



AMERICAN
BANKRUPTCY
INSTITUTE

Distressed Real Estate Symposium

Distressed Leases and Asset Sales: Strategies, Pitfalls and Emerging Trends

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Distressed Leases & Asset Sales: Strategies, Pitfalls, and Emerging Trends

1. Introduction (4:10 – 4:15)

- a. Introductions of panelists
- b. Brief overview of panel topic

2. Out of Court Lease Re-Negotiations (4:15 – 4:25)

- a. Strategy varies depending on whether the goal is close the location or to keep it open
 - i. Writing checks to close locations
 - ii. Closing the location and then negotiating termination payment
 - iii. Re-negotiating lease terms to keep the location open
- b. Discuss how strategy varies by asset class (retail, hospitality, healthcare, multifamily, warehouse) and type of lease (i.e. NNN)
- c. Best practices v. Reality
 - i. Early stakeholder engagement leads to the best outcomes
 - 1. Sophisticated landlords are demanding information about the turnaround itself, so having a proposed strategy in place becomes more critical.
 - 2. Early engagement provides more time for creative solutions.
 - 3. Engaging in negotiations before a lease default can avoid default triggers in related contracts, like loan agreements and subleases.
 - ii. In reality, especially in the middle market, companies often do not seek guidance until they have very little runway left
 - 1. Especially when time is of the essence, bringing on an expert to streamline the process can be critical
 - a. Healthcare rollup example where there were evictions and mechanic's liens, but the workout was still successful
 - 2. Must quickly identify both decisionmakers and must-have concessions

3. Leverage the fact that a bankruptcy and lost income are probably in the absence of an agreement.
 - iii. In any scenario, parties need to be prepared to move quickly
- d. Landlord strategies in response to attempts to re-negotiate lease
 - i. Pre-judgment attachment
 - ii. Taking a security interest and filing a UCC-1
 - iii. Demanding a guaranty
 - iv. Attempting to structure payment to avoid a preference
- e. Is there a trend toward out of court workouts or is bankruptcy still more common?

3. Lease Negotiations in Bankruptcy (4:25 – 4:45)

- a. The strategy differs from an out of court process because there is more leverage in bankruptcy
- b. The mechanics of section 365
 - i. Assumption, assignment or rejection under section 365(a): Pursuant to section 365(a), with the Court's approval, the Debtor can assume, assign or reject unexpired leases
 - ii. Cure requirement under section 365(b): A lease cannot be assumed unless defaults are cured and the landlord receives adequate assurance of future performance
 1. What does cure require?
 - a. Monetary defaults
 - b. Non-monetary defaults
 - i. If the default is about something other than money (like failing to maintain the property, follow a use restriction, or keep the store open), and it's impossible to fix that non-monetary issue now (for example, you can't go back in time and operate the store during months it was closed), the company is not required to fix the past—but must start

performing as required under the lease moving forward.

- ii. If the default was that the tenant failed to operate the business as required by the lease (for example, didn't keep the store open), then to keep the lease, the tenant must start operating the business again as the lease requires.
 - iii. Any financial losses the landlord suffered because of these defaults (like lost rent or damages) must be compensated when the lease is assumed.
2. Under section 365(l), if the debtor-tenant assigns the lease to another party, the landlord has the right to require the new tenant to provide a security deposit or guaranty, just like the landlord would have required if the new tenant had originally signed the lease.
 3. "Adequate assurance" in shopping center leases as required by section 365(b)(3)
 - a. Source of rent: The future rent will not decline significantly due to assignment.
 - b. Financial condition and operating performance: The financial condition and performance of the proposed assignee must be similar to the original tenant.
 - c. Tenant mix and use restrictions: The assignment must not disrupt the tenant mix or violate use restrictions critical to the shopping center's operation.
 - d. Exclusivity and radius clauses: The lease's exclusivity, use, or radius clauses must be honored—assignment cannot violate these provisions.
- iii. Terminated leases under section 365(c)(3): If the lease expires by its own terms or is terminated prior to the bankruptcy, it does not become property of the bankruptcy estate and it cannot be assumed or assigned.
 1. Litigation can ensue over whether a lease was validly terminated prior to a bankruptcy filing
 2. Section 362(b)(10): If the lease is terminated before the bankruptcy petition is filed, the automatic stay is not triggered and

the lessor is not stayed from taking action with respect to a lease of nonresidential real property

- iv. Rent relief under section 365(d)(3): Rent must be paid in the ordinary course of business during the bankruptcy until the lease is rejected. The bankruptcy court may extend the debtors obligation to pay rent due within 60 days following the petition date for cause, but may not extend the time for performance beyond 60 days.
- v. Timing for assumption under section 365(d)(4): The decision to assume a lease must be made by the earlier of plan confirmation or 120 days post-petition (plus possible 90-day extension), unless the landlord consents to a longer time. Otherwise, the lease is automatically rejected.
- vi. Assignment of leases under section 365(f): Leases can be assigned – even if the lease prohibits assignment – if defaults are cured and adequate assurance is provided to the landlord.
- vii. Lease rejection under section 365(g): Rejected leases are treated as breached pre-petition and the landlord becomes a creditor for damages.
- viii. Debtor as lessor under section 365(h): If a debtor rejects a lease under which it is the lessor –
 - 1. The tenant can generally treat the lease as terminated or can choose to stay and keep all their rights under the lease (like how much rent to pay, their right to use the space) for the rest of the term and any renewal as long as the law allows.
 - 2. If the tenant stays and the debtor-landlord does not perform under the lease (like making repairs), the tenant can reduce their rent by the value of any damages caused by the failure, but they cannot make any other claims against the bankruptcy estate for those damages.
 - 3. For leases in shopping centers, if the tenant stays, all special lease rules (like what kind of business can operate, exclusivity, location, and tenant mix) still apply and remain enforceable.
 - 4. A “lessee” under section 365(h) covers the original tenant and anyone allowed to take over the lease, like an assignee or mortgagee.

