

A SIMPLE SOLUTION FOR STUB RENT?
HOW PROPOSED CHANGES TO THE TREATMENT OF STUB RENT
COULD LEAD TO UNFORESEEN CONSEQUENCES

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Abstract

The U.S. Bankruptcy Code includes various sections that protect commercial landlords when their tenants file for Chapter 11 bankruptcy relief. Section 365(d)(3) requires tenants to make post-petition rent payments until their lease is assumed, rejected, or assigned, and provides landlords protection by prioritizing rent payments as administrative priority expenses. Pursuant to Section 502(b), commercial landlords may also pursue unpaid pre-petition rent as a general unsecured claim.

Despite Chapter 11's various protections for landlords, uncertainty remains over the proper treatment of "stub rent." Stub rent is rent owed to a landlord for the tenant-debtor's use and occupancy of the property between the filing of the bankruptcy petition and the date the first post-petition rent payment becomes due pursuant to Section 365(d)(3). Circuits are split on this issue of how to treat stub rent. Some courts have adopted the "accrual" approach and hold that stub rent payments should be treated similar to other post-petition rent, and paid under Section 365(d)(3) on a pro rata basis. Others have adopted a "billing-date" approach, treating stub rent as an unsecured claim under Section 502(b), because the obligation to pay rent arose before the tenant filed for relief.

Inconsistent treatment of stub rent under Section 365(d)(3) has facilitated manipulative filing practices among certain tenant-debtors seeking to limit stub rent payment. This has resulted in non-uniform treatment of landlord-creditors. To remedy the stub rent issue, the American Bankruptcy Institute recently proposed that Congress

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adopt the accrual method. However, the accrual approach may have unforeseen consequences that could hinder debtor liquidity and undermine the tenant's ability to file for relief. This note suggests that the accrual approach may not necessarily provide a simple solution to the stub rent issue.

Table of Contents

<i>I. Introduction</i>	917
<i>II. Background</i>	920
A. The Evolution of the Treatment of Commercial Leases in Reorganization Cases	920
B. Remaining Ambiguity: Landlord's Role and Tenant's Obligation in Chapter 11	924
<i>III. Stub Rent Overview</i>	928
A. What is "Stub Rent"?	928
B. When is Stub Rent Actually a Problem?	935
<i>IV. Courts Weigh In: Circuit Split and Stub Rent Treatment</i>	936
A. Accrual Approach	937
B. Billing Date Approach	940
C. Section 503 Administrative Expenses	942
<i>V. Implications of Each Stub Rent Solution on Landlords and Tenants</i>	944
A. Forum Shopping and Manipulative Filing Practices	946
B. Varying Approaches to Stub Rent Encourages Non-Uniform Treatment of Landlord-Creditors	952
C. Non-Uniform Treatment of Landlords Leads to Non-Uniform Treatment of Other Creditors	957
D. Varying Treatment of the Stub Period Impacts Other Areas of Bankruptcy Practice	959
<i>VI. Stub Rent Solutions</i>	960
A. The Merits of the Accrual Approach	960
B. The Merits of the Billing Date Approach	962
C. The ABI Weighs In	965
<i>VII. Stub Rent in a Post-ABI Commission World</i>	968
A. Implications and Unforeseen Consequences	968
B. Lesser-Known Alternatives: Better Balancing the Interests of All Parties?	970
<i>VIII. Conclusion</i>	973

I. Introduction

When a debtor in possession (DIP) of a commercial property under an unexpired lease files for Chapter 11 bankruptcy, the debtor's commercial landlord immediately faces a variety of financial risks.¹ Because successful reorganization and confirmation of a plan often hinges on the trustee or DIP's ability to assume, reject, and assign executory contracts, including the tenant-debtor's unexpired lease, evicting the tenant-debtor and putting the property back on the market is usually not an option.² Moreover, the commercial landlord may not know if or when it will receive unpaid rent, despite the tenant-debtor's continued use and occupancy of the property.³ As a result, when a DIP files for bankruptcy, a commercial landlord is faced with the risks and uncertainties of what happens to unpaid pre-petition rent under the unexpired lease, what will happen to the commercial property during the bankruptcy, and how the DIP and landlord's obligations will change post-petition.⁴

Chapter 11 of the U.S. Bankruptcy Code (Code) attempts to mitigate financial risk and uncertainty for commercial landlords by providing them with a number of procedural and substantive

¹ See David R. Kuney, *Protecting the Landlord's Rent Claim in Bankruptcy: Letters of Credit and Other Issues*, 29 PRAC. REAL EST. LAW. 17, 17–18 (2013) (“The financial risk to a landlord [typically] involves two discrete time periods . . . the landlord's ability to collect rent and enforce the lease prior to a debtor's decision to ‘assume’ or ‘reject’ the lease . . . [and the] risk of significant monetary loss in a bankruptcy which arises from the [debtor's] rejection of the lease.”).

