

# Pratt's Journal Of Bankruptcy Law

## *Is The Option To Renew A Lease A Privilege Or A Right For A Debtor In A Bankruptcy Case?*

By Leslie A. Berkoff

It is well settled that before a Debtor can assume a lease in a Chapter 11 case, all defaults whether pre or post petition, must be cured.<sup>1</sup> While the term "cure" encompasses satisfying both monetary and non-monetary obligations, generally, the need to satisfy the monetary component or obligation is one reason why executory contracts<sup>2</sup> and leases are not assumed until absolutely necessary in a case. It is not just a question of having the available cash to make the payment, but it is also the fact that in certain instances, depending upon the type of lease and whether the case was commenced pre or post enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA") an assumed lease can become a full administrative obligation of the estate.<sup>3</sup> Thus, if a case does not come to fruition, premature assumption can add administrative obligations without any benefit being incurred. As a result, absent specific circumstances warranting otherwise, the Bankruptcy Code provides that in a Chapter 11 case, decisions to assume a personal property lease<sup>4</sup> can be left until confirmation and real estate leases (now under BAPCPA) until the earlier of confirmation or one-hundred and twenty (120) days after the entry of the Order for relief.<sup>5</sup>

What happens then if a lease is set to expire before confirmation and the Debtor wishes to renew the lease, but is otherwise in default under its terms? Often leases have clauses precluding renewal if a default exists, but in a bankruptcy case pre-petition (or post-petition) defaults are only cured on

assumption. This is the question at hand then: can a Debtor who is in default under a lease (real or personal), avail itself of a provision in a lease to renew or extend that lease without first curing the monetary default.<sup>6</sup> The answer may depend upon which Court you are in at the time. Several Courts have addressed this issue. However, before looking at this issue, let's review some general rules.

### **GENERAL RULES ON LEASES Personal Property Leases**

If an agreement is a "true lease,"<sup>7</sup> a Lessor of personal property is entitled to payments commencing sixty (60) days after the order for relief on a monthly basis until the Debtor assumes or rejects the contract, which must be done on or before confirmation.<sup>8</sup> Payments not made in the first sixty (60) days post-petition are arguably subject to treatment and payment as administrative claims under Section 503(b) of the Bankruptcy Code.<sup>9</sup> If the Debtor assumes a lease, then all pre-petition and unpaid post-petition obligations must be paid and cured in accordance with the terms of the lease.<sup>10</sup> If the Debtor rejects a lease, the Lessor then receives an unsecured claim for the accelerated balance of the unpaid lease term.<sup>11</sup> Moreover, the underlying goods are not part of the Debtor's estate, and upon rejection they are returned to the Lessor and are not available for use to make distributions to creditors.

If the Debtor assumes the lease and then rejects the lease down the road, it has been held that under Section 365 of the Bankruptcy Code, that the Debtor becomes liable for all future obligations under the lease.<sup>12</sup> Upon default, the creditor is entitled to an administrative expense claim for any deficiency on the entire agreement resulting

from rejection of an unexpired lease previously assumed. Thus, the breach of a previously assumed lease is deemed to have occurred post-petition.<sup>13</sup> The claim resulting from the breach is an administrative expense claim under Section 503(b) of the Bankruptcy Code regardless of whether the lease "involved an actual or necessary cost or expense of preserving the estate".<sup>14</sup> Having once assumed the lease, the Debtor is now bound to perform under the lease in accordance with its terms.<sup>15</sup>

### **Real Estate Leases**

The rules change if we are not talking about a personal property lease. If a lease involves nonresidential real property, the Debtor must timely perform all obligations arising from and after the order for relief under any unexpired lease of such property until the lease is assumed or rejected.<sup>16</sup> Payments not made in the first sixty (60) post-petition days are arguably subject to treatment and payment as an administrative claim.<sup>17</sup> Some courts require a Landlord to show that the payments meet the requirements of Section 503(b)(1) of the Bankruptcy Code, although the majority automatically grant administrative status to such claims.<sup>18</sup>

With respect to cases commenced *before* October 17, 2005, the Debtor must assume or reject unexpired commercial leases within sixty (60) days of the petition date.<sup>19</sup> The law differs regarding cases commenced *on or after* October 17, 2005. In such cases, the Debtor's deadline for assuming a lease is the earlier of: (i) one-hundred and twenty (120) days from the date of the order of relief or (ii) the date of the entry of an order confirming a plan.<sup>20</sup> The Debtor ordinarily may obtain only one extension for "cause;" any additional extensions for "cause" must be approved

