Unexpired Leases under the New Bankruptcy Act: A Win-Win for Landlords and Lenders

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Unexpired Leases Under the New Bankruptcy Act: A Win-Win for Landlords and Lenders?

I. INTRODUCTION

After numerous failed attempts and massive lobbying efforts largely by banks and credit card companies, the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005\(^1\) was signed into law by President Bush on April 20, 2005.\(^2\) The legislation represented the largest overhaul of the Bankruptcy Code since its enactment in 1978.\(^3\) With this overhaul, Congress intended to improve the bankruptcy system by curbing abusive practices among consumers.\(^4\) The revisions to the Bankruptcy Code are marked by a restoration of personal responsibility and integrity in the bankruptcy system.\(^5\) While the 2005 Act was driven largely by consumer bankruptcy, several significant provisions affect corporations, farmers, and small businesses.\(^6\) In

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particular, commercial landlords are among the biggest winners of the business bankruptcy changes.\(^7\)

In a reorganization case under Chapter 11, the debtor is attempting to restructure and rehabilitate the operation of its business, providing the debtor the opportunity to preserve all or part of its prepetition estate.\(^8\) In return for this opportunity, the debtor commits to making specified payments to its creditors over a period of time postpetition, as formulated in a plan of reorganization.\(^9\) Unless the court orders otherwise, the existing management of the business remains in place and serves as a debtor-in-possession ("DIP").\(^10\)

In many cases, a DIP will be the lessee on several, sometimes even hundreds, of unexpired leases of nonresidential real property.\(^11\) One of the major components of a successful reorganization in cases which have a great number of leases is the determination of which unexpired leases shall be assumed, and which ones shall be rejected.\(^12\) Section 365(d)(4) of the Bankruptcy Code provides the framework for such decisions.\(^13\)

By assuming an unexpired lease, the DIP is allowed to remain in possession of the premises, but is obligated to make good on all past and present payments due under the lease.\(^14\) On the other hand, by

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9. See id. at 756-59.

10. See id. at 737-38 (acknowledging that in most cases the debtor-in-possession will operate the business after the petition is filed); *In re Cukierman*, 265 F.3d 846, 849 (9th Cir. 2001) (holding that Cukierman, the DIP, had the duties of the trustee under § 1107(a) during the relevant time of the Chapter 11 case).

11. See, e.g., *In re Channel Home Centers*, 989 F.2d 682, 683 (1993) (noting that "[a]s of the filing date, Channel and Channel Realty were parties to about 200 leases at 91 locations in 19 states"); *Company News; Wang Seeks Court's Permission To Terminate Leases*, N.Y. TIMES, Sept. 18, 1992, at D3 ("Wang Laboratories Inc., said it would ask the Federal Bankruptcy Court for authority to terminate more than 115 unexpired leases for various operations throughout the United States, which would save it $35 million in annual rental expenses.").

12. See N.L.R.B. v. Bildisco & Bildisco, 465 U.S. 513, 528, 104 S. Ct. 1188, 1197 (1984) (acknowledging that the assumption or rejection decision is "vital to the basic purpose of a Chapter 11 reorganization").


14. § 365(b)(1).
rejecting an unexpired lease, the DIP surrenders the right to use the
premises, and also relinquishes further personal liability on the lease.\textsuperscript{15}
The rejection of the lease is, however, a breach of the lease\textsuperscript{16} and the
commercial landlord will have a general unsecured prepetition claim for
the damages it suffered as a result of the rejection.\textsuperscript{17} Regardless of
which decision is made, in the interim period the DIP is required to
timely perform all of the obligations due under the lease.\textsuperscript{18}

The 2005 Act amended § 365(d)(4) significantly to the
advantage of the commercial landlord by addressing Congressionally
perceived problems over the past two decades.\textsuperscript{19} This advantage,
however, may not only be realized by commercial landlords, but may
also benefit DIP lenders with the possibility of extending larger DIP
financing to meet a DIP’s immediate cash needs upon filing for
bankruptcy.\textsuperscript{20} Part II of this Note discusses § 365(d)(4) before and after
the 2005 Act.\textsuperscript{21} Part III addresses the increased opportunity presented to
DIP lenders under revised § 365(d)(4) and potential pitfalls associated
with taking advantage of the lending opportunity.\textsuperscript{22} Finally, Part IV
highlights what DIP lenders can do to protect their interests when
lending to DIPs under § 364(b).\textsuperscript{23}


In 1984, Congress enacted the Leasehold Management
Bankruptcy Amendments Act,\textsuperscript{24} adding several pro-landlord provisions