c. Key issues and strategic considerations

- i. Damages cap under section 502(b)(6)

1. Limits landlord's claims for lease rejection damages for nonresidential real property.
2. Calculation approaches
 - a. Time-based approach. *See, e.g., Lincoln Triangle Commer. Holding Co. LLC v. Halperin (In re Cortland Liquidating LLC)*, 658 B.R. 244 (S.D.N.Y. 2024) (holding that the time-based approach is the correct statutory interpretation of section 502(b)(6)).
 - b. Rent-based approach. *See In re Andover Togs, Inc.*, 231 B.R. 521, 547 (Bankr. S.D.N.Y. 1999). After determining that the legislative history was unhelpful and that the Rent Approach was then the majority view, the court held that the Rent Approach was the correct one. The Andover Togs decision also held that the Rent Approach was the “logically sounder” approach, and noted that at the time the Rent Approach was supported by the Collier's treatise and the Norton Bankruptcy Law treatise.
 - c. Note that the *Courtland Liquidating* court found that all reported decisions since 2012 have endorsed the Time Approach.
3. Calculating cap using the time approach
 - a. Step 1: Determine the Relevant Date. The Statute uses the earlier of (1) the bankruptcy filing date, or (2) the date the landlord regained possession.
 - b. Step 2: Calculate Remaining Lease Term. Consider the number of months remaining until the end of the term.
 - c. Step 3: Calculate the Cap. Calculate one year's rent. Calculate 15% of the remaining term of the lease (not to exceed 3 years) multiplied by the monthly rent then in effect. Use the greater of the two calculations.
 - d. Step 4: Add Pre-Petition Unpaid Rent to the Capped Amount. The total allowable claim is the lease rejection damages cap plus unpaid pre-petition rent.
4. What is included in “rent reserved” varies by venue

- a. *See Kuske v. McSheridan (In re McSheridan)*, 184 B.R. 91, 91 (9th Cir. B.A.P. 1995) (enumerating a three-part test for determining the meaning of “rent reserved”); *cf. In re Filene’s Basement, LLC*, No. 11- 13511 (KJC), 2015 WL 1806347, at *12 (Bankr. D. Del. April 16, 2015) (reasoning that the three-part *McSheridan* test is not always required, but that the determination must include analysis into whether the charge in question is “fixed, regular, or periodic.”).
- b. *Saddleback Valley Cmty. Church v. El Toro Materials Co. (In re El Toro Materials Co.)*, 504 F.3d 978, 980-81 (9th Cir. 2007): “Assuming all other conditions remain constant, would the landlord have the same claim against the tenant if the tenant were to assume the lease rather than rejecting it?”
 - i. The *In re Cortland Liquidating LLC* court answered this question in the negative, because under the lease, the lessee’s obligation to clean up the store arose “[u]pon expiration or other termination of this Lease.” At that point, the lease required the tenant to quit and surrender to landlord the premises, “vacant, broom clean, in good order and condition, ordinary wear and tear and damage for which tenant is not responsible under the terms of this lease excepted....”
 - ii. Because the landlord would not have had a claim for cleanup costs, had the lessee assumed the lease, the district court found (a) any claim for cleanup costs only arose from the termination of the lease, and (b) therefore, such claims are “indeed subject to” the Statutory Cap.
- ii. Residential v. Nonresidential lease treatment
 1. Section 365(d)(4) setting forth the timing for lease assumption and rejection applies only to nonresidential real property leases.
 2. Debtors must analyze whether a lease is “nonresidential” even for mixed use properties to determine deadlines and rights.
 3. Issues arises, for example, in healthcare cases. *See, e.g., Erie Acquisition, LLC v. Guardian Elder Care at Johnstown, LLC (In re Guardian Elder Care at Johnstown, LLC)*, 665 B.R. 270 (Bankr.

W.D. Pa. 2024) (adopting a “totality of the circumstances” test to determine whether a lease is for property that is “nonresidential” or residential” in nature).

iii. Stub Rent

1. Stub rent is rent for the period between the petition date and the first post-petition rent due date.
2. Issues:
 - a. Is “stub rent” an administrative expense?
 - b. If so, when must it be paid?
3. Recent cases:
 - a. *In re TRP Brands LLC*, No. 24-B-1529, 2024 Bankr. LEXIS 157 (Bankr. N.D. Ill. Jan. 23, 2026) (holding that stub rent claims are entitled to administrative claim status but are not entitled to automatic payment)
 - b. *In re Avianca Holdings S.A.*, 127 F.4th 414, 425 (2d Cir. 2025) (applying the billing date approach to lease of personal property).
 - c. *In re New Rite Aid, LLC*, 2025 Bankr. LEXIS 2862, *6 (holding that nothing in the Bankruptcy Code requires stub rent, which is an administrative claim under section 503(b)(1)(A), to be paid at a date certain as long as it is paid prior to plan confirmation).

iv. Security Deposits, Letters of Credit, and Guaranties

1. Security Deposits
 - a. Generally held by landlords as collateral for tenant obligations
 - b. Landlords typically apply the security deposit to the tenant’s obligations when the lease is rejected.
 - c. Is the security deposit applied before or after application of the cap?