---

*Leslie A. Berkoff, a member of the board of editors of the Journal of Bankruptcy Law, is a partner in the law firm of Moritt Hock Hamroff & Horowitz LLP. Ms. Berkoff may be reached at lberkoff@moritthock.com*

by the court only with the prior written consent of the Landlord.<sup>21</sup> A lease is deemed rejected in such cases if it is not assumed within the relevant time period unless the court, for "cause," extends the time within which the Debtor must assume or reject.<sup>22</sup>

If the Debtor assumes a real property lease, then all pre-petition and unpaid post-petition obligations must be paid and cured in accordance with the lease terms.<sup>23</sup> If, on the other hand, the Debtor rejects a real property lease, the Landlord's claim for post-petition, pre-rejection rent may be entitled to administrative priority status.<sup>24</sup> A Landlord's claim for post-rejection rent where the Debtor continues to use the leased real property after rejecting the lease may also be entitled to administrative status.<sup>25</sup> However, under Section 502(b)(6) of the Bankruptcy Code, claims filed against a Debtor by a Landlord for damages arising from the termination of a real property lease are capped.<sup>26</sup> Thus, the Landlord may only recover "rent reserved by [a] lease, without acceleration, for the greater of one year or 15 percent, not to exceed three years, of the remaining term of such lease, following the earlier of the date of the filing of the petition and the date on which [the] lessor repossessed, or the lessee surrendered, the leased property."<sup>27</sup> Expenses that are not addressed by Section 502(b)(6) of the Bankruptcy Code, such as common area maintenance charges, taxes and insurance, may also be subject to the cap.<sup>28</sup> Moreover, in cases commenced after October 17, 2005, if a lease is assumed and then subsequently rejected, the obligation is also capped, and ties into the cap under Section 502(b)(6) of the Bankruptcy Code.<sup>29</sup> In any event, the underlying leased property does not constitute part of the Debtor's estate, and upon rejection it is to be returned to the Landlord.<sup>30</sup> It is therefore not available for distribution to creditors.

Additionally, a Debtor cannot "cherry pick leases" no matter what kind they are. Section 365(a) of the Bankruptcy Code allows a trustee or debtor in possession, "subject to the court's approval, [to] assume or reject any executory contract or unexpired lease of the debtor."<sup>31</sup> An executory contract may not be assumed in part and rejected in part.<sup>32</sup> A Debtor seeking to assume an executory contract must accept its burdens as well as its benefits.<sup>33</sup> A Debtor cannot choose to accept the benefits or desirable features of the contract and reject the burdens or undesirable features of the contract to the detri-

ment of the other party.<sup>34</sup>

Under this backdrop then what about simply renewing a lease - is this in and of itself an assumption, must the lease first be assumed and all defaults cured - the answer - it depends.

#### **THE CASELAW**

##### **Renewal of Lease Allowed, but No Assumption Required**

In the Ninth Circuit Court of Appeals decision *Circle K Corporation* the Court in affirming a lower court decision on appeal, found that the Debtor could extend the term of real estate leases without first curing the defaults.<sup>35</sup> Two subsidiaries of the Circle K Corporation acquired the lessees' interest under certain leases by a series of acquisitions and mergers. After one renewal of the leases, Circle K and its subsidiaries filed a Chapter 11 petition in bankruptcy. At the time of the bankruptcy filing the Debtors were in default under some of the leases. At this time, the first five-year extension of the leases was due to expire. Prior to the time when the Debtors were required to assume or reject the leases, and within the timeframe fixed by the Court in order to protect their future choice to assume or reject, the Debtors attempted to exercise their option to extend the leases for a second five-year term.

While there were a variety of issues at hand, the one germane to this Article is whether the Debtor could renew the leases notwithstanding the failure to cure the defaults or whether the Debtor had to cure the defaults, assume the leases and then renew or could simply renew without first assuming.<sup>36</sup> The Courts of Appeals in affirming the decisions of the Bankruptcy Appellate Panel ("B.A.P.") and the Bankruptcy Court, held that the leases could be renewed and then extended despite the uncured defaults.<sup>37</sup>

Both the Bankruptcy Court and the B.A.P. based their rulings upon the purpose of Section 365 of the Bankruptcy Code, which is to balance the state law contract rights of the creditor to receive the benefit of his bargain with the federal law that provides the Debtor an equitable right to have an opportunity to reorganize.<sup>38</sup> As the B.A.P. stated, "[t]he purpose behind §365 is to balance the state law contract right of the creditor to receive the benefit of his bargain with the federal law equitable right of the debtor to have an opportunity to reorganize."<sup>39</sup> The