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\textsuperscript{16} § 365(g); e.g., McLaughlin v. Walnut Properties, Inc., 119 Cal. App. 4th 293, 299-300, 14 Cal. Rptr. 3d 369, 374-75 (2004).
\textsuperscript{17} § 502(g); e.g., McLaughlin, 119 Cal. App. 4th at 299-300, 14 Cal. Rptr. at 374-75.
\textsuperscript{18} § 365(d)(3); e.g., \textit{In re Cukierman}, 265 F.3d 846, 849 (9th Cir. 2001).
\textsuperscript{19} See Levin & Ranney-Marinelli, supra note 6, at 623-24.
\textsuperscript{20} See infra notes 54-77 and accompanying text.
\textsuperscript{21} See infra notes 24-53 and accompanying text.
\textsuperscript{22} See infra notes 54-102 and accompanying text.
\textsuperscript{23} See infra notes 103-19 and accompanying text.
\textsuperscript{24} Pub. L. No. 98-353, 361-363, 98 Stat. 333, 361-64 (1984), as part of the Bankruptcy
as amended in various sections of 11 U.S.C. and 28 U.S.C.). The Act was enacted in the
face of generally perceived problems the prior Act presented to commercial landlords in
obtaining certainty over their leases. 130 CONG. REC. S 8891, June 29, 1984, \textit{reprinted in
to the Bankruptcy Code,\textsuperscript{25} including § 365(d)(4),\textsuperscript{26} a provision which set out the time requirements for assuming or rejecting an unexpired lease of nonresidential real property.\textsuperscript{27} With the addition of § 365(d)(4), Congress hoped to reduce the period that certain leaseholds would remain vacant and thus lessen the uncertainty commercial landlords experienced while a DIP decided whether to assume or reject an unexpired lease.\textsuperscript{28}

With respect to unexpired leases of nonresidential real property, the 1984 version of § 365(d)(4) provided a DIP a sixty-day decision period from the date of the bankruptcy filing to either assume or reject a lease.\textsuperscript{29} If the sixty-day period elapsed and no decision was made on a particular lease, then such lease was deemed rejected and the DIP had to immediately surrender the property to the commercial landlord.\textsuperscript{30} However, the bankruptcy court could, upon a showing of cause, extend the initial sixty-day period for “additional time.”\textsuperscript{31} Oftentimes a court not only extended the initial decision period for a specified time, but extended it multiple times.\textsuperscript{32}

\begin{footnotes}
\item[26] S. REP. NO. 65, 98th Cong., 1st Sess. 32, \textit{reprinted in} 1984 U.S.C.C.A.N. 576, 599 (acknowledging that one of the stated purposes of the changes made to § 365 by the 1984 Amendments was to “strengthen the protections [afforded] ... shopping centers under the Bankruptcy Code”).
\item[28] Id. “Prior to the [1984] Amendments, there was no distinction in § 365 between leases of residential and nonresidential property.” Jane S. Solomon, \textit{Real Estate Aspects of the 1984 Amendments to the Bankruptcy Code}, 58 N.Y. St. B.J. 28, 29 (July 1986).
\item[30] Id. 
\item[31] [The] problem was caused by the ability of the trustee to close a store for an extended period of time without stating his intention regarding the disposition of the premises, thereby preventing the landlord from re-leasing the space to an operating business. Consequently, landlords and solvent tenants suffered from uncertainty while the trustee made his decision.
\end{footnotes}
While Congress intended to reduce the uncertainty experienced by commercial landlords, the 1984 version of § 365(d)(4) had the opposite effect. In fact, the practice of bankruptcy judges granting multiple extensions to a DIP beyond the initial decision period effectively gave DIPs the ability to avoid making decisions as to its unexpired leases for months, even years, after filing for bankruptcy, to the detriment of the commercial landlord. This practice essentially left commercial landlords as forced lenders, compelled to obey the wishes of DIPs indefinitely.


By amending § 365(d)(4) in the 2005 Act, Congress attempted to put to rest the difficulty experienced with unexpired leases of nonresidential real property. The revised section established a "firm, bright line deadline" on a DIP's overall decision period, attempting to cure the previously undesired and unintended result. When a debtor is the lessee of an unexpired lease of nonresidential real property upon filing for bankruptcy, revised § 365(d)(4) provides the DIP with an

33. See Levin & Ranney-Marinelli, supra note 6, at 623-24.
34. Kulak & Lange, supra note 7; see also Jones, supra note 32; Brown & Ahern III, supra note 3, at 97 (explaining that prior practice allowed debtors to withhold for years).
(A) Subject to subparagraph (B), an unexpired lease of nonresidential real property under which the debtor is the lessee shall be deemed rejected, and the trustee shall immediately surrender that nonresidential real property to the lessor, if the trustee does not assume or reject the unexpired lease by the earlier of – (i) the date that is 120 days after the date of the order for relief; or (ii) the date of the entry of an order confirming a plan. (B)(i) The court may extend the period determined under subparagraph (A), prior to the expiration of the 120-day period, for ninety days on the motion of the trustee or lessor for cause. (ii) If the court grants an extension under clause (i), the court may grant a subsequent extension only upon prior written consent of the lessor in each instance.

initial decision period of the earlier of either 120 days from the date of filing or the date of the entry of an order confirming a reorganization plan. On the motion of the DIP or the commercial landlord, the court may extend the initial decision period for ninety days upon a showing of cause. However, the section expressly limits the authority of the court to grant further extensions to situations where the commercial landlord provides written consent for any subsequent extension. If a DIP fails to either assume or reject its unexpired leases within the decision period granted by the statute or by the court, a lease is deemed rejected and the DIP must immediately surrender the property to the commercial landlord.

