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Expert Analysis

The Impact of BAPCPA on Commercial Properties and Leasing

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When the Bankruptcy Abuse Prevention and Consumer Protection Act was formally signed into law April 20, 2005, the act was advertised as a consumer-targeted initiative. While much of the media attention and public debate in the four years since the bill's passage has indeed been focused on its consumer impact, it is now clear that portions of BAPCPA have had a significant impact on retail and other bankruptcies involving nonresidential real estate as well.

The official narrative has been that the intent of the law, which formally went into effect in October 2005, was to minimize abusive or fraudulent bankruptcy filings by implementing a more stringent set of filing requirements for Chapter 7, and subsequently channeling more bankruptcy filings under Chapter 13. When the bill was passed, much of the discussion centered on precisely these issues.

What garnered less attention, however, was the notion that the less-publicized portions of the bill directed at bankruptcies involving nonresidential real estate had the potential for a significant impact on the landlord-tenant dynamic.

In the four years since the bill's passage, BAPCPA has had considerable effects on bankruptcies involving nonresidential real estate. The law affects the timeline for debtor decision-making, requiring debtors to compile and present a plan for reorganization while adhering to new restrictions and greater limitations on their leasing options.

The most profound changes to the U.S. Bankruptcy Code affecting nonresidential tenants consist of three important elements:

- The reduction in the time a debtor has to assume or reject nonresidential real property leases;
- A narrowed scope for anti-assignment claims; and
- The ability to cure certain non-monetary defaults, such as a failure to operate.

These changes are provided for in Section 365 of the Bankruptcy Code.

Taking a look back at the last four years provides an opportunity to reassess how BAPCPA's intentions have played out and the consequences this legislation has had (and will continue to have) going forward.

In light of the economic challenges faced by American businesses in recent years, this legislation has stayed in the spotlight and has prompted an ongoing critical analysis and debate of both its positive and negative impacts.

The new, more limited timeframe has forced retailers to make complex decisions about which stores to close and how to best go about closing them within a dramatically shorter time period.

There is no doubt that the bottom-line result of this legislation has been to dramatically alter the bankruptcy landscape. Retailers have been forced to contend with new circumstances that require them to restructure within bankruptcy faster than ever before, and they are obliged to operate within restrictive new limits that have made the overall bankruptcy process a logistical and conceptual nightmare.

Time Constraints

Probably the most significant alteration to the legislative landscape as a result of BAPCPA's 2005 passage has been the amount of time given to assume or reject leases.

Prior to the legislation, debtors had 60 days from the commencement of bankruptcy to assume or reject an unexpired, nonresidential lease. However, this 60-day period was, in practice, a time limit in name only. It was a legislative formality with little real impact on bankruptcy timelines because courts were permitted to — and often did — grant extension requests, resulting in an unlimited amount of time to restructure.

BAPCPA changed that dynamic significantly by changing the length of the available window to 120 days followed by one 90-day extension irrespective of landlord objection. While increasing the amount of time for debtors to assume or reject leases may seem on paper to be a positive development for retailers, the net

result has actually been, as predicted, a significantly more limiting timeline of 210 total days.

Retailers and other commercial tenants previously had the freedom and flexibility to pick and choose what leases they wanted to come out of Chapter 11, but the new time limitations have forced their hands and made a drawn-out decision-making process a thing of the past.

BAPCPA does provide for a potential exception to the 210-day limit in cases where the debtor and the landlord are able to come to a mutual agreement on an extension — a provision that has been utilized more often than anyone might have predicted at the time of the bill's passage.

There are obvious scenarios where it might be in retailers' and landlords' mutual interests to agree on an extension. A dark storefront is not an appealing prospect for either party, and new tenant options are more limited today than they were five years ago.

The new, more limited timeframe has forced retailers to make complex decisions about which stores to close and how to best go about closing them within a dramatically shorter time period. This has resulted in an unavoidably negative impact on retailers' ability to implement the right strategies for their businesses in an effective manner.

Cutting deals before the filing is often the only realistic way to operate effectively within BAPCPA's stringent new time constraints.

Regional and national chain stores face special challenges in this regard because of their size and the number of locations they must consider.

The prediction that some analysts made when BAPCPA was passed (that the legislation would make it a struggle for large chain stores to emerge from bankruptcy in a timely and successful fashion) has come to pass.

In fact, despite the large number of high-profile bankruptcies filed in the wake of a disastrous 2008 holiday season, the only large, national "successful" retail bankruptcies this year have been those that

were executed in a prepackaged manner. In those “successful” bankruptcies, the retailers worked closely and collaboratively with the landlord *prior* to the filing to ensure that agreements were in place.

I worked with two high-profile retailers (Ultra Diamonds and Z Gallerie Home Furnishings) who were able to successfully emerge from Chapter 11 because we took an aggressive, proactive approach, recognizing that cutting deals before the filing was the only realistic way to operate effectively within BAPCPA’s stringent new time constraints.