B.A.P. noted that once a bankruptcy petition is filed, Section 365 of the Bankruptcy Code, in conjunction with the automatic stay provision of Section 362 of the Bankruptcy Code, work to suspend, the termination of a lease that is in default; it extends a Debtor's obligation to cure any defaults until the Debtor has the chance to decide whether to assume the lease.<sup>40</sup>

The Circuit Court in *Circle K* found that the paramount question before it was whether the need to preserve the Debtor's rights under Section 365 of the Bankruptcy Code to assume or reject the leases overcame the requirement in the leases that none of the leases be in default at the time of renewal.<sup>41</sup> The Circuit Court concluded, as did the Bankruptcy Court and the BAP, that the leases could be renewed despite the uncured defaults.<sup>42</sup>

In determining not to require assumption before renewal, the BAP had concluded that if it could not allow a Debtor to renew a lease without first curing defaults, the basic purpose of Section 365 of the Bankruptcy Code would be frustrated and the Debtors' later choice to assume or reject the leases, guaranteed by Section 365 of the Bankruptcy Code, would become flawed.<sup>43</sup> The Circuit Court agreed.<sup>44</sup> In the usual case where an unexpired lease is rejected by the choice of the Debtor, any pre-petition defaults become unsecured claims against the bankruptcy estate.<sup>45</sup> If, however, the Debtors were forced to cure the pre-petition defaults in order to preserve their choice to assume or reject, then a later election to reject leaves the Landlord with a preference over other pre-petition general creditors.<sup>46</sup>

Moreover, where Debtors have time to assume or reject leases due to an extension of time, then requiring an earlier assumption rendered any extension of time illusory, thus depriving the Debtors of the opportunity to reorganize without prematurely burdening the estate with unexpired lease obligations.<sup>47</sup>

##### **Renewal of the Lease Allowed Only With Assumption of the Lease**

In the case of *Fifth Taste Concepts Las Olsa, LLC, d/b/a The Brasserie*,<sup>48</sup> the Court required the Debtor to assume the lease before exercising the renewal option. The Bankruptcy Court, looking at the *Circle K* case, stated that while the Court agreed that outside of Bankruptcy an option to renew a lease is not a right but a privilege where the

lease language conditions the option to renew on the absence of defaults under the lease.<sup>49</sup> However, the Court in *Fifth Taste* stated that in bankruptcy, the Debtor has the right to assume a lease, and the privilege to exercise a renewal option is not forfeited because of pre-petition defaults.<sup>50</sup>

In *Fifth Taste* prior to filing its Chapter 11 petition, the Debtor entered into a real property lease, which contained an option provision that allowed the Debtor to renew the lease for additional five-year terms on written notice provided that the lessee was not in default of any of the terms and conditions of the lease. The Debtor defaulted under the lease by failing to make rent payments. During the bankruptcy, to save the lease the Debtor sought to assume the lease and renew its term. The Landlord opposed the Debtor's right to assume and exercise any renewal option post-assumption in light of the Debtor's history of defaults.

The opposition on the part of the Landlord in this instance, unlike in the case of *Circle K*, is more tenuous. In *Circle K* as a result of the renewal of the lease without assumption, the Landlord was trapped for a period of time under an extension of the lease terms without the benefit of having received full payment under the original term. As such, the Landlord lost the benefit of its bargain on several fronts, both from the loss of satisfaction of the outstanding monetary obligation and by the forced extension of a lease term at a time where the Landlord was not whole (although it had bargained to prevent that).<sup>51</sup>

It would seem in the case of *Fifth Taste*, wherein the Debtor proposed to make the Landlord whole upon assumption before extending the term, the Landlord should have had no opposition. Had the Debtor not assumed the lease, the Landlord would have been left with an unsecured claim, for the pre-petition unpaid sums capped by Section 502(b)(6) of the Bankruptcy Code.<sup>52</sup> Thus, it would seem that the Landlord would want assumption versus rejection. One can presume perhaps that the Landlord opposed the relief sought because it either feared a further pattern of default, or was prepared to take the loss of full payment on any pre-petition obligations in exchange perhaps for the ability to re-rent the property at a higher rate.