- i. *In re Atl. Container Corp.*, 133 B.R. 980 (Bankr. N.D. Ill. 1991) ("It is well-settled that a security deposit held by a lessor on a rejected lease must be applied against the maximum claim for lease termination damages allowed to the lessor under § 502(b)(6).").

2. Letters of Credit

- a. Letters of credit are third-party guarantees, usually from a bank, that the landlord can draw upon if the tenant defaults.
- b. They are not estate property and are typically independent undertakings.
- c. Is the letter of credit applied before or after application of the cap?

- i. *In re AB Liquidating Corp.*, 416 F.3d 961, 965 (9th Cir. 2005) (affirming district court's application of letter of credit to landlord's allowable claim rather than its gross damages)

- ii. *Solow v. PPI Enters.(U.S.) (In re PPI Enters.(U.S.)*, 324 F.3d 197, 208 (3d Cir. 2003) (landlord's capped claim must be further reduced by application of letter of credit where parties intended the letter of credit to act as a security deposit)

- iii. *Lincoln Triangle Commer. Holding Co. LLC v. Halperin (In re Cortlandt Liquidating LLC)*, 658 B.R. 244, 255-256 (S.D.N.Y. 2024) (holding that letter of credit proceeds were properly deducted from landlord's claim after the section 502(b)(6) cap was applied where the letter of credit was satisfied with estate assets).

- iv. *In re Tupperware Brand Corp.*

3. Guaranties

- a. General Rule: The bankruptcy of the tenant (debtor) does not typically discharge the obligations of a third-party guarantor. Landlords can still pursue guarantors for unpaid rent and other lease obligations, even if the tenant rejects the lease.

- b. Exception: If the guarantor is itself in bankruptcy, its liability may be affected or discharged. *In re Interco Inc.*, 137 B.R. 1003 (Bankr. E.D. Mo. 1992) (cap applies if guarantor also becomes debtor).
 - c. Is guaranty liability subject to the section 502(b)(6) cap?
4. Takeaway: Venue matters. The treatment of LCs, security deposits, and guaranties varies, so the choice of bankruptcy venue or anticipation of venue law in lease, LC, and guaranty drafting is crucial.
- d. Lease-only sales
 - i. Successes: Party City, Rite Aid, Joann
 - ii. Cautionary Tale: Bed, Bath & Beyond, Eddie Bauer (no bids)
 - iii. Certain buyers have been aggressive in buying leases
 - iv. Can create issues for landlords relating to tenant mix
 - e. Implications for stakeholders when companies undergo multiple bankruptcy filings

4. Out of Court Distressed Asset Sales (4:45 – 4:55)

- a. When:
 - i. The asset or portfolio is distressed, but all parties are motivated to avoid the time, cost, and uncertainty of bankruptcy.
 - ii. The property's value can be maximized through a private sale rather than a public auction.
 - iii. The borrower and lender (and other stakeholders) can agree on a process without judicial intervention.
- b. Why:
 - i. Faster, less expensive, and more private than formal bankruptcy or foreclosure proceedings.
 - ii. Reduces reputational risk and operational disruption for both the seller and the property.

c. Key Issues:

- i. Diligence challenges: Buyers may have limited access to information with operationally challenged assets. Appraisals may be stale or disputed. Market value is often less certain in distressed contexts.
- ii. Negotiating with multiple stakeholders: Secured lenders, mezzanine lenders, equity holders, tenants, and ground lessors may all have approval or consent rights.
- iii. Successor liability: Buyers may be concerned about assuming environmental, tax, and other liabilities.
- iv. Third-party consents: Required consents from franchisors, grounds lessors, governmental authorities, and others can delay or derail a sale.
- v. Navigating lender rights and consents: Lender approval is likely necessary for the asset sale. Negotiating forbearance and release terms can add complexity.

d. Trends

- i. “Loan-to-own” tactics: Secured lenders, mezzanine lenders, equity holders, tenants, and ground lessors may all have approval or consent rights.
- ii. Combining out-of-court sales with the threat of receivership or bankruptcy to push parties to a deal

e. Receivership Sales

- i. Nature of receivership sales
 1. Court-appointed receiver takes control of the property, often at the lender’s request, to preserve value and potentially market or sell the property.
 2. Sales are typically subject to court approval.
- ii. Sales processes are increasingly modeled after section 363 bankruptcy sales.
- iii. Process is highly dependent on state law, which varies
 1. Illinois receivership statute was recently enacted.

5. Distressed Asset Sales in Bankruptcy (4:55 – 5:05)

- a. Section 363 allows a debtor to sell assets “free and clear” of liens, claims, and interests, with court approval.
- b. Asset class issues
 - i. Office, retail, hospitality, industrial, and multi-family assets may require different marketing, diligence, and buyer pools.
 - ii. Specialized assets (e.g., hotels, healthcare) may need industry-specific brokers and extra regulatory diligence.
- c. Stalking horse bidders
 - i. Purpose: Set a floor price, signal asset value, and provide a template sale agreement.
 - ii. Must negotiate reasonable overbid protections, break-up fees, and milestones
 - iii. If the bid protections are overly restrictive, it can chill the auction process.
- d. Credit bidding
 - i. Secured creditors can “bid” their debt (in lieu of cash) up to the amount owed, per section 363(k).
 - ii. Strategic Considerations:
 - 1. Lenders may credit bid to protect collateral or to take ownership at a discount.
 - 2. Sometimes, lenders act as stalking horse bidders to set a base price and stimulate additional bids.
 - iii. Aggressive credit bidding can chill interest from other buyers.
 - iv. Always a preliminary question: Is there equity in the property or is the secured lender willing to take a haircut? If not, lender’s credit bid may dominate.
- e. Example: In the Toys R Us bankruptcy, the real estate lease portfolio was widely marketed, with lenders credit bidding and third parties encouraged to participate, maximizing value.
- f. Successor liability issues