² 9 CHAPTER 11 REORGANIZATIONS § 13 (2d ed. 2015); see 11 U.S.C. § 362 (2012) (codifying the rights of debtors under the automatic stay); § 362(a)(3) (providing protection against “any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate”). *But see* § 362(b)(10) (noting that in the case of a “non-residential” lease, the stay does not apply where the lease has been “terminated by the expiration of [its] stated term[s],” either before or during the bankruptcy case).

³ See Dylan G. Trache, *Commercial Leases in Bankruptcy*, LEXOLOGY (Feb. 17, 2012), <http://www.lexology.com/library/detail.aspx?g=cc1b5c7d-cd4f-43d3-b06c-31626b9cc155> [<https://perma.cc/734S-XPWY>].

⁴ See J. McBride, *What Happens When a Commercial Tenant Files Bankruptcy*, PROPERTYMETRICS (June 22, 2015), <http://www.propertymetrics.com/blog/2015/06/22/what-happens-when-a-commercial-tenant-files-bankruptcy/> [<https://perma.cc/P58Q-R4JD>].

protections.⁵ These protections include claims for unpaid pre-petition rents and other tenant fees,⁶ post-petition administrative claims for continued use and occupancy of the premises,⁷ and claims for damages and other charges after post-petition rejection.⁸ Thus, while the automatic stay under Section 362 of the Code bars other unsecured creditors from enforcing their pre-petition contract rights, commercial landlords have several alternative means of enforcing their lease agreements, often even as an administrative claim against the estate.⁹

However, one issue that the Code fails to address clearly, but which frequently affects commercial landlords, is whether a debtor must timely pay rent for the “stub” period under Section 365(d)(3).¹⁰ “Stub rent” is generally defined as “the amount due to a [commercial] landlord for the period of use and occupancy between the petition date and the first postpetition rent payment date.”¹¹ While some courts hold

⁵ See generally § 365.

⁶ § 502(b)(6); see LAURENCE D. CHERKIS & MICHAEL L. TEMIN, COLLIER REAL ESTATE TRANSACTIONS AND THE BANKRUPTCY CODE, ¶ 3.01 (LexisNexis Matthew Bender 2015) [hereinafter Collier on Real Estate Transactions]; Nicholas Rigano et al., *My commercial tenant filed for bankruptcy! Now what? The rights and obligations of landlords*, N.Y. REAL EST. J. (July 14, 2015), <http://nyrej.com/84100> [<https://perma.cc/M6W2-8K7U>] (“[T]he landlord can file a proof of claim against the debtor for: (i) all amounts owed to the landlord that arose prior to the filing date, and (ii) future rent under the lease for the greater of (a) one year or (b) 15 percent, not to exceed three years, of the remaining lease term.”).

⁷ See generally § 365(d) (2012); § 503(b)(1)(A).

⁸ §§ 365(g), (g)(2); § 502(b)(6); see also Thomas S. Onder, *Landlord Issues, Opportunities In The Wave Of Retail Chapter 11 Filings*, GLOBEST (June 3, 2016), <http://www.globest.com/sites/paulbubny/2016/06/03/landlord-issues-opportunities-in-the-wave-of-retail-chapter-11-filings/?slreturn=20160509131636> [<https://perma.cc/8M54-E2FX>].

⁹ David R. Kuney, *The Debtor's Obligations to the Landlord Prior to Assumption or Rejection of the Lease*, in AM. BANKR. INST., BANKRUPTCY ISSUES FOR COMMERCIAL LANDLORDS, TENANTS AND MORTGAGES 11 (2006).

¹⁰ Brian W. Hockett, *Payment Of “Stub Rent” In Commercial Tenant Bankruptcy Cases*, A.B.A. REAL PROPERTY, TRUST & ESTATE SECTION REPORT, Oct. 2010, http://www.americanbar.org/content/dam/aba/publishing/rpte_ereport/2010/5/rp_hockett.authcheckdam.pdf [<https://perma.cc/8W-MV-8WYB>].

