

Congress Enacts Modification to Bankruptcy Procedures Governing Assumption and Rejection of Leases

The Consolidated Appropriations Act of 2021 (the Appropriations Act) is a \$2.3 trillion spending bill that combines stimulus relief for the COVID-19 pandemic and an omnibus spending bill for the federal fiscal year. While the Appropriations Act is intended to enhance stimulus relief under the CARES Act and does so in many profound ways, it also includes provisions narrowly targeted to assist companies that have filed for protection under the U.S. Bankruptcy Code (Bankruptcy Code) by temporarily modifying the rules governing a tenant's performance under its leases. The procedural revisions to the Bankruptcy Code will sunset on December 27, 2022, but its provisions will be applicable to any case filed prior to the sunset date.

The procedural revisions are summarized as follows:

A small business debtor (under the CARES Act, a debtor with no more than \$7.5 million of debt) electing to proceed under Subchapter V of Chapter 11 will have an additional 60 days to pay rent or perform other lease obligations if it is "experiencing or has experienced a material financial hardship due, directly or indirectly, to the coronavirus disease 2019 (COVID-19) pandemic." By this amendment, the debtor-tenant now may have up to 120 days to begin performing according to the terms of a commercial lease, significantly modifying the rule that the debtor-tenant must comply with its obligations under the lease pending assumption or rejection (discussed below) under Section 365(d)(3) of the Bankruptcy Code. This revision promotes conservation of short-term cash liquidity in the hope of a strong recovery following success in defeating the pandemic. Several bankruptcy judges had granted some form of extension prior to the statutory amendment and Congress deferred to their expertise in enacting this revision; *see, e.g., In re Pier 1 Imports, Inc.*, 615 B.R. 196 (Bankr. E.D. Va. May 10, 2020).

All debtor-tenants will have an extended period to assume or reject existing leases under Section 365 of the Bankruptcy Code. Under current law, debtors enjoy only until the earlier of 120 days from the date of filing bankruptcy and the date of an order confirming a plan of reorganization to make such a determination, although the 120-day deadline may be extended by 90 days for cause. The Appropriations Act extends the period by 90 days to 210 days, increasing uncertainty for landlords while providing additional flexibility to reorganize affairs for debtor-tenants who may not be in a position early in the case to make important decisions of this nature. The traditional rules for assumption or rejection remain intact, including the requirement of court approval for any assumption or rejection of the subject lease. Therefore, if the debtor-tenant was in default under the lease at the time of filing bankruptcy, it must propose the method by which it will cure the default(s) while providing adequate assurance of future performance under the lease (Section 365(b)(2)(C) of the Bankruptcy Code).

Lease modifications or rent deferrals negotiated between commercial landlords and debtor-tenants are not subject to being labeled alleged preferential transfers under Section 547 of the Bankruptcy Code. Here, the Appropriations Act protects payment of deferred or postponed rent negotiated pre-bankruptcy as lease concessions by landlords attempting to assuage the economic harm occasioned by the COVID-19 pandemic to tenants from being avoided or clawed-back by the trustee as preferences, provided the payment arrangement (that is, a lease modification or rent deferral agreement) between landlord and debtor-tenant was entered into on or after March 13, 2020. This relaxation of the preference rules only applies to rent and expressly excludes payments of fees, penalties, or interest made pursuant to lease modifications.

In summary, the Appropriations Act relaxes critical time periods for the debtor-tenant to act and to make major decisions affecting the restructuring efforts undertaken in response to one of the greatest economic challenges in U.S. history. While these revisions to the procedural rules create



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additional uncertainty for commercial landlords, Congress attempts to offset such uncertainty with new landlord-friendly rules governing preferential transfers, thereby allowing landlords to recover rent arrears without fear of having to turn over such payments in the event that the tenant enters bankruptcy. In striking a balance between the debtor's increased flexibility to consider major decisions governing lease assumption or rejection and providing protections to landlords with respect to pre-bankruptcy lease modifications, the Appropriations Act promises to promote successful reorganizations without imposing undue burdens on any parties-in-interest.
