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## Questions or Assistance?

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## Commercial Leases and Bankruptcy— Will the Rent Get Paid?

The Bankruptcy Code contains certain provisions that protect commercial landlords when a tenant files a bankruptcy case. One of those provisions, 11 U.S.C. § 365(d)(3), requires a debtor to timely perform all post petition obligations under a lease until that lease is assumed or rejected. Section 365(d)(3) was enacted to alleviate the need for commercial landlords to seek an administrative expense claim for unpaid post petition rent.

Although Section 365(d)(3) requires a debtor to pay rent in full that becomes **due** after a bankruptcy case is filed, it does not squarely address the issue of whether a debtor must pay “stub rent”. Stub rent is the term commonly used to describe the rent for the period of time from the date of filing of the petition through the first date a payment is contractually **due** under the lease. Court decisions have been inconsistent as to whether a debtor is required to pay “stub rent” under Section 365(d)(3) or any other provision of the Bankruptcy Code. Over the course of the last several years, two schools of thought have emerged regarding the payment of “stub rent.”

The first approach courts have followed regarding the payment of “stub rent” is the “proration” approach. The proration approach requires a debtor to pay the *pro-rata* portion of rent from the date the case is filed, *regardless of the date on which such rent was due*. The second approach is referred to as the “billing date” approach, which requires a debtor to only pay rent that *first becomes due* under the lease after the case is filed. For example, under the “billing date” approach, if a debtor files a bankruptcy case on the fifth day of a month, but the lease provides that rent is **due** on the first day of each month, only the rent due for each successive month after the filing would have to be paid under Section 365(d)(3).

The payment of “stub rent” is a particularly significant issue in jurisdictions which follow the “billing date” rule. The Third Circuit, which follows the “billing date” rule, recently issued an interesting decision concerning “stub rent” in the case of *In re Goody's Family Clothing Inc.* (“Goody's”). Upholding the decisions of both the Delaware Bankruptcy Court and the Delaware Federal District Court, the Third Circuit held that a landlord is entitled to make a claim for “stub rent” as an administrative expense of a debtor's estate and that such claim is not precluded by Section 365(d)(3).

The facts of the Goody's case were carefully reviewed by the Third Circuit in its decision. On June 9, 2008, Goody's and certain of its subsidiaries filed voluntary Chapter 11 bankruptcy petitions. Prior to filing the bankruptcy case, Goody's had entered into numerous commercial



leases in various shopping centers around the country. Each lease required that rent be paid in advance of the first day of the month in which the rent was due. Before filing for bankruptcy, Goody's had paid all of its rent obligations through May 2008. However, Goody's did not pay the rent due on June 1, 2008.

After filing the Chapter 11 case, Goody's continued to occupy the leased properties and conducted store closing sales at numerous locations. Goody's hired a liquidating agent to conduct the store closing sales, Goody's merchandise was sold in the leased properties, and the liquidating agent paid Goody's *per diem* rent to use the leased properties to conduct the store closing sales. In addition, Goody's fully paid its rent obligations for July 2008, as required under Section 365(d)(3). However, because Goody's had not paid the "stub rent" for the period of June 9, 2008 through June 30, 2008, Goody's landlords moved for the allowance of an administrative expense claim under Section 503(b)(1) for the "stub rent."

The Third Circuit rejected Goody's arguments that the "stub rent" was a general unsecured claim and that Section 365(d)(3) precluded the landlords from seeking an administrative expense claim under Section 503(b)(1). Rather, the Third Circuit held that Section 365(d)(3) does not foreclose a landlord's ability to seek an administrative expense claim in situations not addressed by the provisions of Section 365(d)(3). Administrative claims have priority under the Bankruptcy Code. In order for a debtor to emerge from Chapter 11, administrative claims must be paid 100%, as compared to general unsecured claims, which tend to receive *pro rata* distributions of a debtor's assets. For this reason, if administrative claim status is available to landlords, landlords will want to seek such status.

In determining if the landlords were entitled to an administrative expense, the Third Circuit applied the standard for granting an administrative claim: whether Goody's continued occupancy of the stores in which the store closing sales were held conferred an "actual and necessary benefit to the estate." The Third Circuit noted that mere continued occupancy of a leased premise by a debtor does not always benefit a debtor's estate. However, the Third Circuit observed that Goody's store closing sales, which were an integral part of its Chapter 11 case, required a physical venue. Furthermore, the Third Circuit noted that since Goody's charged the liquidating agent *per diem* rent, Goody's saw the continued occupation of the stores as a necessary expense of its bankruptcy estate. Under the circumstances presented to the Court, the Third Circuit held that the landlords were entitled to an administrative expense for the "stub rent."

In jurisdictions like the Third Circuit where the "billing date" approach is followed, the Goody's case presents landlords with the option of seeking the payment of "stub rent" as an administrative expense of a debtor's estate. However, as the Goody's case demonstrates, the determination of whether a commercial landlord is entitled to an administrative expense for "stub rent" is very fact specific. The full text of the Goody's decision may be found at 610 F.3d 812, or by contacting any member of the Bankruptcy and Creditors' Rights Practice Group.

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