In any event, the Landlord opposed the relief sought and postured that the Debtor's prior defaults under the terms of the lease disqualified the Debtor from assuming the lease and precluded exercising the option

provision according to the lease's plain language. The Landlord argued that the Bankruptcy Code did not provide the Debtor with any rights greater than those which it has under the terms of the lease.<sup>53</sup>

The Court determined that all concerns were balanced by allowing the Debtor to renew the lease provided it cured all existing defaults, which in turn made the Landlord whole.<sup>54</sup>

The Court in *Fifth Taste* further asserted that its Order was consistent with the purpose of Section 365 of the Bankruptcy Code, noting that the purpose of Section 365(b)(1)(A) of the Bankruptcy Code is to preserve the entirety of an unexpired lease upon assumption and cure of any defaults.<sup>55</sup> The policy that favors preserving the entirety of an unexpired lease would put the parties to a lease back in the position they would have been in had no defaults occurred and no bankruptcy petition been filed. The policy behind Section 365(b)(1)(A) of the Bankruptcy Code that encourages reorganization requires a Debtor to cure all existing defaults under a lease while simultaneously preserving those provisions in the lease that may benefit the Debtor's reorganization. The Court found that the option provision in the lease would aid the Debtor's efforts at reorganization because having a stable location for its restaurant beyond the lease's current expiration date would prove essential to the Debtor in the event that its efforts at reorganization are successful to that point.<sup>56</sup>

The Court rejected the *Circle K* holding which would permit a Debtor to exercise a renewal option without first curing any defaults and assuming a lease. The Court also rejected the cases cited by the Landlord which would have precluded the Debtor from exercising a renewal option after curing defaults and assuming the lease. The Court determined its position was a proper balance of "the Debtor's equitable right to assume the lease intact and the [Landlord's] right to have the Debtor perform under the terms of the lease."<sup>57</sup>

### **Defaults Under Lease Precluded Assumption and Renewal**

A variation of these results, unfavorable to the Debtor on the whole, was arrived at in the case of *In re Tut's Pyramid, Inc.*<sup>58</sup> In *Tut's Pyramid*, a Debtor, who had defaulted under a commercial lease, attempted to exercise an option clause within the lease despite

its pre-petition monetary and non-monetary defaults. The Court in *Tut's Pyramid* held that the Debtor, despite its efforts to exercise a renewal option, could not exercise the option because the clear contractual provisions of the lease required that the Debtor not be in default prior to its exercise of said option.<sup>59</sup>

The Court in this case denied the Debtor's motion to assume the lease, finding that its term had expired shortly after the filing and could not be renewed.<sup>60</sup> The Court stated that nothing in the Bankruptcy Code granted the Debtor rights greater than it had prior to the filing and since the lease clearly stated no renewal in the event of default, it could not be assumed because of those defaults regardless of cure.<sup>61</sup> However, the Court also pointed to the fact that the Debtor's motion to assume made no provisions to cure the pre-petition arrearage and no proof of ability to perform in the future.<sup>62</sup> Query what if these arrangements had been put forth, would the Court would have still ruled in this manner.

### **CONCLUSION**

Clearly, Debtors have to focus on the law of their jurisdictions or surmise how a Court will rule in a particular case if leases are coming to the end of their term early on in a case then renewal may be a desired option. Depending upon the jurisdiction, Debtors may have to file motions to assume long prior to ordinary deadlines on assumption in order to avoid losing renewal rights under leases coming to term. Obviously, the modifications under BAPCPA to the time frames within which some leases (i.e. real estate) can be assumed, will require that this decision be made earlier regardless. Yet, while all of the aforementioned cases relate to real estate leases, the analysis can be said to equally apply to personal property leases which leases do not have to be assumed until confirmation. Therefore, there is also potential impact on personal property leases and both their terms and renewal provisions need to be carefully evaluated in pre and post bankruptcy planning.

### **NOTES**

1. 11 U.S.C. §365(b)(1)(A) specifically provides that "[i]f there has been a default in an executory contract or unexpired lease of the debtor, the trustee may not assume such contract or lease unless, at the time of assumption of such contract or lease, the trustee - (a) cures, or provides adequate assurance that the trustee will promptly cure, such default." Upon the adoption of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, the following additional language was added; "other than a default that is a breach of a provision relating to the satisfaction of any provision (other than a penalty rate or penalty provision)

relating to a default arising from any failure to perform, nonmonetary obligations under an unexpired lease of real property, if it is impossible for the trustee to cure such default by performing nonmonetary acts at and after the time of assumption, except that if such default arises from a failure to operate in accordance with a nonresidential real property lease, then such default shall be cured by performance at and after the time of assumption in accordance with such lease, and pecuniary losses resulting from such default shall be compensated in accordance with the provisions of this paragraph." 11 U.S.C. §365(b)(1)(A) (2005) (as amended April 20, 2005).