In revising § 365(d)(4), Congress addressed the problem of allowing bankruptcy judges to extend a DIP’s decision period indefinitely. In fact, this revision is designed to “limit[ ] the bankruptcy judges’ discretion to grant extensions of the time for the . . . debtor to decide whether to assume or reject a lease.” In response to the practice of granting indefinite extensions, the decision period was changed from sixty days with multiple time period extensions available to 120 days subject to a single extension of ninety days upon a showing of cause, and further extensions only with the written consent of the commercial landlord. While the initial time period was doubled, Congress definitively took control away from DIPs. Absent consent of a commercial landlord, DIPs now have a maximum of 210 days (roughly seven months) from the date of filing to make the assumption or rejection decision. Practice under the prior law allowed deferring

39. Id.
40. Id.
41. Id.
43. Hatch, supra note 35, at 6-7.
44. Id. ("The current Code permits a retail debtor as long as years to decide what it will do with its leases. This legislation . . . acts to curb this abuse.").
46. H.R. REP. NO. 109-31, pt. 1, at 86 (2005), reprinted in 2005 U.S.C.C.A.N. 152-53; Hatch, supra note 35, at 6-7 ("Beyond that maximum period, there is no authority to grant further time unless the lessor has agreed in writing to the extension.").
47. See supra note 45 and accompanying text (120 day initial decision period plus a single ninety day extension equals 210 days, or roughly seven months).
the assumption or rejection decision up to the point of plan confirmation. The revised law substantially reduces that period, presumably leading to faster decisions and increasing the level of certainty for landlords that was envisioned by Congress when it added § 365(d)(4) two decades ago.

For many proponents the revisions to § 365(d)(4) were long overdue. As was testified to by a representative from the International Council of Shopping Centers before the Senate Judiciary Committee’s Subcommittee on Administrative Oversight and The Courts, “[today, we are faced with a bankruptcy system and process that is vastly different than what Congress envisioned,” and “this legislation represents a common sense approach to balancing the needs of debtors and creditors during business reorganizations.” Others remain strongly opposed, arguing that while the prior law may have provided “an inordinate amount of time to determine whether a location was viable, it did allow for an orderly and studied approach to rehabilitating companies in bankruptcy.”

III. IMPACT OF REVISED § 365(d)(4) ON THE LENDING WORLD

The revisions to § 365(d)(4) will undoubtedly alter the way a DIP deals with assumption and rejection of its unexpired leases of

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further time unless the lessor has agreed in writing to the extension.

Whether landlords will consent to further extensions or not will almost certainly be a function of the relevant lease market at the time the decision has to be made. If the lease is at a below-market rent in a market where alternative tenants are available, there is no reason for consent to be provided because the landlord would have the opportunity to find a new tenant at a higher rent. Conversely, if the lease is at or above the market, consent would likely be given (if requested) in the interests of certainty.

Reimer, supra note 6.

49. Reimer, supra note 6; Levin & Ranney-Marinelli, supra note 6, at 623.

50. See BROWN & AHERN III, supra note 3, at 97 (2005); infra notes 51-52 and accompanying text.

51. See, e.g., Testimony of Ellen B. Marshal, supra note 35.

52. Id.

nonresidential real property.\textsuperscript{54} In some cases, forcing a DIP to decide by a strict deadline, without the possibility of further extension, may drive up the amount of cash required immediately upon filing for bankruptcy.\textsuperscript{55} This may benefit DIP lenders by requiring larger DIP financing to meet a DIP's immediate cash needs.\textsuperscript{56} On the other hand, requiring DIPs to borrow more cash up front may imperil the reorganization's success, to the possible detriment of DIP lenders.\textsuperscript{57}

