity restructurings, including loan modifications and workouts, and extension and forbearance agreements
- preferred equity investments and mezzanine loans in distressed situations
- acquisition and restructuring of distressed loans or interests in loans and ownership vehicle (including from government entities),
- formation of investment structures to acquire such assets
- loan enforcement and lien priority disputes, including judicial and non-judicial foreclosures and UCC foreclosures, deeds or assignments-in-lieu-of-foreclosure, receiverships and property recovery issues, writs of attachment or possession, analysis and defense of liability claims and analysis of intercreditor or co-lender agreements in complex debt stacks
- providing advice on alternatives to bankruptcy
- negotiation of rescue and exit financing

## Real Estate bankruptcy experience:

- relief from stay litigation
- cash collateral stipulations and adequate protection
- bankruptcy sales
- resolution of lien priority and intercreditor issues
- cram-down litigation
- prosecution and defense of avoidance actions (e.g., fraudulent transfers and preferences)
- representation of indenture trustees
- all facets of unexpired leases, executory contracts and intellectual property licenses
- bankruptcy discharge and non-dischargeability actions
- negotiating and confirming plans of reorganization

# Pillsbury's Distressed Real Estate Taskforce

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