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CLIENT ALERT

CHANGES IN THE BANKRUPTCY CODE OF INTEREST TO OUR CLIENTS IN THE REAL ESTATE BUSINESS

On April 20, 2005, President Bush signed into law the Bankruptcy Abuse Prevention Consumer Protection Act of 2005 (the "Act"). While much of the attention from the press focused on the Act's provisions concerning consumer bankruptcies, it will also have an impact on business bankruptcy cases. This alert is directed to certain changes in the law that affect rights in real property in the business context.

Debtors now have less time to decide whether to assume or reject commercial real property leases.

Under § 365 of the Bankruptcy Code, the debtor or bankruptcy trustee may assume, assume and assign (i.e., sell), or reject commercial real property leases. This provision is often used to eliminate unprofitable locations in above-market leases, or to assume and, in some cases, assign below-market leases for significant value. Prior to the Act, a debtor or trustee was required to decide to assume, assume and assign, or reject a real property lease within 60 days after the bankruptcy filing unless the bankruptcy court extended the deadline "for cause." Bankruptcy courts normally treated the "for cause" requirement liberally and gave trustees and debtors numerous extensions of the deadline.

The Act extends the initial deadline to assume or reject from 60 to 120 days, but limits the ability to obtain an extension. A bankruptcy court may now only extend the 120-day deadline for up to another 90 days. To extend the deadline further, the debtor or trustee must obtain the landlord's written consent. As was the case prior to the Act, if the debtor fails to assume or reject the unexpired lease within this deadline, the lease is deemed rejected and the trustee or debtor is required to immediately surrender the property to the lessor.

In the event a debtor or trustee does assume a commercial real property lease and subsequently rejects it, the lessor will have an administrative priority claim for up to two years of monetary obligations under the lease. The administrative priority claims are

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entitled to payment before other priority claims in general unsecured claims, but are paid after secured claims.

These new provisions under the Act give landlords additional leverage in bankruptcy cases, especially where they can re-let the space for increased rent or otherwise want to control how the space is used.

Debtors will not be prevented from assuming commercial real property leases based on “impossible to cure” non-monetary defaults.

In order to assume an unexpired lease, a debtor or trustee must cure all defaults other than “ipso facto” or “bankruptcy termination” defaults caused by the fact of the debtor filing a bankruptcy. Bankruptcy courts have been divided over whether non-monetary defaults must be cured as a requirement to assume a lease. This is especially true for those non-monetary defaults that cannot be cured, such as a store in a shopping center “going dark” for a particular period of time.

The Act provides that a trustee or debtor may assume an unexpired lease if it is not possible to cure a non-monetary default by “performing non-monetary acts at or after the time of assumption,” provided that if the default “arises from a failure to operate in accordance with a non-residential real property lease,” the default must be cured at and after the time of assumption and the debtor must compensate the landlord for “pecuniary losses resulting from such default.” Thus, if a retail debtor breached a lease by “going dark,” it would still be able to assume the lease even though that prior default could never be cured. To the extent the landlord suffered pecuniary loss as a result of that breach, however, the debtor or trustee would be required to pay such damages as a condition to assumption.

There are other changes in the Bankruptcy Act that affect business bankruptcy that are not the subject of this alert. For more information, please contact Robert A. Soriano at 813.229.4230 or rsoriano@carltonfields.com or visit www.carltonfields.com.

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