¹¹ Victoria Vron, *Stub Rent Debate Continues: Another Jurisdiction Adopts the Billing Date Approach*, WEIL BANKR. BLOG (Mar. 24, 2014), <http://business-finance-restructuring.weil.com/claims/stub-rent-debate-continues-an->

that “the date a rental payment is due determines whether [stub rent] constitutes a prepetition or a postpetition obligation,” other courts hold that “a debtor is obligated to make pro rata rental payments for any postpetition period in which it utilizes a leased space, regardless of when the monthly payment was due.”¹² When the tenant’s rent is due, the date that the tenant files its Chapter 11 petition and how the court has interpreted Section 365(d)(3) thus define the treatment of stub rent claims, and ultimately whether a landlord will receive payment for use and occupancy during the stub period.

While non-uniform treatment of stub rent is problematic, varying interpretations of Section 365(d)(3) become particularly troublesome for both commercial landlords with high-value real estate and retail landlords with various properties linked to one tenant. For these landlords, rent for use and occupancy for only a portion of the month can often equate to hundreds of thousands or even millions of dollars in rent.¹³ In these circumstances, non-uniform application of Section 365(d)(3) facilitates tenant-debtor forum shopping, which can result in dramatically different stub rent payouts for landlords.¹⁴

This note explores the origins of the stub rent issue, the resulting circuit split, and the significance of different approaches for commercial landlord-creditors and tenant-debtors. Given the significance of stub rent for commercial landlords, this note calls for greater evaluation of the treatment of stub rent claims in light of a number of likely changes to Chapter 11 on the horizon.¹⁵ Following this Introduction, Part II of this note provides a background on the evolution of the landlord-tenant relationship during bankruptcy, and outlines how the existing Chapter 11 schema attempts to balance creditor and debtor interests in the context of commercial leases. Part

other-jurisdiction-adopts-the-billing-date-approach/ [<https://perma.cc/P85Y-SLE2>].

¹² Joel H. Levitin & Richard A. Stieglitz Jr., *The Ticket to Solving the Stub Rent Dilemma*, 28 AM. BANKR. INST. J. 1 (2009).

¹³ See, e.g., *In re Circuit City Stores, Inc.*, 447 B.R. 475 (Bankr. E.D. Va. 2009).

¹⁴ See generally Aaron H. Stulman, *Stub Rent Under Section 365(d)(3): A Call for A Unified Approach*, 36 DEL. J. CORP. L. 655 (2011) (comparing two methods for calculating obligation... one that “creates a windfall” and one that is more “equitable and consistent”).

¹⁵ See generally AM. BANKR. INST., AMERICAN BANKRUPTCY INSTITUTE COMMISSION TO STUDY REFORM OF CHAPTER 11, FINAL REPORT AND RECOMMENDATIONS (2014) [hereinafter ABI COMMISSION REPORT].

III of this note examines the stub rent issue and discusses the unique scenarios in which stub rent can significantly impact the reorganization process. Part IV of this note explores the current circuit split and various approaches to stub rent problems, while Part V details the impact of each stub rent approach on various actors and aspects of the bankruptcy process. Part VI discusses the rationale for two approaches to the stub rent issue and American Bankruptcy Institute's (ABI's) proposed solution. Finally, Part VII of this note offers observations on the sufficiency of the ABI's proposed approach along with a few other considerations in solving the stub rent issue.

II. Background

A. The Evolution of the Treatment of Commercial Leases in Reorganization Cases

Modern bankruptcy legislation began with the Bankruptcy Act of 1938 (1938 Act)¹⁶ that amended the Bankruptcy Reform Act of 1898 (1898 Act),¹⁷ which is the Code's predecessor.¹⁸ The 1938 Act "substantially revised virtually all of the provisions of the 1898 Act,"¹⁹ and codified much of the predominant case law surrounding a trustee's ability to assume or reject unexpired leases, including commercial leases.²⁰ Notably, Section 70(b) of the 1938 Act afforded commercial

¹⁶ Act of June 22, 1938, ch. 575, 52 Stat. 840, *repealed by* Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549.

¹⁷ Bankruptcy Act of 1898, Pub. L. No. 696, 30 Stat. 544 (repealed 1978).