A. Opportunities for DIP lenders under revised § 365(d)(4)

Adequate DIP financing is the lifeblood for most debtors attempting to reorganize and rehabilitate their business.\textsuperscript{58} DIP financing may come from either a prior lender, secured or unsecured, or from a lender not involved with the borrower prior to bankruptcy.\textsuperscript{59} Statutory authority for a DIP to obtain credit and incur debt in order to operate the business while bankrupt is found in § 364 of the Bankruptcy Code.\textsuperscript{60}

\begin{itemize}
  \item \textsuperscript{54} Reimer, supra note 6.
  \item \textsuperscript{55} See Marcia L. Goldstein & Victoria Vron, Chapter 11 Business Reorganizations, Current Issues in Debtor in Possession Financing, SK092 ALI-ABA 115, 149 (June 9-11, 2005) ("In essence, the 2005 Act increases the cash requirements for DIPs, both shortly after the date of filing of the petition and upon the effective date of the plan of reorganization."); Erik Moser, How The New Bankruptcy Law May Affect Troubled Companies, Capital Eyes E-newsletter (Bank of America) (Sept. 2005), http://www.bofbusinessequipal.com/resources/capeyes/a09-05-302.html ("The Bankruptcy Abuse Prevention and Consumer Protection Act is likely to increase the amount of cash a company needs upon filing for bankruptcy.").
  \item \textsuperscript{56} Moser, supra note 55 ("[T]his extra cash requirement will mean bigger DIP commitments . . . "); see also Goldstein & Vron, supra note 55, at 149.
  \item \textsuperscript{57} See Reimer, supra note 6; Goldstein & Vron, supra note 55, at 149; Moser, supra note 55.
  \item \textsuperscript{58} E.g., Marcia L. Goldstein, Michele J. Meises & Timothy Graulich, Current Issues In Debtor In Possession Financing, 857 PLI/Comm 251, 253 (Oct. 2004); In re Ames Dep't Stores, Inc., 115 B.R. 34, 36 (Bankr. S.D.N.Y. 1990) ("Most successful reorganizations require the debtor in possession to obtain new financing simultaneously with or soon after the commencement of the Chapter 11 case."); Moser, supra note 55 ("Debtor-in-possession (DIP) financing is a lifeline for many bankrupt companies . . . "); David A. Skeel, The Past, Present, and Future of Debtor-In-Possession Financing, 25 Cardozo L. Rev. 1905, 1906, 1934 n.5 (2004) (citing that in 1996, 48.21\% of publicy held debtors who filed for bankruptcy obtained DIP financing).
  \item \textsuperscript{59} See Jon M. Labovitz, Taking A Fresh Look At DIP Budgeting, 24 AM. BANKR. INST. J. 34, 34 (March 2005) (acknowledging that DIP financing typically comes from the same lenders or syndicate of lenders of the debtor prepetition); Goldstein, Meises & Graulich, supra note 58, at 274-76 (outlining a number of ways a debtor may receive DIP financing through entities other than a bank).
  \item \textsuperscript{60} 11 U.S.C. § 364(a)-(d) (2000).
\end{itemize}
fact, to promote the paramount goal of reorganization and rehabilitation of the bankrupt entity, the Bankruptcy Code provides numerous protections and incentives to encourage lenders to provide DIP financing.\textsuperscript{61} Under § 364(a) and (b), a DIP lender has the potential to receive administrative priority among all unsecured claims when extending unsecured credit.\textsuperscript{62} If a DIP is unable to obtain financing under § 364(a) or (b), § 364(c) and (d) provide a DIP lender with a "superpriority" administrative expense claim, superior to all other administrative priority claims, and possibly a security interest in the assets of the DIP.\textsuperscript{63} While powerful incentives to become a DIP lender already exist under § 364, the revisions to § 365(d)(4) may provide additional incentives.\textsuperscript{64}

When a debtor files for protection under Chapter 11, the debtor is typically not current on all lease obligations.\textsuperscript{65} In some instances these claims accumulate to significant dollar amounts and commercial landlords are eager to receive payment.\textsuperscript{66} Upon filing for bankruptcy, however, collection of prepetition payments are subject to the automatic stay under § 362(a), halting the collection efforts of all creditors, including commercial landlords.\textsuperscript{67}

At this point, if a DIP chooses to assume a lease, the DIP must make good on all past-due monetary lease obligations, commonly known as cure payments.\textsuperscript{68} With the unlimited time period DIPs