2. See Countryman "Executory Contracts in Bankruptcy," (pts. I and II), 57 MINN. L. REV. 439 (1973), 58 MINN. L. REV. 479 (1974) (for the definition of an executory contract); see also *Griffel v. Murphy (In re Wegner)*, 839 F.2d 533 (9th Cir. 1988); *Pacific Express v. Teknekron Infoswitch Corp. (In re Pacific Express)*, 780 F.2d 1482, 1487 (9th Cir. 1986); *Lubrizol Enters. v. Richmond Metal Finishers (In re Richmond Metal Finishers)*, 756 F.2d 1043, 1045 (4th Cir. 1985), cert. denied, 475 U.S. 1057 (1986); see also *In re Learning Publications, Inc.*, 94 B.R. 763 (Bankr. M.D. Fla. 1988); *In re Sun City Inv., Inc.*, 89 B.R. 245 (Bankr. M.D. Fla. 1988).

3. Prior to BAPCPA, an assumed personal property lease and non-residential real estate lease were full obligations of the estate even if subsequently rejected. See *GATX Leasing, Corp. v. Airlift Int'l, Inc. (In re Airlift Int'l, Inc.)*, 761 F.2d 1503, 1508-09 (11th Cir. 1985) (holding that where an assumed equipment lease is subsequently rejected, the entire lease obligation becomes an administrative expense of the estate under Section 503(b) of the Bankruptcy Code "regardless of whether the lease involved an actual or necessary cost of preserving the estate"); *Compare Costich v. Nostas Assoc. (In re Kleinsleep Products, Inc.)*, 78 F.3d 18, 26 (2d Cir. 1996) with 11 U.S.C. §503(b)(7) (2005), which under BAPCPA maintains claims for an assumed and subsequently rejected non-residential real property estate lease. See 11 U.S.C. §503(b)(7) (2005) (as amended April 20, 2005). Post BAPCPA, nonresidential real property leases, that are assumed and then rejected Section 503(b)(7) of the Bankruptcy Code are subject to a limitation on the available priority claim under Section 502(b)(6) of the Bankruptcy Code. The limitation with respect to a sum is equal to all monetary obligations due, excluding those arising from or relating to a failure to operate or a penalty provision, for the period of two (2) years following the later of the rejection date or the date of actual turnover of the premises, without reduction or setoff for any reason whatsoever except for sums actually received or to be received from any entity other than the debtor, and the claim for remaining sums due for the balance of the term of the lease.

4. See 11 U.S.C. §365(d)(5) (2005).

5. See 11 U.S.C. §365(d)(4) (2005) (as amended April 20, 2005).

6. A different question, not the subject of the Article at hand, is whether once a contract is automatically renewed post-petition, is it a continuation of the pre-petition executory agreement subject to assumption or rejection. See *In re Country Club Estates atventura Maint. Ass'n*, 227 B.R. 565 (Bankr. S.D. Fla. 1998); *Birmingham News Company v. Patterson*, 224 F. Supp. 670 (N.D. Ala. 1963) (holding that any renewal following the initial term of a contract is a fresh contract). However, the majority of published case law treats renewal as the continuation of the original contract allowing for assumption or rejection. See *Gurley v. Carpenter*, 855 F.2d 194 (5th Cir. 1988); *Williams Petroleum Co. v. Midland Coop.*, 679 F.2d 815 (10th Cir. 1982).

7. A question also not addressed by this Article, but addressed by many others, is whether an executory contract is a true lease or a secured financing arrangement. See Carolyn Hochstader Dicker and John P. Campo, *FF&E and the True Lease Question: Article 2A and Accompanying Amendments to UCC Section 1-201(37)*, 7 AM. BANKR. INST. L. REV. 517 (1999); see also *Dukes Energy Royal, LLC v. Pillowtex Corp. (In re Pillowtex)*, 349 F.3d 711 (3d Cir. 2003). To determine this, the true intent of the parties must be determined by what has been termed the "Economic Reality Test". The first prong of the Economic Reality Test is whether the agreement is terminable by the lessee during the term of the lease; if the agreement is not terminable by the lessee during the lease term, then the first factor has been established. The second prong of Economic Reality Test focuses on whether the agreement meets any one of four factors, such as the original term of the lease is equal to, or greater than, the remaining economic life of the goods; the lessee is bound to renew the lease for the remaining economic life; the lessee has an option to renew the lease for the remaining economic life; or the lessee has an option to become the owner for no additional consideration or for nominal additional consideration. See U.C.C. §1-201(37) (2005); see also *In re Fleming Companies, Inc.*, 308 B.R. 693, 696 (Bankr. D. Del. 2004).