- i. Buyers seek to acquire assets “free and clear” of pre-existing liabilities.
 - ii. Certain successor liability claims, including environmental liability or tax liability may survive.
 - g. Third-party consent challenges
 - i. Assignment of leases or permits may require landlord or governmental consent.
 - ii. Debtors proactively engage counterparties and be prepared to use the sale order provisions to compel consent where necessary.
6. Takeaways and Questions (5:05 – 5:10)

1

Distressed Leases & Asset Sales: Strategies, Pitfalls, and Emerging Trends

2

Agenda

Out-of-Court Lease Negotiations

Focuses on decisions about closing or preserving locations, shaped by timing, liquidity, and landlord responses.

Lease Negotiations in Bankruptcy

Covers Bankruptcy Code section 365 tools including assumption, assignment, rejection, and rent obligations.

Distressed Asset Sale Strategies

Compares private transactions, receivership, and section 363 sales, focusing on stalking horse bids and credit bidding.

Panelists

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Out-of-Court Lease Strategies

Out-of-Court Lease Renegotiations

Negotiation Strategies

- Strategies differ based on whether tenants aim to close or continue operations, affecting payment and rent terms.
- Sometimes the company decides to write a check to close a location.

Asset and Lease Type Impact

- Strategies can vary based on the asset class. For example, the negotiation strategy for a retail space likely differs from negotiations for leases of healthcare or warehouse spaces.
- The type of lease, such as a triple net lease, can also influence the strategy.

Best Practices Versus Market Reality

Early Stakeholder Engagement

Engaging landlords, lenders, and counterparties early prevents loan defaults and allows creative workout solutions.

Challenges in Market Reality

Many companies delay advice until liquidity is low, resulting in compressed, adversarial negotiations with landlords.

Role of Advisors

Advisors help identify decision-makers, prioritize concessions, and efficiently drive negotiations for better outcomes.

Importance of Speed and Coordination

Successful workouts often depend on quick, coordinated actions rather than perfect planning.

Landlord Strategies and Responses

Defensive Recovery Strategies

Landlords use tactics like eviction, pre-judgment attachment, and additional credit support to protect their interests.

Payment Structuring to Avoid Risks

Landlords structure payments strategically to avoid preference exposure near potential bankruptcy filings.

Security Interests and Legal Filings

Some landlords seek security interests in tenant assets and file UCC-1 financing statements to secure claims.

Tenant Bankruptcy Impact

The threat of tenant bankruptcy acts as a counterbalance, affecting landlord leverage and income recovery.

Leases in Bankruptcy

Leases in Bankruptcy: Statutory Framework

Lease Negotiations in Bankruptcy

Bankruptcy alters lease negotiations through court supervision and the requirements of section 365 of the Bankruptcy Code.

Debtor's Leverage and Lease Options

Debtors can assume, assign, or reject unexpired leases subject to court approval, changing landlord-debtor dynamics.

Landlord Protections

Landlords have protections including cure requirements and adequate assurance standards under bankruptcy law.

Automatic Stay Impact

The automatic stay restricts landlords from unilateral actions, balancing interests between parties.

Assumption, Assignment, and Cure under Section 365

Assumption, Assignment or Rejection under Section 365(a)

Section 365(a) allows debtors to assume, assign, or reject unexpired leases with court approval to manage lease portfolios strategically.

Cure Requirements under Section 365(b)

Assumption and assignment require compliance with cure payments and adequate assurance protections under section 365(b).

Shopping Center Lease Safeguards under Section 365(b)(3)

Section 365(b)(3) provides extra safeguards for shopping center leases, addressing tenant mix and use restrictions.

Terminated Leases under Section 365(c)(3)

Section 365(c)(3) provides that, if the lease expires by its own terms or is terminated prior to the bankruptcy, it does not become property of the bankruptcy estate, and it cannot be assumed or assigned.

Assumption, Assignment, and Cure under Section 365

Rent Relief under Section 365(d)(3)

Rent must be paid in the ordinary course of business during the bankruptcy until the lease is rejected. The bankruptcy court may extend the debtor's obligation to pay rent due within 60 days following the petition date for cause but may not extend the time for performance beyond 60 days.

Timing for Assumption under Section 365(d)(4)

The decision to assume a lease must be made by the earlier of plan confirmation or 120 days post-petition (plus possible 90-day extension), unless the landlord consents to a longer time. Otherwise, the lease is automatically rejected.

Assumption of leases under section 365(f)

Leases can be assigned – even if the lease prohibits assignment – if defaults are cured and adequate assurance is provided to the landlord.

Residential Lease Treatment, Debtor as Lessor, and Stub Rent Issues

Residential v. Nonresidential Lease Treatment

Section 365(d)(4) setting forth the timing for lease assumption and rejection applies only to nonresidential real properties. Parties must analyze whether a lease is "nonresidential" even for mixed use properties to determine deadlines and rights.

Debtor as Lessor under section 365(h)

If the debtor rejects a lease under which it is the lessor, the tenant can treat the lease as terminated or it can stay for the remainder of the term but cannot make any claim for damages against the bankruptcy estate.

Stub Rent Litigation

Stub rent is rent for the period between the petition date, and the first post-petition rent due date. Parties litigate whether "stub rent" is an administrative expense and when it must be paid.