\textsuperscript{61} Goldstein, Meises & Graulich, supra note 58, at 253-56 (citing § 364 as the main incentive to loan to a DIP).
\textsuperscript{62} § 364(a)-(b). The DIP lender who extends unsecured credit will receive administrative expense priority "allowable under Section 503(b)(1) of this title." \textit{Id.}
\textsuperscript{63} § 364(c)-(d). To receive this high priority the debtor will have to demonstrate to the court that financing on more favorable terms is unavailable. \textit{See, e.g., In re Shaw Indus., Inc., 300 B.R. 861, 863 (Bankr. W.D.Pa. 2003)} (noting debtor's "significant efforts to obtain alternative financing," which included contacting "numerous lenders, both institutions and individuals").
\textsuperscript{64} \textit{See infra} notes 65-77 and accompanying text.
\textsuperscript{65} \textit{See, e.g., McLaughlin v. Walnut Properties, Inc., 119 Cal. App. 4th 293, 296, 14 Cal. Rptr. 3d 369, 372} (noting that Walnut Properties' unpaid rent totaled over $1 million); \textit{Company News; Wang Seeks Court's Permission To Terminate Leases, supra note 11} ("Wang Laboratories Inc., said it would ask the Federal Bankruptcy Court for authority to terminate more than 115 unexpired leases for various operations throughout the United States, which would save it $35 million in annual rental expenses.").
\textsuperscript{66} \textit{Id.}
\textsuperscript{67} 11 U.S.C. § 362(a) (2000) (providing that a voluntary, joint or involuntary petition for bankruptcy operates as a stay, applicable to all entities).
\textsuperscript{68} § 365(b)(1) (providing that in the event of a default, the trustee may not assume the lease unless the default is cured). On the other hand, if the lease is rejected either by
typically enjoyed under the previous § 365(d)(4) to decide whether to assume or reject unexpired leases, DIPs were able to wait until confirmation of the plan of reorganization and its accompanying exit loan facility to satisfy cure payments. If a DIP could postpone the assumption decision until plan confirmation, no money was needed for cure payments until that time.

This practice may continue for debtors with a relatively small number of unexpired leases to handle when filing for bankruptcy protection under Chapter 11. A 210-day decision period is ample time to assume a small number of leases in conjunction with plan confirmation. However, for larger, national chains, with dozens or even hundreds of unexpired leases of nonresidential real property, this old practice will quickly erode. The shorter, stricter overall time period to assume or reject unexpired leases may add to the immediate cash needs of a DIP in order to effectuate the reorganization and rehabilitation of its business. If a DIP intends to assume certain leases within the maximum 210-day decision period (absent commercial landlord consent to an extension) and the plan of reorganization and its accompanying exit loan facility are still far from complete, the money for cure payments must come from another source. The need to fund larger cure payments before a final plan of reorganization is effectuated will often increase the amount of DIP financing required when a DIP files for bankruptcy protection under Chapter 11. This is where larger DIP loans will be required, and thus, where the opportunity is created

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69. See Moser, supra note 55.
70. See id.
72. Cf. id.
74. Goldstein & Vron, supra note 55, at 149 ("In essence, the 2005 Act increases the cash requirements for DIPs, both shortly after the date of filing of the petition and upon the effective date of the plan of reorganization."); Moser, supra note 55 ("[T]he Bankruptcy Abuse Prevention and Consumer Protection Act is likely to increase the amount of cash a company needs upon filing for bankruptcy.").
75. Moser, supra note 55.
76. Id.
for increased lending with unsecured, and possibly secured, administrative priority.\textsuperscript{77}

\textbf{B. DIP lender beware: potential pitfalls in lending under revised § 365(d)(4)}

While the opportunity to make larger loans to DIPs with administrative priority has presented itself through the revisions to § 365(d)(4), lenders may want to seize it cautiously.\textsuperscript{78} Conforming to the stricter time period under revised § 365(d)(4) will likely increase the pressure on a DIP to make their assumption or rejection decision.\textsuperscript{79} In some instances, this increased pressure may force DIPs to make a number of improvident assumption decisions,\textsuperscript{80} after which commercial landlords will be on an equal playing field with DIP lenders with respect to administrative priority, which could possibly imperil the success of the reorganization.\textsuperscript{81}

In the ordinary course of a Chapter 11 case, DIPs are to be expected to make the decision to reject leases clearly unlikely to succeed.\textsuperscript{82} However, because the revisions to § 365(d)(4) require a DIP to make a decision about its leases within an overall shorter amount of time, DIPs may unwisely choose to keep leases that are marginally promising.\textsuperscript{83} If a DIP decides to assume a marginally promising lease and is later unable to maintain the monetary lease obligation, the DIP is

\textsuperscript{77} See \textit{supra} notes 58-76 and accompanying text.

\textsuperscript{78} See \textit{infra} notes 79-102 and accompanying text.

\textsuperscript{79} See Goldstein & Vron, \textit{supra} note 55, at 149 ("As a result of this change, many debtors will be forced into making premature decisions on lease assumption/rejection . . ."); Peter Edmonston, \textit{Now, the Bad News}, DAILY DEAL, May 9, 2005, \textit{available at} 2005 WLNR 7172254 ("You'd better be making the right decision the first time."); \textbf{BROWN & AHERN III, supra} note 3, at 98 ("This new timeline is designed to focus the judge's attention on the interests of landlords and, over the course of the bankruptcy process, to increase the pressure on the tenant.").

\textsuperscript{80} Reimer, \textit{supra} note 11.

\textsuperscript{81} See \textit{infra} notes 82-102 and accompanying text; \textbf{BROWN & AHERN III, supra} note 3, at 97 (explaining that the new revisions will "level the playing field" for landlords and lenders).

