

**First Impressions: Commercial Leases May Be  
Assumed Within 210-Day Deadline and Assigned Later**

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Commercial landlords hailed as a significant victory the enactment in 2005 of a 210-day “drop dead” period after which a lease of nonresidential real property with respect to which the debtor is the lessee is deemed rejected unless, prior to the expiration of the period, a chapter 11 debtor in possession (“DIP”) or bankruptcy trustee assumes or rejects the lease. However, the deadline—which is imposed by amended section 365(d)(4)—has been widely criticized because it forces a DIP or trustee to make premature (and potentially costly) decisions regarding leases that may be vital to the prospects for a successful reorganization.

Amended section 365(d)(4) has been a magnet for controversy in the eight years since it became effective as part of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“BAPCPA”). One focus of the ongoing debate has been whether, to ward off automatic rejection, the bankruptcy court must actually enter an order approving assumption or rejection—as distinguished from the DIP or trustee moving to assume or reject—prior to the expiration of the 210-day period. Another bone of contention was the subject of a ruling recently handed down by a New York bankruptcy court. In *In re Eastman Kodak Co.*, 495 B.R. 618 (Bankr. S.D.N.Y. 2013), the court, in an apparent matter of first impression, held that a commercial lease timely assumed under section 365(d)(4) may be assigned at a later date after the expiration of that subsection’s 210-day deadline.

## **Assumption, Rejection, and Assignment of Executory Contracts and Unexpired Leases**

Section 365(a) of the Bankruptcy Code authorizes a trustee or DIP, with court approval, to assume or reject most executory contracts and unexpired leases during the course of a bankruptcy case. If the debtor has defaulted under the contract or lease, assumption is subject to the conditions set forth in section 365(b) (e.g., cure of certain defaults and adequate assurance of future performance).

Section 365(f) authorizes the trustee or DIP to assign an assumed contract or lease. With certain exceptions, assignment is permitted notwithstanding any provision in the contract or lease (or in applicable law) that “prohibits, restricts, or conditions” assignment.

Section 365(d) governs the time frame for assumption, depending upon the chapter of the Bankruptcy Code that applies and the nature of the contract or lease. For unexpired nonresidential real property leases with respect to which the debtor in any bankruptcy case (except a chapter 15 case) is the lessee, section 365(d)(4) provides as follows:

(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 90 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.

The 210-day “drop dead” date (120 days plus a single 90-day extension) was added to the Bankruptcy Code in 2005 as part of BAPCPA. Prior to the amendment, section 365(d)(4) provided that a DIP or trustee was obligated to assume any nonresidential real property lease pursuant to which the debtor was the lessee within the first 60 days of the case; otherwise, the lease was deemed rejected. However, the trustee or DIP could request multiple extensions of this period for “cause,” and in large chapter 11 cases, extensions were commonly granted through confirmation of a plan.

BAPCPA amended section 365(d)(4) by extending this initial 60-day period to 120 days, but limiting any augmentation of this period without the landlord’s written consent to a single 90-day extension, after which the lease would be deemed rejected. The purpose of the change was “to limit the discretion of judges to extend time to assume or reject certain commercial contracts and to provide landlords with greater certainty as to such tenancies.” *Eastman Kodak*, 495 B.R. at 620; accord *In re Michael H. Clement Corp.*, 446 B.R. 394 (N.D. Cal. 2011); *In re Treasure Isles HC, Inc.*, 462 B.R. 645 (B.A.P. 6th Cir. 2011); H.R. Rep. No. 109-31, at 153 (2005) (“[The amendment] is designed to remove the bankruptcy judge’s discretion to grant extensions of the time for the retail debtor to decide whether to assume or reject a lease after a maximum possible period of 210 days from the time of entry of the order of relief”).

Neither section 365(d)(4) nor any other provision of the Bankruptcy Code specifies when an assumed contract may be assigned under the provisions of section 365(f). This was the issue addressed by the bankruptcy court in *Eastman Kodak*.

### ***Eastman Kodak***

In 2004, Eastman Kodak Company (“Kodak”) leased land in Rochester, New York, from ITT Space Systems, LLC (“ITT”) for the purpose of operating a fire water pump. The ground lease prohibited any assignment or sublease without ITT’s prior written consent.

Kodak filed for chapter 11 protection in January 2012 in the Southern District of New York. On May 10, 2012, the bankruptcy court granted Kodak’s motion for a 90-day extension through August 16, 2012, of the initial 120-day period specified by section 365(d)(4) for assumption or rejection of the ground lease with ITT.

Kodak filed a motion for authority to assume the ground lease and various other unexpired commercial real property leases on July 17, 2012, and the court granted the motion on August 15, 2012—within the 210-day period. The assumption order expressly preserved Kodak’s rights to “assign any of the Assumed Leases pursuant to, and in accordance with, the requirements of section 365 of the Bankruptcy Code.” ITT objected to neither the assumption motion nor the court order approving it.