8. 11 U.S.C. § 365(d)(5) (2004).

9. See *In Palace Quality Serv.*, 283 B.R. 868 (E.D. Mich. 2002) (wherein an equipment Lessor moved for allowance, and for the immediate payment, as an administrative expense, of the rent due, post-petition, under the equipment lease, in a Chapter 11 case, which was subsequently converted to a Chapter 7. The Landlord had claimed an administrative priority for the unpaid post-petition rents and late fees, under Section 365(d)(10) of the Bankruptcy Code, but the Court rejected that argument and held that the Landlord was entitled to a claim "simply because these unpaid rents and late fees constitute expenses entitled to administrative priority under §503(b)(1)". The Trustee acknowledged that case law holds that the failure to comply with the performance mandated by Section 365(d)(10) of the Bankruptcy Code, created the equivalent of a priority claim, citing *In re Kyle Trucking, Inc.*, 239 B.R. 198 (Bankr. N.D. Ind. 1999); *Omni Partners, LP v. Pudgie's Dev. of NY, Inc. (In re Pudgie's Dev. of NY, Inc.)*, 239 B.R. 688 (S.D.N.Y. 1999).

However, the Trustee contended that a Landlord's claim for this unfulfilled obligation loses its priority status upon conversion of the Chapter 11 proceeding to a Chapter 7 proceeding because of Section 348(d) of the Bankruptcy Code. Section 348(d) of the Bankruptcy Code states that all post-petition claims incurred in a Chapter 11 proceeding, other than those entitled to priority under Section 503(b) of the Bankruptcy Code, are to be treated as if they arose pre-petition if the Chapter 11 proceeding is subsequently converted to a Chapter 7 proceeding. See *In re Eastern Agri-Systems, Inc.*, 258 B.R. 352 (Bankr. E.D.N.C. 2000) which involved the lease of farm equipment and the conversion from a Chapter 11 to a Chapter 7, the parties had agreed that the debtor did not operate any of the equipment during the Chapter 11, but the Landlord claimed an administrative expense in the amount of the unpaid lease payments during the Chapter 11 pursuant to Section 365(d)(10) of the Bankruptcy Code. The Court noted the apparent conflict between Section 365(d) of the Bankruptcy Code and Section 365(d)(3) of the Bankruptcy Code. The Court resolved the conflict by ignoring Section 348(d) of the Bankruptcy Code, and theorized that Congress simply overlooked Section 348(d) of the Bankruptcy Code, when it was making amendments to the Bankruptcy Code to accommodate the addition of Sections 365(d)(3) and 365(d)(10) of the Bankruptcy Code.

10. 11 U.S.C. §365(b)(1) (2005).

11. 11 U.S.C. §502(g) (2005).

12. *In re D&S Electrical Mechanical Co.*, 297 B.R. 805, 807 (Bankr. N.D. Ala. 2003).

13. *Id.*

14. See *In re D&S Electrical Mechanical Co.*, 297 B.R. 805, 807 (Bankr. N.D. Ala. 2003) (wherein the Court noted in dicta that had the Debtor "been required to assume the entire contract under Section 365, upon default, [the creditor] would have an administrative expense claim for any deficiency on the entire note after it repossessed and sold the [property].")

15. See *In re Tezas Health Enters., Inc.*, 246 B.R. 832, 835 (Bankr. E.D. Tex. 2000); see also *In re Nat'l Gypsum Co.*, 208 F.3d 498, 505 (5th Cir. 2000). Moreover, once assumed, damages flowing from a post-assumption breach are entitled to administrative claim status in the case. 11 U.S.C. §503(b)(1)(A); see also 3 COLLIER ON BANKRUPTCY 365.03[2] at 365-22 (Lawrence P. King et al 15th ed. 2000); *In re Greystone III Joint Venture*, 995 F.2d 1274, 1281 (5th Cir. 1991), cert. denied, 506 U.S. 822, 113 S.Ct. 72, 121 L.Ed. 2d 37 (1992); *In re Boston Post Road Ltd. P'ship*, 21 F.3d 477, 484 (2d Cir. 1994); *In re Frontier Props, Inc.*, 979 F.2d 1358, 1367 (9th Cir. 1992); *In re Sporting Way Inc.*, 126 B.R. 110, 112 (Bankr. M.D. Fla. 1991).