\textsuperscript{82} Cf. Levin & Ranney-Marinelli, \textit{supra} note 11, at 623-24; Reimer, \textit{supra} note 11.

\textsuperscript{83} Edmonston, \textit{supra} note 79 ("[M]anagement is usually going to push to keep the marginal stores open . . ."). The problem, of course, is that pushing to keep the marginal stores open is often what caused the bankruptcy in the first place. \textit{Id.} See also Levin & Ranney-Marinelli, \textit{supra} note 11, at 623-24.
then forced to subsequently reject the lease. The result of an improvident, possibly premature, assumption decision is the creation of an administrative expense claim for the commercial landlord which the DIP must pay before it can exit bankruptcy. The landlord's claim receives the same priority DIP lenders get when lending to DIPs under § 364(b). Thus, unless a DIP lender is protected by a superpriority administrative expense claim under § 364(c) or (d), the commercial landlord will be on an equal playing field with the DIP lender when the DIP initially assumes and then subsequently rejects a lease.

Prior to the enactment of the 2005 Act, courts typically allowed administrative expense claims for subsequent lease rejection on a dollar-for-dollar basis, meaning that a DIP was burdened by the full monetary amount of the lease obligation that remained due to the landlord. In apparent anticipation of forced assumption decisions that may lead to subsequent rejections, Congress added § 503(b)(7) to the section of allowable administrative expenses. As a result of this addition, courts are no longer able to grant landlords administrative priority for the full amount of all monetary lease obligations. The administrative priority for such a claim is capped at the sum of all monetary obligations due under the lease for the two-year period following the rejection date or actual turnover of the premises, whichever is later. If any monetary

84. 11 U.S.C. § 365(d)(4) (2000) (stating that if the lease is deemed rejected, either by operation of the statute or by election, the "trustee shall immediately surrender such nonresidential real property to the lessor").
85. Levin & Ranney-Marinelli, supra note 11, at 624; see also In re Klein Sleep Products, Inc., 78 F.3d 18, 23-28 (2d Cir. 1996) (holding that an assumed lease which is later rejected receives administrative priority status).
86. § 1129(a)(9) (stating that priority claims must be paid in full before leaving bankruptcy).
87. See supra notes 58-63, 82-86 and accompanying text.
88. § 364(c)-(d); see infra notes 112-14 and accompanying text.
89. See supra notes 58-88 and accompanying text. The DIP lender’s administrative expense claim is created by financing the DIP with unsecured credit in bankruptcy, while the commercial landlords’ is created by the subsequent rejection of a previously assumed lease by the DIP. See supra notes 58-88 and accompanying text.
90. Goldstein & Vron, supra note 55, at 149. The lease obligation the nondebtor party was entitled to included both the prepetition lease obligation as well as the postpetition lease obligation. See In re Norwegian Health Spa, 79 B.R. 507 (Bankr. N.D. Ga. 1987); In re Mushroom Transportation Co., 78 B.R. 754 (Bankr. E.D. Pa. 1987).
92. See id.
93. Id.
obligations remain under the lease after the allowable two-year period, they become a general unsecured prepetition claim under the calculation set forth in § 502(b)(6).\textsuperscript{94} While this may seem to be a positive addition for DIP lenders by limiting what was once an unlimited claim, commercial landlords will remain equally ranked with DIP lenders who lend under § 364(b) in the administrative priority line as to the allowable portion of the lease obligation claim.\textsuperscript{95} With respect to large, national chains who hold a significant number of leases, the rent amount could equal, if not be greater than, the DIP loan itself, even if the landlord's claim is capped at two years' rent payments.\textsuperscript{96}

Additionally, improvident assumption decisions by a DIP may not only lead to subsequent rejection, but also to multiple administrative expense claims that may have a cumulative effect of triggering liquidation.\textsuperscript{97} If a Chapter 7 liquidation ensues and commercial landlords are on an equal playing field with DIP lenders with respect to their administrative expense claims, DIP lenders may be forced to compete with commercial landlords over whose administrative claim receives priority in a liquidation proceeding.\textsuperscript{98} If the success of the reorganization could be imperiled in this manner, lenders may want to rethink large DIP loans for fear of significant opposing administrative expense claims in a subsequent liquidation.\textsuperscript{99} Conversion to a Chapter 7 case, however, would mean that the priority established for Chapter 11 administrative expense claims would no longer be honored with priority, as the Chapter 11 claims would become subordinated to the priority claims of the Chapter 7 case.\textsuperscript{100} In light of the fact that "less than ten percent of businesses filing in Chapter 11 ever successfully confirm a reorganization plan,"\textsuperscript{101} DIP lenders may want to rethink making large

