

COMMERCIAL LEASE ASSUMPTION UNDER CHAPTER 11 BANKRUPTCY

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The Bankruptcy Code provides a Chapter 11 debtor a powerful tool to aid its restructuring efforts. A debtor may assume valuable real estate leases, and reject onerous ones. As explained below, a debtor's time to assume commercial leases under which it is a lessee is limited to either 210 or 300 days from the date of the bankruptcy filing, unless the landlord consents to further extensions. The Bankruptcy Code further provides that a debtor's failure to assume a commercial lease before expiration of this time limit results in the lease being "deemed rejected," requiring the debtor to surrender immediately possession of the leases premises.

Given the potentially harsh consequence of failing to timely assume a vital lease, a Chapter 11 debtor must be vigilant to avoid a forfeiture. It is important to know, however, that all might not be lost even if the debtor misses this deadline. The Bankruptcy Code allows a debtor to assume an executory contract at any time up to confirmation of a plan of reorganization. There is case law supporting the proposition that separate lease agreements and contracts executed as part of a single, integrated transaction should be construed as a single agreement so the lease may be assumed even if the Bank-

ruptcy Code's shorter deadlines for assumption and rejection of commercial leases has expired. Accordingly, a debtor may have until plan confirmation to assume a commercial lease that was signed as part of a single integrated agreement that includes other executory contracts.

DEADLINES TO ASSUME OR REJECT EXECUTORY CONTRACTS AND UNEXPIRED LEASES UNDER THE BANKRUPTCY CODE

The Bankruptcy Code permits a trustee (or debtor in possession) to "assume or reject any executory contract or unexpired lease of the debtor." 11 U.S.C. §365(a). Generally, a debtor may assume or reject leases of residential or personal property and executory contracts at any time before confirmation of a plan. *See*, 11 U.S.C. §365(d)(2).

But under Section 365(d)(4)(A) of the Bankruptcy Code, "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 210 days after the date of the order for relief; or (ii) the date of the entry of an order confirming a plan." 11 U.S.C. §365(d)(4)(A). (This 210-day limit was established under a COVID-related amendment to the Bankruptcy Code enacted in 2020, and will be reduced, after Dec. 27, 2022, to the pre-COVID 120-day limit, un-

less Congress decides to amend the law.) The debtor may seek a 90-day extension of this deadline, but any further extensions can only be granted upon the prior written consent of the landlord. *See*, 11 U.S.C. §365(d)(4)(B)(i) & (ii). This automatic termination of a commercial lease after expiration of the initial assumption period is rather draconian. A court is powerless to extend the deadline retroactively if the court has not entered an order doing so within that time frame. *See, e.g., In re Southampton Yen Rest. Group LLC*, 2009 WL 3925563, *3 (Bankr. S.D.N.Y. Nov. 16, 2009) ("Because this Court cannot retroactively extend the deadline under [section 365(d)(4)], the lease is deemed rejected as a matter of law and the Debtor must immediately surrender the property."); *In re Tubular Techs., LLC*, 348 B.R. 699, 709-10 (Bankr. D.S.C. 2006) (holding that section 365(d)(4) as revised by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 makes clear that the court must enter an order before the expiration of the 120-day period).

If the bankruptcy court timely enters an order granting a full 90-day extension of the Debtor's time to assume and the landlord does not consent to any further extension, a debtor-lessee now has 300 days from the commencement of its Chapter 11 case in which to assume or reject a commercial lease. In most situations, if the debtor does not assume

the lease within that time frame, the lease will be deemed rejected and the debtor must immediately surrender the premises. If the debtor finds itself in the unfortunate position of having missed this deadline for assumption, it should examine whether the commercial lease at issue is actually one of multiple agreements that taken together constitute a single, integrated transaction.

THE NON-DIVISIBILITY OF CONTRACTS AND LEASES

Whether a single contract contains severable agreements is a question of state law. *See, In re Contract Research Solutions, Inc.*, 2013 WL 1910286, at *2 (Bankr. D. Del. May 1, 2013). There appear to be certain common elements that courts consider. For example, courts will look to whether the parties intended for several agreements to constitute a single agreement and the economic arrangement for the transaction (*i.e.*, whether separate consideration is given for each agreement). *See, e.g., In re Nickels Midway Pier, LLC*, 255 Fed. Appx. 633, 636 (3d Cir. Nov. 27, 2007) (“[A] contract is said to be divisible when performance is divided in two or more parts with a definite apportionment of the total consideration to each part.”); *In re Gardinier, Inc.*, 831 F.2d 974 (11th Cir. 1987) (applying 11th Circuit three-factor test to examine whether: i) the nature and purpose of the agreements are different; ii) the consideration for each agreement is separate and distinct; and iii) the parties’ obligations under the agreements are interrelated); *In re FPSDA I, LLC*, 450 B.R. 392, 397 (Bankr. E.D.N.Y. 2011)

(finding leases and related franchise agreements were “economically interrelated and interdependent” and thus they “constituted an integrated transaction and should be treated as a single controlling agreement”); *In re T&H Diner, Inc.*, 108 B.R. 448, 454 (D.N.J. 1989) (“The essential inquiry in determining the divisibility of a transaction is whether there was a single assent to a whole transaction involving several kinds of property or a separate assent to each of the several things involved.”) (quotation and citation omitted); *In re Harrison*, 117 B.R. 570 (Bankr. C.D. Cal. 1990) (finding gasoline dealer agreement and gas station lease (and related agreements) were integrated to form one controlling agreement because the agreements were executed contemporaneously between the same parties, the dealer agreements specified the use and maintenance requirements under the lease, and the dealer agreement provided that it and related agreements comprised the entire agreement).

