



PARTIES OTHER THAN LANDLORDS HAVE STANDING TO PREVENT ASSIGNMENT OF A TENANT'S LEASE IN BANKRUPTCY

When a retail business becomes a debtor in bankruptcy, it often decides to trim its operations by closing some of its retail stores. This strategy inevitably leaves the debtor with unnecessary leases. Instead of simply rejecting the leases, retail debtors often assume the agreements and assign them to other entities. The assumption and assignment of the unnecessary leases may allow a debtor to avoid potentially significant rejection damage claims from landlords. In addition, and depending on economics, an assignee may pay a debtor tenant for a lease assignment.

This process, while beneficial to retail debtors, may have a negative impact on other tenants within the various commercial developments from which the debtor previously leased property. This is especially

true when a debtor assigns a lease to a business that could detrimentally affect the retail mix within a commercial development. Rather than relying on their landlords, retail tenants may attempt to object to a proposed assignment themselves (assuming they are aware of the potential assignment). For instance, retail tenants may attempt to enforce anti-assignment provisions contained in a debtor's lease. It is unclear in these situations, however, whether retail tenants possess the requisite standing to enforce such provisions. Following a recent bankruptcy court decision from the District of Delaware, it appears that such a strategy does exist when a shopping center is subject to a recorded declaration of covenants, conditions, and restrictions incorporated into a debtor's lease.

IN RE THREE A'S HOLDINGS, L.L.C.

In *Three A's Holdings*, the debtor, Tower Records, operated a specialty music and video business. Prior to its bankruptcy, Tower Records entered into a lease at the Birch Street Promenade Shopping Center located in the city of Brea, California. The Birch Street Shopping Center is part of Brea Downtown, a retail/mixed-use project created under California state law as a "common interest development." As part of the Brea Downtown development, the original developer and the city of Brea entered into a master development agreement. Later, the same parties created and recorded a declaration of covenants, conditions, and restrictions for the Brea Downtown Owners Association. The covenants cover various issues, including common parking, common area maintenance and improvements, trash removal, marketing, and permitted uses.

As part of its bankruptcy, the debtor sold to various investment companies the rights to designate whether the debtor should reject or assume and assign various unexpired leases. The investment companies determined the debtor should assume its Birch Street lease and assign it to a retail pharmacy, Walgreens. A retail pharmacy, however, did not constitute a permitted use within the Brea Downtown development's declaration of covenants, conditions, and restrictions. As a result, the city and the Brea Downtown Owners Association filed an objection to the assignment with the bankruptcy court. In response, Tower Records argued that only the landlords had standing to assert an objection to the assignment.

Bankruptcy Code section 365 governs the assumption and assignment of unexpired leases. Generally, in order for a debtor to gain court approval of the assumption and assignment of a lease, the debtor need only cure monetary defaults and provide adequate assurance that the proposed assignee will fulfill its obligations under the lease. If the debtor satisfies this burden, the bankruptcy court may then exercise its discretion to void lease terms that would otherwise

prevent the assignment. The Bankruptcy Code, however, limits a bankruptcy court's ability to void lease provisions when a debtor seeks to assume and assign a shopping center lease. A debtor may assign a shopping center lease only if the assignment does not violate, among other things, the lease's own provisions.

In *Three A's Holdings*, the parties agreed that Tower Records' Birch Street lease constituted a shopping center lease. The Birch Street lease incorporated the declaration of covenants, conditions, and restrictions, which prevented retail pharmacies, such as Walgreens, from leasing property in the Birch Street Shopping Center. Thus, as long as the city and the Brea Downtown Owners Association had standing to object, Tower Records could not assign the lease to Walgreens. The landlord to Tower Records did not object to the assignment.

The *Three A's Holdings* court indicated that the legislative history behind the Bankruptcy Code's provisions involving shopping centers provided that the purpose of these provisions was to protect a landlord's ability to collect rent and perform its obligations to other shopping center tenants. The court further acknowledged that neither the owners' association nor the city was the landlord of the Birch Street Shopping Center. The court did note, however, that the owners' association performed many of the tasks generally performed by a landlord.

In its analysis, the *Three A's Holdings* court first examined California state law and the declaration of covenants itself and found that the owners' association possessed standing under both. In addition, the court found that the Brea Downtown Owners Association was likely a "party in interest" in the Tower Records bankruptcy and therefore the owners' association held the right "to appear and be heard on any issue in a case under Chapter 11." In support of this conclusion, the court noted that bankruptcy courts broadly construe the term "parties in interest."

Finally, the court examined what it considered the typical standing dispute in the context of a shopping center lease assignment. The typical dispute occurs when another tenant attempts to enforce an assignment restriction contained in a lease between a debtor and a landlord. In this scenario, courts have determined that the other tenant does not have standing to enforce the restrictions, because the other tenant is not a party to the lease. The *Three A's Holdings* court determined that this line of case law did not apply to the Brea Downtown Owners Association's objection, however, because (1) the recorded restrictive covenants for the Brea Downtown development contained provisions that specifically permitted the Brea Downtown Owners Association to enforce the restrictive covenants, and (2) the covenants were expressly incorporated into the debtor's lease. As a result, the Brea Downtown Owners Association was enforcing its own rights, rather than another party's rights, under the declaration of covenants. Based upon its analysis, the *Three A's Holdings* court concluded that the Brea Downtown Owners Association possessed standing to object to the assignment of the lease.

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