\textsuperscript{94} Id.
\textsuperscript{95} See supra notes 78-94 and accompanying text.
\textsuperscript{96} See, e.g., Company News; Wang Seeks Court's Permission To Terminate Leases, supra note 11 ("Wang Laboratories Inc., said it would ask the Federal Bankruptcy Court for authority to terminate more than 115 unexpired leases for various operations throughout the United States, which would save it $35 million in annual rental expenses.").
\textsuperscript{97} Reimer, supra note 6; see also Levin & Ranney-Marinelli, supra note 6, at 624.
\textsuperscript{99} See supra notes 97-98 and accompanying text.
\textsuperscript{100} In re Sun Runner Marine, Inc., 134 B.R. 4, 6-7 (9th Cir. 1991) (holding that the administrative expenses of a Chapter 7 case have priority over superpriority administrative claims from the superseded Chapter 11 case).
\textsuperscript{101} Testimony of H. Elizabeth Baird, supra note 53 (finding by the National Bankruptcy Review Commission in 1994); see also Rosemary Williams, Time Limits on
DIP loans to DIPs with significant commercial lease obligations, or at least requiring a significantly greater risk premium for those DIPs who could pose higher risk than others (e.g., retailers). 102

IV. WHAT CAN DIP LENDERS DO TO PROTECT THEIR POSTPETITION INTERESTS WHEN LENDING UNDER § 364(b)?

Unless DIP lenders take the proper steps to protect their interests at the right time, they may find themselves facing several significant opposing administrative expense claims from commercial landlords in the event a DIP prematurely assumes a lease and subsequently rejects it while in bankruptcy. 103 Whether prepetition or pre-DIP financing, a lender may require borrowers to do several things before extending credit, while at the same time adding more factors to an already extensive risk analysis, in order to reduce the number of opposing administrative expense claims encountered postpetition. 104

Because DIP lenders are typically also the prepetition lenders with significant bargaining power at the initial loan stage, DIP lenders may be able to protect their postpetition position up front. 105 Those prepetition lenders who may eventually become DIP lenders should provide for the unfortunate event of a bankruptcy in the original loan agreement by requiring thorough prepetition planning by the borrower prior to filing for bankruptcy. 106 If a good plan of reorganization is

Assumption or Rejection on Executory Contract or Lease Under § 365 of Bankruptcy Code (11 U.S.C. § 365), 137 A.L.R. Fed. 137, § 3(a) (1997) ("Only a small percentage of the rehabilitative cases filed every year result in confirmation and consummation of a plan."). But see Epstein, supra note 6, at 734-35 ("[T]he Chapter 11 of a big business usually leads to some form of reorganization of the company that is 'successful' at least in the sense that some part of the business continues as a going concern.").

103. See supra notes 78-102 and accompanying text.
104. See infra notes 105-119 and accompanying text.
105. See Labovitz, supra note 59, at 34 (acknowledging that DIP financing typically comes from the same lenders or syndicate of lenders of the debtor prepetition); Goldstein, Meises & Graulich, supra note 58, at 274-76 (outlining a number of ways a debtor may receive DIP financing through entities other than a bank).
106. Edmonston, supra note 79 ("It's possible the lease decisions would have to be made before a reorganization plan even exists."); Katherine Clayton, North Carolina Bankers Association Legal Memorandum, Business Provisions – The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Vol. 37, No. 12 (Oct. 26, 2005) ("The changes require debtors to do more advance planning prior to filing for bankruptcy...[and] there may be more pre-packaged bankruptcy filings...."); Levin & Ranney-Marinelli, supra note 55, at 624-25 ("Clearly, the new statute will require careful prebankruptcy
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formulated prior to filing for bankruptcy, or can at least be completed within the 210-day decision period to either assume or reject unexpired leases, many premature assumption decisions by a DIP can be avoided entirely, and commercial landlords' administrative expense claims may never arise.107

If a DIP lender was also the prepetition lender, at either the prepetition or pre-DIP financing phase, it may also require the borrower to obtain written landlord consent to waive and/or subordinate any administrative expense claim it may have in bankruptcy.108 This consent form has the practical effect of subordinating the commercial landlord's administrative expense claim to the DIP lender's administrative expense claim, in the event the two parties compete for priority.109 However, with the increased ability of commercial landlords to control the pace of a Chapter 11 proceeding by forcing assumption or rejection within a shorter time period under revised § 365(d)(4), no incentive may exist for commercial landlords to consent to such a request, either prepetition or postpetition.110 The leverage wielded by commercial landlords under the revised § 365(d)(4) may leave unsecured DIP lenders who were also prepetition lenders with no recourse, or at least no way to place their interests above that of the commercial landlords'.111

If a DIP lender is not in a position to protect itself in the prepetition phase of lending, it may still lend under the more favorable § 364(c) and (d) in order to protect its postpetition interests, which would give the DIP lender a superpriority administrative expense claim.112 To receive a superpriority administrative expense claim under § 364(c) or (d), a DIP must demonstrate to the bankruptcy court that financing on

planning . . . "

107. See supra notes 78-96 and accompanying text. If the DIP does not make any improvident assumption decisions in regards to unexpired leases because of a well thought out plan of reorganization, the commercial landlord will not have any claim rising to the level of administrative priority. See supra notes 78-96 and accompanying text. Thus, the commercial landlord would not be competing with the DIP lender, as the commercial landlord would have no administrative priority claim and the DIP lender would. See supra notes 78-96 and accompanying text.