Lease Rejection and Damages Cap

Lease Rejection as Prepetition Breach

Lease rejection under section 365(g) converts future rent into a damages claim.

Damages Cap on Landlord Claims

Section 502(b)(6) caps landlord damages to prevent disproportionate recovery in nonresidential leases.

Damages to Property

Most courts distinguish between capped lease termination damages and uncapped claims for physical property damage. Obligations under a lease to restore the property are often capped.

Calculating Lease Rejection Damages Under Section 502(b)(6)

Section 502(b)(6) limits a landlord's allowed claim for damages resulting from a tenant's rejection of a lease. The cap is:

"the rent reserved by such 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—

- (i) the date of the filing of the petition; and
- (ii) the date on which such lessor repossessed, or the lessee surrendered, the leased property;

plus any unpaid rent due under such lease, without acceleration, on the earlier of such dates."

Calculation Methods Debate

Courts debate time-based versus rent-based approaches in calculating damages caps. What is included in "rent reserved" varies by venue.

Calculating Lease Rejection Damages Under Section 502(b)(6) Using Time Approach

Step 1: Determine the Relevant Date

The Statute uses the earlier of (1) the bankruptcy filing date, or (2) the date the landlord regained possession.

Step 2: Calculate Remaining Lease Term

Consider the number of months remaining until the end of the term.

Step 3: Calculate the Cap

Calculate one year's rent. Calculate 15% of the remaining term of the lease (not to exceed 3 years) multiplied by the monthly rent then in effect. Use the greater of the two calculations.

Step 4: Add Pre-Petition Unpaid Rent to the Capped Amount

The total allowable claim is the lease rejection damages cap plus unpaid pre-petition rent.

Security Deposits, Letters of Credit, and Guaranties

Role of Security Deposits

Generally held by landlords as collateral for tenant obligations. Case law holds that security deposits must be applied only after calculating the maximum lease rejection claim.

Letters of Credit Treatment

Letters of credit are third-party obligations, with courts differing on timing of proceeds application.

Complexities with Guaranties

The bankruptcy of the tenant does not typically discharge the obligations of a third-party guarantor unless the guarantor is itself in bankruptcy.

Takeaway: Venue Matters

The treatment of letters of credit, security deposits, and guaranties varies by venue, so the choice of bankruptcy venue or anticipation of venue law in the lease, letter, or guaranty is crucial.

Lease-Only Sales and Portfolio Strategies

Lease-Only Sale Strategy

Lease-only sales allow buyers to acquire prime locations without buying entire businesses, unlocking value in bankruptcies.

Success and Failure Examples

Party City and *Rite Aid* succeeded with lease-only sales, while *Bed Bath & Beyond* faced challenges due to execution risks.

Landlord and Buyer Tensions

Aggressive lease portfolio buyers may clash with landlords over tenant mix and covenant compliance issues.

Implications for Stakeholders

Repeated tenant bankruptcies can have implications for landlords, especially if the landlord agreed to provide rent concessions in an initial bankruptcy.

Distressed Asset Sales

When and Why to Pursue an Out-of-Court Distressed Asset Sale

When to Pursue an Out-of-Court Sale

1. The asset or portfolio is distressed, but all parties are motivated to avoid the time, cost, and uncertainty of bankruptcy.
2. The property's value can be maximized through a private sale rather than a public auction.
3. The borrower and lender (and other stakeholders) can agree on a process without judicial intervention.

When to Pursue an Out-of-Court Sale

1. Faster, less expensive, and more private than formal bankruptcy or foreclosure proceedings.
2. Reduces reputational risk and operational disruption for both the seller and the property.

Key Issues in Out-of-Court Distressed Asset Sales

Diligence Challenges

Diligence, disputed valuations, successor liability concerns can complicate the sale process.

Negotiating with Multiple Stakeholders

Secured lenders, mezzanine lenders, equity holders, tenants, and ground lessors may all have approval or consent rights. Lender approval is likely necessary and negotiating forbearance and release terms can add complexity.

Third-Party Consents

Required consents from franchisors, grounds lessors, governmental authorities, and others can delay or derail a sale.

Trends

Loan-to-own strategies and bankruptcy threats are increasingly used to accelerate agreement and resolution.

Receivership and Bankruptcy Asset Sales

Receivership and Section 363 Sales

Receivership and section 363 sales offer structured asset sale alternatives with court oversight and competitive bidding.

Asset Class and Industry Issues

Office, retail, hospitality, industrial, and multi-family assets may require different marketing, diligence, and buyer pools. Specialized assets (e.g., hotels, healthcare) may need industry-specific brokers and extra regulatory diligence.

Stalking Horse Bidders

Stalking horse bidders establish floor prices and deal terms to encourage competitive bidding in bankruptcy sales.

Credit Bidding Protections

Section 363(k) credit bidding enables secured lenders to protect collateral value during bankruptcy asset sales.

Key Takeaways and Audience Questions

Importance of Context

Successful outcomes depend on timing, venue, asset class, and stakeholder alignment in distressed asset situations.

Early Planning Benefits

Early planning and honest assessment of leverage help preserve value and maintain flexibility during asset sales.

Bankruptcy vs Out-of-Court

Bankruptcy offers powerful tools but adds cost and uncertainty; out-of-court solutions require coordination and credibility.