16. 11 U.S.C. §365(d)(3) (2005).

17. 11 U.S.C. §503(b)(7) (2005) (as amended April 20, 2005).

18. *Compare In re Orvco*, 95 B.R. 724 (B.A.P. 9th Cir. 1989) (indicating that a Landlord must establish its claim for administrative status under Section 503(b)(1) with respect to claims for post-petition, pre-rejection payments) with *In re Worths Stores Corp.*, 135 B.R. 112 (Bankr. E.D. Mo. 1991) (stating that Section 365(d)(3) of the Bankruptcy Code, provides that Debtors must pay all rents up until the time the lease is rejected because such obligations constitute an administrative expense independent of Section 503(b)(1) of the Bankruptcy Code, payable without notice and hearing).

19. See 11 U.S.C. §365(d)(4) (2005).

20. See 11 U.S.C. §365(d)(4)(A) (2005) (as amended April 20, 2005); see also Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8 stat. 256, Title XV, § 1501(b)(1) (indicating that amendments to Bankruptcy Code do not apply to cases commenced prior to October 17, 2005, the effective date of the Act).

21. 11 U.S.C. §365(d)(4)(B)(ii) (2005) (as amended April 20, 2005).

22. *See id.*

23. See 11 U.S.C. §365(b)(1) (2005); see also *In re Mr. Gatti's, Inc.*, 164 B.R. 929, 933 (Bankr. W.D. Texas 1994).

24. See *In re Mr. Gatti's*, 164 B.R. at 1007-1011 (stating such claims are not automatically entitled to administrative priority). Courts have split on this issue. Some cases order immediate payment. See *In re Pacific-Atlantic Trading Co.*, 27 F.3d 401 (9th Cir. 1984); *In re Brennick*, 178 B.R. 305 (Bankr. D. Mass. 1995); *In re Telesphere Communications Inc.*, 148 B.R. 525 (Bankr. N.D. Ill. 1992); *In re Rare Coin Galleries of Am., Inc.*, 72 B.R. 415 (D. Mass. 1987). Other cases have refused to grant the Landlord immediate payment because that would amount to a super priority not expressly provided for in the Code. See *In re Spiess Co.*, 145 B.R. 597 (Bankr. N.D. Ill. 1992); *In re Virginia Packaging Supply Co. Inc.*, 122 B.R. 491 (Bankr. E.D. Va. 1990); *In re Granada Inc.*, 88 B.R. 369 (Bankr. D. Utah 1988). Another line of cases grants immediate payment to Landlord, but requires disgorgement to the extent necessary to provide all administrative claimants a pro rata share. See *In re Almac's Inc.*, 167 B.R. 4 (Bankr. D.R.I. 1994); *In re Four Star Pizza*, 135 B.R. 498 (Bankr. W.D. Pa. 1992); *In re Buyer's Club Mkts., Inc.*, 115 B.R. 700 (Bankr. D. Colo. 1990); *In re Cardinal Indus., Inc.*, 109 B.R. 738 (Bankr. S.D. Ohio 1989); *In re Dieckhaus Stationers of King of Prussia, Inc.*, 73 B.R. 969 (Bankr. E.D. Pa. 1987); see also *In re Pudgie's Dev. of NY, Inc.*, 239 B.R. 688 (S.D.N.Y. 1999) (wherein the Court focused on the timing and status of solvency or potential solvency and held with regard to timing, that when the bankruptcy estate is administratively solvent then the Landlord is entitled to immediate payment of the rent as it becomes due under the lease citing, *In re Four Star Pizza, Inc.*, 135 B.R. 498 (Bankr. W.D. Pa. 1992), but if the estate is administratively insolvent, or if it may be administratively insolvent, then the effect of requiring immediate payment is to give Landlords a super priority administrative expense).

25. See *In re DVI, Inc.*, 308 B.R. 703, 708 (Bankr. D. Del. 2004) (holding Landlord is entitled to an administrative claim for the debtor's post-rejection use of the premises).

26. See 11 U.S.C. §502(b)(6) (2005).

27. See 11 U.S.C. §502(b)(6) (2005).

28. See *In re Crown Books Corp.*, 291 B.R. 623, 627 (Bankr. D. Del. 2003) (indicating that "rent reserved" under 11 U.S.C. §502(b)(6) included such charges).