THE APPLICABILITY OF THE SECTION 364(D)(4) TO A COMMERCIAL LEASE THAT IS PART OF A SINGLE INTEGRATED CONTRACT

Once a court determines that a commercial lease should be construed together with one or more executory contracts as a single agreement, the question becomes whether the shorter deadlines for assumption set forth in section 364(d)(4) should apply to the single integrated contract. The few courts that have decided this issue have held that the deadline in section 364(d)(4) does not apply to a commercial lease that

is part of an integrated transaction with related executory contracts, and that the lease is not automatically deemed rejected if it is not assumed before the expiration of the deadline contained in section 364(d)(4).

The most in-depth analysis of this issue can be found in *In re FPSDA I, LLC*, 450 B.R. 392 (Bankr. E.D.N.Y. 2011). There, the debtors operated a number of Dunkin’ Donuts/Baskin-Robbins franchises pursuant to franchise agreements with franchisors and related leases with affiliated landlords. The debtors owed some prepetition amounts under the leases, but were current on their postpetition obligations. The debtors also owed substantial sums under the franchise agreements. The debtors received a 90-day extension under section 365(d)(4)(B)(i) to assume the leases, but the landlords refused to consent to any further extension. As a result, the debtors moved for an order determining that that deadline to assume or reject the leases under section 365(d)(4) did not apply, or, alternatively, that the debtors could assume the leases without curing the defaults under the related franchise agreements. The franchisors/landlords argued that the contracts and leases should be construed as a part of a single transaction and that any assumption of the leases would require the defaults under the franchise agreements to be cured as well. The court agreed with the franchisors/landlords that the franchise agreements and leases constitute a single agreement, and that assumption of those agreements required *all* defaults to be cured — including the

defaults under the franchise agreements. The court, however, also held that the deadline to assume or reject leases and contracts under section 365(d)(2) applied to all of the agreements including the leases, and the deadline for assuming commercial leases under section 365(d)(4) was not applicable. The court observed that, “[i]n considering the purpose of the Bankruptcy Code and the equities of the situation, it is reasonable and appropriate that a debtor’s time to assume or reject integrated agreements that are treated as one controlling agreement be subject to the more generous deadline for executory contracts set forth in section 365(d)(2) rather than section 365(d)(4).” *In re FPSDA I, LLC*, 450 B.R. at 400.

In *In re A&F Enters., Inc., II*, 742 F.3d 763 (7th Cir. 2014), the Seventh Circuit Court of Appeals reversed the district court’s denial of a stay pending appeal of the bankruptcy court’s orders deeming certain gas station leases rejected because the debtors failed to assume the leases within the initial 120-day time limit then applicable under section 365(d)(4). There, the affiliated debtors operated IHOP franchises pursuant to franchise agreements and corresponding equipment and building leases. The bankruptcy court entered orders deeming the property leases rejected because the debtors failed to assume, or obtain an extension of time to assume, the leases within the 120-day deadline. The bankruptcy court then denied the debtors’ request for a stay of the rejection orders. The bankruptcy court rejected the debtors’ argument that the leases were part of the

franchise agreement and not subject to section 365(d)(4), concluding that the plain language of section 365(d)(4) does not contain an exception for commercial leases tied to franchises. The district court affirmed that bankruptcy court’s denial of a stay of the rejection orders. On appeal to the Seventh Circuit, the Appeals Court reversed the district court and the bankruptcy court. Because that appeal addressed whether the standard for granting the debtor the injunctive relief it requested was satisfied, the Seventh Circuit did not directly hold on the merits whether section 365(d)(4) applied to a commercial lease that was part of a single integrated agreement with other executory contracts. But the appellate court considered the debtors’ likelihood of success on the merits and noted that “[t]hough we are provisionally persuaded that [the debtors’] position has substantial merit, we emphasize that we aren’t deciding the issue today.” *In re A&F Enters., Inc., II*, 742 F.3d at 768.

Both the *In re FPSDA I, LLC* and *In re A&F Enters., Inc., II* cases relied on the earlier decision of the bankruptcy court in *In re Harrison*, 117 B.R. 570 (Bankr. C.D. Cal. 1990). That court held that the debtor’s dealer agreement and gas station lease (and related agreements) together controlled the franchise and relationship between the parties to those agreements, so those agreements were deemed integrated contracts forming one controlling agreement. The *Harrison* court held that the requirement to assume or reject within 60 days under the prior version of section 365(d)(4) of

the Bankruptcy Code did not apply.

These cases, particularly *In re FPSDA I, LLC*, support the proposition that a commercial lease tied to one or more executory contracts as part of a single, integrated transaction should be construed as one integrated agreement subject to the deadline to assume or reject under section 365(d)(2) and not 365(d)(4).

CONCLUSION

For a debtor-lessee having a valuable commercial lease that, for whatever reason, the debtor failed to assume within the deadlines prescribed by section 365(d)(4), the argument that the lease is one part of a larger integrated transaction involving other contracts might save the debtor from immediate forfeiture of the property. With that possibility in mind, lessees (particularly franchisees) entering into multi-agreement transactions may want to ensure that their agreements bear the hallmarks of a single, integrated transaction. These include contemporaneous execution of documents with the same (or related) counterparties; provision of a single consideration to support all of the agreements; cross-references to each contemporaneous agreement; and language recognizing the agreements as an integrated agreement. With these actions taken, if the lessee ends up in Chapter 11 bankruptcy, it may have until plan confirmation to assume the lease.