Ongoing Legal Developments

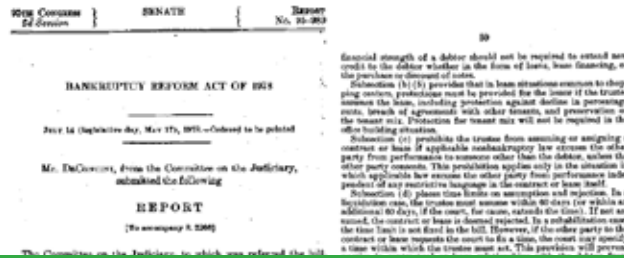
Case law continues to evolve, making it essential to stay updated on venue-specific legal developments.

SHOPPING CENTER PROTECTIONS UNDER SECTION 365(B)(3)

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OVERVIEW

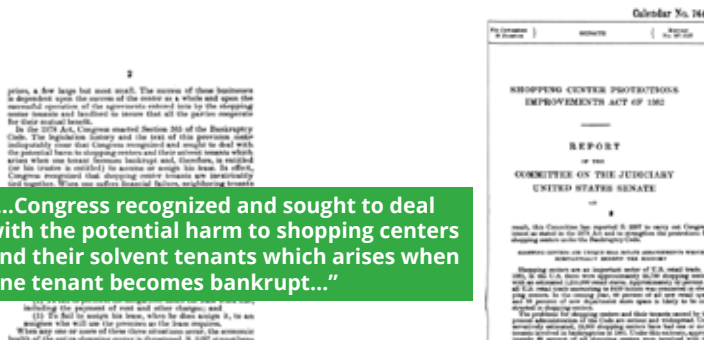
365(b)(3): Bankruptcy Reform Act of 1978



“Subsection (b)(3) provides that in lease situations common to shopping centers, protections must be provided for the lessor if the trustee assumes the lease, including protection against decline in percentage rents, breach of agreements with other tenants, and preservation of the tenant mix.”

3

365(b)(3): Shopping Centers Protections Improvements Act of 1982



“...Congress recognized and sought to deal with the potential harm to shopping centers and their solvent tenants which arises when one tenant becomes bankrupt...”

“Where the trustee is unable to find an assignee within the use clause...the Committee believes that it is appropriate for the lease to revert to the landlord.”

“Shopping centers are an important sector of U.S. Retail Trade...the linchpin of this entire operation is the freely accepted and openly negotiated contractual agreements among the parties. While the operation of the bankruptcy law necessarily alters contractual relationships, these alterations have direct and potentially crippling impacts on other shopping center businesses, and consequently, must be strictly limited and minimized.”

4

Post-BABCPA: Shopping Center Adequate Assurance of Future Performance

- 365(b)(1) ***Debtor's burden*** to provide adequate assurance of future performance must be provided ***at the time of assumption*** of such contract or lease.
- 365(b)(3)(A)-(D) lists the shopping center heightened standards.
 - (b)(3)(C): assumption/assignment is subject to all provisions thereof, including ***radius, location, use or exclusivity provisions***, and will not breach any such provision contained in ***any other lease***, financing agreement, or master agreement relating to such shopping center.
 - (b)(3)(D): assumption/assignment must not disrupt ***any tenant mix or balance***.
- 365(f)(1): the shopping center protections in 365(b) ***are not unenforceable anti-assignment provisions***.

5

SECTION 365(b)(3)(C): PLAIN MEANING

365(b)(3)(C): Original Version (1978)

- No reference to debtor's lease
- Only other tenant leases
- Some debtors argued assignee not required to comply with debtor's lease

(3) For the purposes of paragraph (1) of this section, adequate assurance of future performance of a lease of real property in a shopping center includes adequate assurance—
 (A) of the source of rent and other consideration due under such lease;
 (B) that any percentage rent due under such lease will not decline substantially;
 (C) that assumption or assignment of such lease will not breach substantially any provision, such as a radius, location, use, or exclusivity provision, in any other lease, financing agreement, or master agreement relating to such shopping center; and
 (D) that assumption or assignment of such lease will not disrupt substantially any tenant mix or balance in such shopping center.

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“(C) that assumption or assignment of such lease will not breach substantially any provision, such as a radius, location, use, or exclusivity provision, in any other lease, financing agreement, or master agreement relating to such shopping center;”

365(b)(3)(C): 1984 - Problem/Solution

October 26, 1984

Public Law 98-499

SHOPPING CENTER PROVISIONS
 IMPROVEMENTS ACT OF 1984

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The assignee (tenant, the assignee) should have a careful reading and financial performance when all factors, including advertising signs, parking, trash removal, security, and other factors, are considered.

4. Provisions of existing lease to be assumed

a. *Problem.*—Some trustees have interpreted the Code as providing that an assignee of a shopping center lease does not have to comply with the use and other important clauses contained in the lease being assumed, but only is bound to comply with such clauses contained in the other leases, financing agreements, and master agreements relating to the shopping center. Such an incorrect interpretation would allow an assignee to violate the use clause of the lease being assumed, which is clearly contrary to the intent of this Code and would result in the detriment of the shopping center and all other tenants.

b. *Solution.*—The bill confirms that under the Code, the new tenant must comply with all the provisions of the lease being assumed, as well as the provisions of other agreements relating to the shopping center.

1. Compliance with provisions of the lease assumed

a. *Problem.*—Some trustees have interpreted the Code as providing that an assignee of a shopping center lease does not have to comply with the use and other important clauses contained in the lease being assumed, but only is bound to comply with such clauses contained in the other leases, financing agreements, and master agreements relating to the shopping center. Such an incorrect interpretation would allow an assignee to violate the use clause of the lease being assumed, which is clearly contrary to the intent of this Code and would result in the detriment of the shopping center and all other tenants.