¹⁸ David B. Simpson, *Leases and the Bankruptcy Code: Tempering the Rigors of Strict Performance*, 38 BUS. LAW. 61, 66-67 (1982) ("Prior to the enactment of the Bankruptcy Code, the predecessor statute . . . expressly recognized the contractually established right of a landlord."). *See generally* Charles J. Tabb, *The History of the Bankruptcy Laws in the United States*, 3 AM. BANKR. INST. L. REV. 5 (1995).

¹⁹ Tabb, *supra* note 18, at 29. For a comprehensive overview of the Bankruptcy Act of 1938, see generally Carl Wilde, *The Chandler Act*, 14 IND. L.J. 2 (1938).

²⁰ Act of June 22, 1938, ch. 575, § 70(b), 52 Stat. 840, 880, *repealed by* Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 ("Within sixty days after adjudication, the trustee shall assume or reject an executory contract, including unexpired leases of real property: *Provided, however*, That the court may for cause shown extend or reduce such period of time. Any such contract or lease not assumed or rejected within such time, whether or not a trustee has been appointed, or has qualified, shall be deemed to be

landlords special protections if their tenants filed for bankruptcy relief.²¹ In relevant part, Section 70(b) stated:

A general covenant or condition in a lease that it shall not be assigned shall not be construed to prevent the trustee from assuming the same at his election and subsequently assigning the same; but *an express covenant that an assignment by operation of law or the bankruptcy of a specified party thereto or of either party shall terminate the lease or give the other party an election to terminate the same shall be enforceable.*²²

Under this framework, anti-assignment clauses were unenforceable.²³ However, in contrast with current law, bankruptcy default clauses or *ipso facto*²⁴ termination clauses, were permissible.²⁵ Under the 1938 Act, a commercial landlord could simply insert a provision into the lease that stated the landlord's right to terminate the contract and repossess the property in the event the tenant filed for bankruptcy. As a result, Section 70(b) provided a mechanism

rejected.”); Julia S. Jansen, *Executory Contracts with Financial Accommodations: A Plea for Bifurcation Under 11 U.S.C. § 365*, 71 WASH. U.L.Q. 807, 811–12, 812 n.32 (1993) (“Early case law tied a trustee’s right to reject an executory contract with his ability to abandon burdensome property of the estate. A trustee could opt to assume or reject an executory contract depending on its potential profit to the estate.”).

²¹ Wilde, *supra* note 19, at 125–30.

²² Act of June 22, 1938, ch. 575, § 70(b), 52 Stat. 840, 880, *repealed by Bankruptcy Reform Act of 1978*, Pub. L. No. 95-598, 92 Stat. 2549 (emphasis added).

²³ *Id.*

²⁴ As used here, *ipso facto* means a provision within a lease “that effects, or gives an option to effect, a forfeiture, modification, or termination of a debtor’s interest in a contract or lease because of the commencement of a [bankruptcy] case.” Richard F. Broude, *Executory Contracts and Unexpired Leases in Bankruptcy*, SR047 A.L.I.-A.B.A. 609, 613 (2010) (internal quotations omitted). [edies, including eviction.”].iliated iwth ion LLC, et al.,rchase and Saleother human waste. at stems from the environmental

²⁵ *Id.*; see also JOHN R. KNAPP JR. & JOHN A. GOSE, AM. COLL. OF REAL ESTATE LAWYERS, THE DEVELOPMENT OF SECTION 365 3 (2001), <https://c.ymcdn.com/sites/acrel.site-ym.com/resource/collection/33D33641-7114-4481-A099-3220169F5C8A/a002191.pdf> [<https://perma.cc/5XH2-ZQ8P>].

for landlords to quickly recapture their property from a tenant who sought bankruptcy relief by asserting that the lease was terminated by reason of the commencement of the bankruptcy case. In this manner, landlords protected their commercial property from inclusion in a reorganization proceeding.²⁶

The balance of power between tenants and landlords shifted dramatically with the enactment of the Code. In the Bankruptcy Reform Act of 1978 (Reform Act), Congress removed Section 70(b) and replaced it with Section 365, entitled “Executory contracts and unexpired leases.”²⁷ Similar to Section 70(b), Section 365 attempted to codify the means of assuming and rejecting executory contracts and unexpired leases.²⁸ Anti-assignment clauses remained largely unenforceable,²⁹ and Congress recognized problems with allowing

²⁶ Collier on Real Estate Transactions, *supra* note 6. However, courts generally did recognize that strict application of Section 70(b) was required, and carved out a number of exceptions. *See, e.g.,* Queens Boulevard Wine & Liquor Corp. v. Blum, 503 F.2d 202, 204 (2d Cir. 1974) (“Courts traditionally have not favored lease forfeitures . . . [and] have created two exceptions to mitigate the harsh consequences of what otherwise would be the absolute mandate of Section 70(b).”).