29. 11 U.S.C. §503(b)(7) (2005) (as amended April 20, 2005); see also *supra* n. 3.

30. 11 U.S.C. §365(d)(4) (2005) (as amended April 20, 2005).

31. See 11 U.S.C. §365(a) (2005).

32. See *In re Yates Dev., Inc.*, 241 B.R. 247, 252 (Bankr. M.D. Fla. 1999). A Debtor must either assume the entire contract, "cum onere," or reject the entire contract. See *Piecco, Inc. v. Atlantic Computer Systems, Inc. (In re Atlantic Computer Systems, Inc.)*, 173 B.R. 844 (S.D.N.Y. 1994) (citing additional caselaw).

33. See *In re St. Johns Home Health Agency, Inc.*, 173 B.R. 238, 246 (Bankr. S.D. Fla. 1994).

34. See *In re Yates Dev., Inc.*, 241 B.R. at 252 citing *Richmond Leasing Co. v. Capital Bank*, 762 F.2d 1303, 1311 (5th Cir. 1985); *In re Auto Dealer Services, Inc.*, 65 B.R. 681, 684 (Bankr. M.D. Fla. 1986).

35. See *Coleman Oil Co. v. Circle K Corp. (In re Circle K)*, 127 F.3d 904, 906 (9th Cir. 1997).

36. Other issues on appeal had included whether the Debtor was in fact an assignee of the leases and whether the Debtor had extended the leases previously. See *Coleman Oil Co. v. Circle K Corp. (In re Circle K)*, 190 B.R. 370, 372 (B.A.P. 9th Cir. 1997).

37. See 127 F.3d at 906.

38. *See id.* at 909.

39. See 190 B.R. at 376; see also *City of San Francisco Market Corp. v. Walsh (In re Moreggia & Sons, Inc.)*, 852 F.2d 1179, 1185 (9th Cir. 1988).

40. See *Circle K*, 127 F.3d at 909 (discussing the lower court decision and citing 11 U.S.C. §§362, 365 (2005) and *Post v. Sigel & Co., (In re Sigel & Co.)*, 923 F.2d 142, 144-45 (9th Cir. 1991)).

41. See 127 F.3d at 906.

42. *See id.* at 906.

43. *See id.* citing 11 U.S.C. §365(d)(4)(g) (2005).

44. See *Circle K*, 127 F.3d at 906.

45. *See id.* at 910 citing *Pacific Express, Inc. v. Teknetron Infoswitch Corp. (In re Pacific Express, Inc.)*, 780 F.2d 1482, 1486 (9th Cir. 1986).

46. See *Circle K*, 127 F.3d at 910 (9th Cir. 1997).

47. Of course, the Debtors were required to perform obligations of the leases arising after the order for relief and before assumption of the leases. See 11 U.S.C. §365(d)(3) (2005). It should be noted that the only post-petition default established here was less than \$200 with regard to one property. The amount was tendered when notice of the default was given to the Debtors. The bankruptcy court characterized this default as *de minimis*.

48. *In re Fifth Taste Concepts Las Olas, LLC, d/b/a The Brasserie*, 325 B.R. 42 (Bankr. S.D. Fla. 2005).

49. *See id.* citing *In re Eastern Systems*, 105 B.R. at 230.

50. *See id.*

51. *See id.* at 46.

52. See 11 U.S.C. §502(b)(6) (2005).

53. See *Fifth Taste*, 25 B.R. at 44.

54. *See id.* at 48 - 49.

55. Section 365(b)(1)(A) of the Bankruptcy Code provides: "[i]f there has been a default in an executory contract or unexpired lease of the debtor, the [debtor-in-possession] will promptly cure such default."

56. See *Fifth Taste*, 325 B.R. at 49.

57. *See id.* at 49.

58. 178 B.R. 867 (Bankr. M.D. Fla. 1995).

59. See *In re King Tut's Pyramid, Inc.*, 178 B.R. 867, 870-71 (M.D. Fla. 1995).

60. *See id.* at 871.

61. *See id.*

62. *See id.*



Moritt Hock Hamroff & Horowitz LLP

ATTORNEYS AT LAW

400 Garden City Plaza • Garden City, NY 11530

Tel: (516) 873-2000 • Fax: (516) 873-2010

www.morittthock.com

Offices: Long Island • Manhattan