Problem: Debtors are IGNORING the need to comply with their own lease terms; arguing they are only required to comply with other, non-debtor leases

b. *Solution.*—The bill confirms that under the Code, the new tenant must comply with all the provisions of the lease being assumed, as well as the provisions of other agreements relating to the shopping center.



Solution: Assignments must comply with BOTH the DEBTOR'S lease AND OTHER leases

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365(b)(3)(C): Two clauses

1 (C) that assumption or assignment of such lease is subject to all the provisions thereof, including (but not limited to) provisions such as a radius, location, use, or exclusivity provision, **and**

2 will not breach any such provision contained in any other lease, financing agreement, or master agreement relating to such shopping center;

(B) For the purposes of paragraph (3) of this subsection and paragraph (2)(B) of subsection (f), adequate assurance of future performance of a lease includes adequate assurance—

(A) of the source of rent and other consideration, and of the financial condition and operating performance of the debtor and its guarantors, if any, shall be sufficient to ensure the performance of the debtor and its guarantors under the lease;

(B) that any percentage rent due under such lease will not decline substantially;

(C) that assumption or assignment of such lease is subject to all the provisions thereof, including (but not limited to) provisions such as a radius, location, use, or exclusivity provision, and will not breach any such provision contained in any other lease, financing agreement, or master agreement relating to such shopping center; and

(D) that assumption or assignment of such lease will not disrupt any tenant mix or balance in such shopping center.

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365(b)(3)(C): Clause 1 – Debtor’s Lease

1 (C) that assumption or assignment of such lease is subject to all the provisions thereof, including (but not limited to) provisions such as a radius, location, use, or exclusivity provision, **and**

(B) that any percentage rent due under such lease will not decline substantially;

(C) that assumption or assignment of such lease is subject to all the provisions thereof, including (but not limited to) provisions such as a radius, location, use, or exclusivity provision, and will not breach any such provision contained in any other lease, financing agreement, or master agreement relating to such shopping center; and

(D) that assumption or assignment of such lease will not disrupt any tenant mix or balance in such shopping center.

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365(b)(3)(C): Clause 2 – Any Other Lease

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will not breach any such provision contained in **any other lease**, financing agreement, or master agreement relating to such shopping center;

assignee and its guarantors, if any, shall be similar to the financial condition and operating performance of the debtor and its guarantors, if any, at the time the debtor became the lessee under the lease;

(B) that any percentage rent due under such lease will not decline substantially;

(C) that assumption or assignment of such lease is subject to all the provisions thereof, including (but not limited to) provisions such as a radius, location, use, or exclusivity provision, and will not breach any such provision contained in any other lease, financing agreement, or master agreement relating to such shopping center; and

(D) that assumption or assignment of such lease will not disrupt any tenant mix or balance in such shopping center.

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365(b)(3)(C) vs. (b)(3)(A): Don't Look Back

(C) that assumption or assignment of such lease is subject to all the provisions thereof, including (but not limited to) provisions such as a radius, location, use, or exclusivity provision, and will not breach any such provision contained in any other lease, financing agreement, or master agreement relating to such shopping center;

- No direction to look backwards

(A)...financial condition and operating performance of the proposed assignee ... shall be similar to the financial condition and operating performance of the debtor ... **as of the time the debtor became the lessee under the lease**;

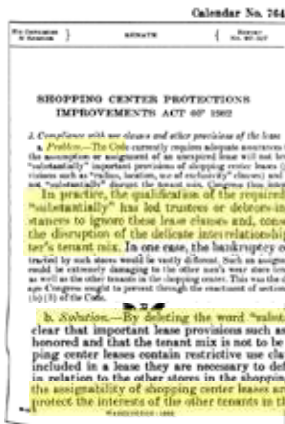
- Express direction to look backwards

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SECTION 365(b)(3)(D): TENANT MIX DISRUPTED

365(b)(3)(D): 1984 Amendment

- Original 365(b)(3)(D) prohibited assignments that “substantially” disrupted tenant mix and balance
- Congress deleted “substantially” to protect other tenants



Problem: Debtors and courts used “substantially” to ignore use restriction and other protected provisions

Solution: Delete “substantially” to protect other tenants.

Congressional Hypothetical



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“While it may seem reasonable to permit the assignment of a women’s wear store lease to a men’s wear store, such an assignment can be commercially unreasonable because the clientele attracted by such stores would be vastly different. Such an assignment could be extremely damaging to the other men’s wear store tenants as well as the other tenants in the shopping center. This was the damage Congress sought to prevent through the enactment of section 365 (b) (3) of the Code.

- Our Case:**
- Replace non-arts and craft retailer with specialty arts and craft retailer
 - Damages existing arts and craft retailer and other tenants in the shopping center

365(b)(3)(D): Current Standard

(D) that assumption or assignment of such lease will not disrupt **any tenant mix or balance** in such shopping center.

...with (2)(B) of subsection (f), ... in a shopping center ...

...in lease, and in the case of an assignment, that the financial condition and operating performance of the proposed assignee and its guarantors, if any, shall be similar to the financial condition and operating performance of the debtor and its guarantors, if any, at of the time the debtor became the lessee under the lease:

(B) that any percentage rent due under such lease will not decline substantially;

(C) that assumption or assignment of such lease is subject to all the provisions thereof, including (but not limited to) provisions such as a radius, location, use, or exclusivity provision, and will not breach any such provision contained in any other lease, financing agreement, or master agreement relating to such shopping center; and

(D) that assumption or assignment of such lease will not disrupt any tenant mix or balance in such shopping center.