Narrowing the Scope of Anti-Assignment Claims

Another important change to the Bankruptcy Code with the passage of BAPCPA was the narrowing of the scope of previous anti-assignment provisions, which invalidated lease terms that condition or restrict a debtor’s right to assign its interest in a lease.

The effect is to clarify that codified, adequate assurance provisions take precedent over anti-assignment language. The new law requires that debtors provide adequate assurance to landlords that an assignee will be able to perform the obligations under the lease. This provision resolves the inconsistency in legal interpretation of the use clause by some courts.

Previously, many of the transaction limitations imposed on debtors trying to sell a lease when in bankruptcy would be characterized as “anti-assignment.” Since BAPCPA’s passage, however, debtors face a new obstacle — identifying users who fit within a lease’s use clause, providing landlords with more leverage and ultimately reducing the asset value for the debtor.

What was once considered an “even playing field” of power is now tipping in the landlord’s favor — in theory. With landlords now holding an even stronger position equipped to limit or even veto transactions, the risk of purchasing a lease increases. Because of this increased risk, bidders will bid less for the asset, leaving designation-rights purchasers and debtors with a lease that is considered less valuable than its actual worth.

These new debtor limitations also have increased andlord control over issues such as tenant mix and retail-entertainment balance in a commercial center.

This perception of power really only exists on paper because, despite this new influence, the current marketplace has created challenges in which a landlord’s ability to follow through on limiting or vetoing a proposed tenant has been stunted by economic circumstance.

The commercial real estate market is teetering right now, and a vulnerable marketplace is in a position where, if one more sizeable retailer files for bankruptcy, the industry will suffer a significant blow. Landlords are recognizing that the timing is not in their favor. The backfill potential today is nothing like it was a few years ago when BAPCPA was passed.

Whether because of BAPCPA or despite it, we have seen a renewed emphasis on the value of honest negotiation and clear, consistent landlord-debtor communication in recent years.

The Effects on Non-Monetary Defaults

The third significant BAPCPA-related legislative change relates to the curing of non-monetary defaults. Prior to 2006 tenants who were in violation of a valid operating agreement because of a premature store closing or other similar circumstance had some recourse. It was determined that some non-monetary defaults could not be cured, and the lease could not be assumed.

Under BAPCPA, however, all defaults must be cured, and landlords are entitled to fair compensation for any losses incurred as a result of that default.

At the time of the bill’s passage, this provision of BAPCPA was thought by many to be one of the most significant components of the legislation. Over the last few years, however, we have seen that the practical implications of the new law have been less significant than anticipated.

While some observers have taken issue with courts assigning a clear-cut monetary value on circumstances that are inherently difficult to quantify and have challenged the notion that it is possible to equitably determine precise damages in the event of a non-monetary default, the real-world impact of the change has been relatively minimal.

New Legislation

It was perhaps only a matter of time before legislative rollback was proposed. In April Rep. Jerrold Nadler, a Democrat from New York's 8th congressional district, introduced the Business Reorganization and Job Protection Act of 2009, H.R. 1942. This ambitiously titled piece of legislation would attempt to increase the likelihood of retailers reorganizing successfully by rolling back some of the changes instituted with BAPCPA.

The bill would change a number of utility and administrative issues that have made it harder for a debtor to come out of Chapter 11, but perhaps most significantly, would repeal BAPCPA's 210-day period in which a debtor can assume or reject leases. The bill would revert back to an initial 60-day period and allow bankruptcy courts the opportunity to grant further extensions without any time limit.

With health care and banking issues seemingly taking legislative priority at the moment, the fate of Nadler's legislation, or any other significant bankruptcy reform legislation, remains uncertain.

Regardless of the fate of H.R. 1942, there is a sense that the current economic uncertainties have deepened the understanding of all parties involved in commercial real estate. Whether *because* of BAPCPA or *despite* it, we have seen a renewed emphasis on the value of honest negotiation and clear, consistent landlord-debtor communication in recent years. There is more reason than ever for both sides to work together to resolve their issues.

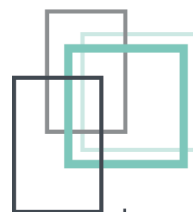
Four years ago many predicted that the passage of The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 would alter the landlord-debtor dynamic and provide additional leverage to commercial landlords.

The timeline limitations and practical constraints that BAPCPA places on retailers has contributed to that shifting balance of power. With a more restrictive period in which to assume or reject leases, and a dramatic reduction in their ability to obtain extensions, debtors have had to move faster and make less informed decisions, replacing thoughtful analysis with necessary quick evaluations.

Speedy decision-making is often a necessity for debtors in a post-BAPCPA world, and debtors now also face significantly more formidable obstacles to a rights sale. Maximizing asset value in such a challenging environment — particularly during a recessionary cycle — has proven to be an insurmountable obstacle for some retailers.



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