

Navigating Lease Negotiations in Chapter 11

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*This presentation does not express the views of the Honorable Marvin Isgur,
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When a tenant with an unexpired lease files Chapter 11, both the landlord and the debtor-tenant confront numerous issues.¹ The landlord, first and foremost, is concerned about getting paid its rent. The landlord also faces uncertainty about whether the tenant will stay in the space or close its doors. If the tenant decides to vacate the space, the landlord will want to maximize its recovery on any claim it may have in the tenant's bankruptcy. The debtor-tenant, likewise, meets several challenges. Primarily, a debtor undergoing operational restructuring efforts faces a task that is two-fold: increasing cash reserves while disposing of burdensome assets or contracts, including leases.

Notwithstanding the many tools provided to a debtor-tenant under the Bankruptcy Code, the debtor is not permitted to unilaterally re-write its lease. Rather, a debtor-tenant has three options: (i) assume the lease (with all of its burdens); (ii) reject the lease and forfeit possession of the property; or (iii) negotiate a commercial solution. In a Chapter 11 case, there are certain leases and contracts that will obviously be rejected, as the debtor may be ceasing operations in a certain operating segment or locale. Conversely, other truly beneficial and necessary leases will undoubtedly be assumed (*e.g.*, under-market leases of assets central to the debtor's operations). A significant number of leases, however, will fall in the middle—a lease the debtor would like to assume if it could renegotiate the terms.

This paper addresses the process of lease negotiations between debtor-tenants and creditor-landlords against the backdrop of rights provided in Chapter 11 cases. Part I outlines the absolute legal rights concerning assumption and rejection of a lease. Against this background, the

¹ This paper analyzes the process of lease negotiations where the relationship between the parties is one of debtor-tenant and creditor-landlord. The limited focus of this article, however, does not signify that landlords are somehow immune from, or less susceptible to, insolvency, or that the Bankruptcy Code affords little to no relief to debtor-lessors. In fact, the most recent economic downturn has not only significantly impacted commercial tenants, such as retailers and restaurants, but it has also caused numerous property owners to seek bankruptcy protection.

section details negotiating points available to the parties to obtain leverage and facilitate the renegotiation of the lease. Next, Part II provides a hypothetical that demonstrates the tools “in action.”

I. Renegotiations of Leases in Chapter 11

While the absolute rights of assumption or rejection are well defined under the Bankruptcy Code² and caselaw, the practitioner will often be presented with a situation where a debtor seeks the renegotiation of a lease. For example, in many cases, the debtor may seek to sell its assets in a competitive sale and bidding process pursuant to Section 363 of the Bankruptcy Code. In this situation, the prevailing purchaser is generally given the option to choose which contracts and leases will be assumed or rejected. Consequently, a landlord may find itself negotiating with numerous counterparties because it may not know who the prevailing purchaser will ultimately be. In other cases, the debtor may seek to reorganize, resulting in binary negotiations between the debtor-tenant and the landlord. In either event, lease negotiations are a commercial endeavor wherein the debtor (or prevailing purchaser) and the landlord each seek to protect their self-interest by ascertaining the best deal possible. As part of this process, both debtors and landlords can utilize the legal protections provided under the Bankruptcy Code to influence the other’s decision.

A. The Debtor-Tenant’s Tool Kit

While the Bankruptcy Code provides a debtor-tenant³ with a panoply of tools to address claims, the debtor’s primary tool for addressing real property leases is the ability to assume or reject leases. To maximize a debtor’s reorganization efforts, whether by reducing contractual

² See 11 U.S.C. §§ 365, 502.

³ It is the debtor’s “trustee” who has the rights and responsibilities created by Section 365. In most Chapter 11 cases, however, the debtor exercises the powers conferred on a bankruptcy trustee by the Bankruptcy Code. See, e.g., 11 U.S.C. § 1107 (which provides that a Chapter 11 “debtor in possession” has most of the “rights, title and powers,” and “shall perform [most of] the functions and duties . . . of a trustee”). As used in this article, the debtor is assumed to be a “debtor in possession” exercising all the rights and powers of a bankruptcy trustee in a Chapter 11 case.

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