108. See Goldstein, Meises & Graulich, supra note 58, at 258-59 (acknowledging that waivers have been, and continue to be, used to waive debtor rights).

109. See id.


111. See supra notes 78-102 and accompanying text.

more favorable terms is unavailable.\textsuperscript{113} If the DIP is successful in convincing the court of its need for superpriority lending, the DIP lender will then be above all unsecured administrative expense claims, including the commercial landlords', and will no longer need to worry about competing for priority.\textsuperscript{114}

Being cognizant of the newly created risks and rewards associated with lending to a DIP under the revised § 365(d)(4) may be the most important factor to consider in evaluating whether or not to lend at all.\textsuperscript{115} While the prepetition lender may theoretically require a borrower to take steps prepetition to ensure a successful reorganization and thus DIP lender priority, reality may dictate otherwise.\textsuperscript{116} Today, more money is at stake with the likelihood of many competing administrative expense claims from improvident assumption decisions and the possibility of forced liquidation.\textsuperscript{117} Without any real safeguard to protect against these risks, DIP lenders must realize what they are getting themselves into from the outset and have confidence in the business to which it will lend.\textsuperscript{118} Otherwise, DIP lenders may be taking unnecessary risks in lending to a potentially liquidating company.\textsuperscript{119}

V. CONCLUSION

The revisions to § 365(d)(4) are obviously favorable for commercial landlords who have often waited years for a determination whether their leases would be assumed or rejected.\textsuperscript{120} Not so obvious, however, is whether or not DIP lenders will experience benefits from these revisions.\textsuperscript{121} Lending to a DIP is already attractive with the built-

\begin{itemize}
\item \textsuperscript{113} \textit{E.g.}, \textit{In re} Shaw Indus., Inc., 300 B.R. 861, 863 (Bankr. W.D. Pa. 2003) (noting debtor's "significant efforts to obtain alternative financing," which included contacting "numerous lenders, both institutions and individuals").
\item \textsuperscript{114} Compare § 364(a)-(b) with § 364(c)-(d).
\item \textsuperscript{115} See Goldstein & Vron, \textit{supra} note 55, at 149.
\item \textsuperscript{116} See infra notes 117-119 and accompanying text.
\item \textsuperscript{117} See supra notes 78-102 and accompanying text.
\item \textsuperscript{118} \textit{DIP Financing: Breathing New Life Into Ailing Companies}, Capital Eyes E-newsletter (Bank of America) (Feb. 2003), http://www.bofabusinesscapital.com/resources/capeyes/a02-03-148.html ("Just as important as cash is confidence."); see also supra notes 103-117 and accompanying text.
\item \textsuperscript{119} See supra notes 78-102 and accompanying text.
\item \textsuperscript{120} See Levin & Ranney-Marinelli, \textit{supra} note 6, at 624; Jones, \textit{supra} note 32.
\item \textsuperscript{121} See supra notes 54-102 and accompanying text.
\end{itemize}
in incentive of administrative priority,\textsuperscript{122} but with a shorter time period for debtors to decide whether to assume or reject an unexpired lease of nonresidential real property, a debtor's cash needs upon filing for bankruptcy may rise dramatically.\textsuperscript{123} In turn, DIP lenders must rise to the occasion, accounting for these increased needs of debtors upon filing for bankruptcy with the same advantage of administrative priority.\textsuperscript{124}

Before a DIP lender jumps into larger loans, however, it may want to proceed cautiously.\textsuperscript{125} With the revisions to § 365(d)(4), an increasing number of debtors may find themselves making a number of improvident assumption decisions leading to competing administrative expense claims from commercial landlords.\textsuperscript{126} As the number of administrative expense claims rise from these forced assumption decisions, so too does the possibility of subsequent liquidation.\textsuperscript{127} Without any significant safeguard to protect the postpetition interests of a DIP lender against competing administrative expense claims, and the likelihood of subsequent liquidation, the lender must realize what type of risks it is taking in lending to a debtor who has significant lease obligations and must account for those risks in evaluating whether or not to lend at all.\textsuperscript{128}

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\textsuperscript{123} See supra notes 54-77 and accompanying text.
\textsuperscript{124} See supra notes 54-77 and accompanying text.
\textsuperscript{125} See supra notes 78-102 and accompanying text.
\textsuperscript{126} See supra notes 78-96 and accompanying text.
\textsuperscript{127} See supra notes 97-102 and accompanying text.
\textsuperscript{128} See supra notes 103-19 and accompanying text.