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SECTION 365(b)(3): CASE LAW ANALYSIS & DEVELOPMENT

In re Toy's "R" Us (Bankr. E.D. Va. 2019)

- **Background:** LL objected to proposed assignment to Burlington Coat Factory on the grounds that the assignment would breach LL's exclusive granted to Ross.
 - **Ruling:** Objection overruled.
 - Ross's exclusive did not come into existence until after the debtors' lease was in effect
 - LL not in breach of the Ross lease because the assignment order precludes LL's ability to protect Ross's exclusive
 - **Analysis:**
 - The court "rewrote" section 365(b)(C) to impose a "look back" to the time that the debtor's lease was executed.
 - The court overstepped by interpreting availability of remedies under the Ross lease
- 18 — not property of the estate and leads to jurisdiction issues.

In re BBY (Bankr. D.N.J. 2023)

- **Background:** LL objected to proposed assignment to Michaels because Hobby Lobby had exclusive right to operate as a crafts retailer and disruption of tenant mix/balance.
- **Ruling:** Objection overruled.
 - Like Toy's, debtors' lease predated Hobby Lobby's exclusive.
 - Plain language of section 365(b)(3)(C) is conflicts with Congress's intentions to maximize estate assets for the benefit of creditors.
- **Analysis:**
 - Like Toy's, the court imposed a non-existent "look back" requirement to 365(b)(3)(c).
 - The court overstepped by interpreting remedies available under the Hobby Lobby lease — not property of the estate and could lead to jurisdiction issues.
 - Issue ultimately moot as auction was reopened and Hobby Lobby declared winner.

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In re Party City (Bankr. S.D. Tex. 2024)

- **Background:** LL objected to proposed assignment to Dollar Tree on the grounds that Dollar Tree would not comply with use restriction limited to the retail of "party supplies . . . and goods commonly sold at a Party City store."
- **Ruling:** Objection sustained.
 - Use restriction is enforceable under the plain language of 365(b)(3)(c)
 - Use restriction is also enforceable under state law, and performance not "impossible" because other party supply stores could have complied with the use restriction.
- **Analysis:**
 - Correctly notes that section 365(b)(3)(C) applies regardless of marketability of the lease
 - LL entitled to deference on its judgment of tenant mix/balance when enforcing use restrictions

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Faculty

Harold J. Bordwin is a principal and co-president of Keen-Summit Capital Partners LLC in New York, where he is responsible for all aspects of business development and execution at the firm. He focuses on developing and implementing strategic real estate and corporate finance plans for his clients, which involves real estate analysis, real estate acquisitions and dispositions, lease modifications and terminations, and corporate finance and capital market services. In addition, Mr. Bordwin is a receiver and provides fiduciary services to his clients. A real estate broker, he has more than 33 years of real estate advisory and transactional experience, with particular expertise in workouts and restructurings and other special situations. Mr. Bordwin has represented financial, corporate and retail clients. As a recognized expert on real estate restructuring issues, he has testified before the Judiciary Committee of the U.S. House of Representatives. He also has been interviewed and quoted in numerous articles for *The Wall Street Journal*, *The New York Times*, *USA Today* and various trade publications. Mr. Bordwin previously was a principal with KPMG LLP and CEO of Keen Consultants. He is a member of ABI, the American and California State Bar Associations, the International Council of Shopping Centers and the Turnaround Management Association, and he holds Series 7, 24, 63 and 79 licenses. Mr. Bordwin received the 2023 Commercial Real Estate Visionary award from the *NY Real Estate Journal* the 2021 ABI Asset Sale of the Year award for his work in the *Lighthouse* case, and the 2021 ALIS – Single Asset Transaction of the Year over \$25M award and Turnaround Atlas Awards for Hospitality & Real Estate Restructuring of the Year for his work on the *L’Ermitage* case. He received his undergraduate degree in government from Wesleyan University in 1982 and his J.D. from Georgetown University Law Center in 1985, where he was a staff member of *Law & Policy in International Business* and published articles in the *Ecology Law Quarterly* of the University of California at Berkeley Boalt Hall School of Law.

Robert Klyman is a partner and global co-chair and U.S. co-chair of DLA Piper’s Restructuring Practice in Los Angeles. In his international practice, he represents companies, lenders, other creditors, acquirers, and boards of directors in all phases of restructurings and workouts. Mr. Klyman’s practice includes advising companies and key stakeholders in complicated workouts, including traditional, pre-packaged and prenegotiated bankruptcies, structuring cutting-edge distressed mergers and acquisitions, negotiating bankruptcy financings, and litigating complex bankruptcy and commercial matters related to financial distress. Much of his practice also involves representing companies and other stakeholders in complicated out-of court workouts that avoid bankruptcy. Mr. Klyman developed, and for 20 years co-taught, a case study for the Harvard Business School on prepackaged bankruptcies and bankruptcy valuation issues. He has also taught bankruptcy dealmaking and strategy classes at the University of Michigan Business School, Massachusetts Institute of Technology’s Sloan School of Management, and UCLA Law School. Mr. Klyman is a frequent panelist on topics relating to financial distress and bankruptcy. He also was a member of the ABA Subcommittee that drafted the ABA Model Bankruptcy Asset Purchase Agreement. Mr. Klyman has been listed in *The Best Lawyers in America*, *Chambers USA*, *The Legal 500 United States* and as one of *Lawdragon’s* 500 Leading U.S. Bankruptcy and Restructuring Lawyers for 2024, and he was named one of the world’s leading Insolvency and Restructuring Lawyers by *Euromoney* in 2020. He received his B.A. from the University of Michigan and his J.D. from the University of Michigan Law School.

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