On June 28, 2013, Kodak filed a motion for authority to assign the ground lease to RED-Rochester, LLC, as part of an asset sale agreement. ITT objected to the proposed assignment.

ITT argued that a nonconsensual assignment of an unexpired lease of nonresidential real property must occur simultaneously with, not after, assumption of the lease—and thus cannot occur outside the 210-day period set forth in section 365(d)(4). According to ITT, the use of the present tense of the verb “to assume” in section 365(f)(2) (authorizing assignment only if “the trustee assumes such contract or lease”) leads to the inference that assignment must take place at the time of the assumption.

### **The Bankruptcy Court’s Ruling**

The court acknowledged that there were no cases directly on point regarding the issue. Even so, it rejected ITT’s argument, explaining that a plain reading of the statute simply does not support any requirement for simultaneous assumption and assignment. Instead, the court wrote, “[t]he plain reading of the statute is that an assignment cannot occur unless the debtor has satisfied the provisions of § 365 governing assumption.” Moreover, the court noted that other parts of section 365 make it clear that assumption and assignment are “independent concepts.”

For example, section 365(k), which provides that the estate is not liable for post-assignment breaches of a contract, uses the past tense of “to assume” (i.e., “[a]ssignment by the trustee to an entity of a contract or lease assumed under this section”). Also, use of the conjunctive phrase “assume or assign” in section 365(c) (prohibiting nonconsensual assumption or assignment where applicable nonbankruptcy law excuses the nondebtor from accepting performance from another party) and section 365(b)(3) (establishing special rules for shopping-center leases) implies that assumption and assignment can take place at different times.

Similarly, the court wrote, “[section] 365(d)(4) does not contain a deadline for assigning, as opposed to assuming, a contract.” According to the court, interpreting the Bankruptcy Code to permit the assignment of a previously assumed commercial lease beyond the deadline for assumption “reasonably balances the goal of providing protection to landlords and the goal of maximizing the value of a debtor’s estate.” By contrast, “[c]onstruction of § 365(d)(4) to cut off assignment rights would shift the balance in favor of landlords beyond what Congress provided and improperly undermine the policy of § 365 that gives a debtor broad rights to benefit from beneficial contracts.”

Furthermore, the court explained, because section 365(k) relieves the estate from liability for post-assignment breaches of assigned contracts, post-assumption assignment allows a DIP to avoid accruing administrative claims under a contract whose assumption “proves to be improvident either because of issues with the contract or because the reorganization fails.”

Lawmakers gave landlords additional protection when they amended section 365(d)(4) in 2005, the court concluded, “but [Congress] did not choose to create the same deadline for the assignment of a commercial lease as it did for the assumption of such a lease.”

Finally, the court rejected ITT’s argument that a rule allowing assignment to occur in the later stages of a bankruptcy case is unfair to landlords. “Even if it were unfair,” the court wrote, “the disruption of non-debtors’ expectations of profitable business arrangements is common in bankruptcy proceedings” (citations and internal quotation marks omitted).

## **Outlook**

*Eastman Kodak* is welcome news for debtors. If followed by other courts, the ruling may portend a slight swing of the pendulum back toward debtors after BAPCPA's landlord-friendly amendments imposed a significant disadvantage on companies with large numbers of leases attempting to reorganize in chapter 11. Permitting assignment of nonresidential real property leases beyond the 210-day drop-dead date imposed by section 365(d)(4) would alleviate at least some of the burden borne by a debtor confronted with the need to decide whether particular leases are more beneficial to its own restructuring by assumption and continued performance or through assumption and assignment for value.

Even with the relief provided by *Eastman Kodak*, however, section 365(d)(4)'s 210-day drop-dead date still stacks the deck against retailers and other debtors in chapter 11 that are highly dependent upon leased properties. Section 365(d)(4) forces such a debtor to decide whether to assume or reject its unexpired leases on a highly expedited basis. Debtors with a large number of real property leases must now perform a significant amount of prepetition planning with respect to the restructuring of their operations. The level of planning required is even greater for debtors that are party to a significant number of leases subject to a master agreement.

Moreover, in jurisdictions where courts take the approach that an order approving assumption must actually be entered within the 210-day period, a debtor will need to have made its assumption decision well before the deadline to ensure enough time to convene a court hearing on its motion seeking assumption of its leases and entry of the court order.

It bears noting that the negative impact of being forced prematurely to assume a commercial lease is mitigated somewhat by another BAPCPA amendment. Prior to 2005, if a debtor assumed a commercial lease and later decided to reject it, the lease-rejection damages were entitled to administrative-expense priority, likely with no cap that would otherwise apply under section 502(b)(6) of the Bankruptcy Code if the lease had not been assumed prior to rejection. BAPCPA added section 503(b)(7) to the Bankruptcy Code, which provides that if a debtor assumes a lease and then later decides to reject it, the landlord is entitled to an administrative-expense claim for up to two years of rent, but any remaining claim of the landlord is deemed a prepetition claim subject to the cap on lease-rejection damages in section 502(b)(6).