²⁷ Act of June 22, 1938, ch. 575, § 70(b), 52 Stat. 840, 880, *repealed by* Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (emphasis added). *See generally* KNAPP & GOSE, *supra* note 25.

²⁸ S. REP. NO. 95-989, at 5 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5791.

²⁹ *See* 11 U.S.C. § 365(f)(1) (2012) (“[N]otwithstanding a provision in an executory contract or unexpired lease of the debtor, or in applicable law, that prohibits, restricts, or conditions the assignment of such contract or lease, the trustee may assign such contract or lease . . .”). *But see* § 365(c) (“The trustee may not assume or assign any executory contract or unexpired lease of the debtor, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties, if (1) (A) applicable law excuses a party, other than the debtor, to such contract or lease from accepting performance from or rendering performance to an entity other than the debtor . . . and (B) such party does not consent to . . . assumption or assignment; or (2) such contract is a contract to make a loan, or extend other debt financing or financial accommodations, to or for the benefit of the debtor . . . or (3) such lease is of nonresidential real property and has been terminated under applicable nonbankruptcy law prior to the order for relief.”).

landlords to opt-out of the bankruptcy process through the use of *ipso facto* clauses³⁰ and generally invalidated their use in Section 365(e).³¹

The removal of Section 70(b) and addition of Section 365 tipped the scales back in favor of tenant-debtors.³² The prohibition against *ipso facto* clauses in Section 365(e), coupled with the inclusion of the automatic stay,³³ “significantly curtailed” the commercial landlord’s ability to regain control of the property.³⁴ Under this regime, one of the only means of collecting post-filing rent was through filing an administrative expense claim under Section 503(b)(1).³⁵ This mechanism not only put the burden on commercial landlords to show that continued use and occupancy of the property was an “actual and necessary expense for the benefit of the estate,” but also provided no guarantee of repayment.³⁶

³⁰ S. REP. NO. 95-989, at 59 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5791 (“These clauses, protected under present law, automatically terminate the contract or lease, or permit the other contracting party to terminate the contract or lease, in the event of bankruptcy. This frequently hampers rehabilitation efforts. If the trustee may assume or assign the contract under the limitations imposed by the remainder of the section, the contract or lease may be utilized to assist in the debtor’s rehabilitation or liquidation.”).

³¹ § 365(e). *But see* § 365(e)(2)(A).

³² *See, e.g.,* Pamela Smith Holleman & Magdalena Ellis, *Reexamining the Protections Afforded to Solvent Shopping Center Tenants Under § 365 in Light of In re Trak Auto Corp. Part II*, 24 AM. BANKR. INST. J. 12, 51–53 (2005). *But see* Tabb, *supra* note 18, at 36–37 (“The treatment of individual debtors otherwise represented a fairly even balance between the interests of the credit industry and debtors (although creditors might take issue with that assertion!).”).

³³ *See* § 362(a)(3) (stating the automatic stay bars “any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate”). [edies, including eviction.”]. filiated iwth ion LLC, et al.,rchase and Saleoother human waste. at stems from the environmental

³⁴ Victoria Kothari, *11 U.S.C. § 365(d)(3): A Conceptual Status Argument for Proration*, 13 AM. BANKR. INST. L. REV. 297, 299 (2005).

³⁵ § 503(b)(1); Albert D. Lichy, *11 U.S.C. § 365(d)(3)’s Creation of the Dueling “Billing Date” and “Proration” Approaches and A Simple Fix*, 40 REAL EST. L.J. 285, 288 (2011) (“The only recourse for the commercial landlord for unpaid services provided during the post-petition period was filing an administrative claim with the bankruptcy court.”).

³⁶ Lichy, *supra* note 35, at 288–89; *see also* § 503(b)(1)(A).

Following the enactment of the Code in 1978, Congress sought to better balance the interests of tenant-debtors and landlord-creditors.³⁷ One of the biggest efforts at reform came with the Leasehold Management Amendments, which were part of the Bankruptcy Amendments and Federal Judgeship Act of 1984 (1984 Amendments).³⁸ As part of the 1984 Amendments, Congress amended Sections 365(d)(1) and 365(d)(2), and added Sections 365(d)(3) and 365(d)(4) under the Leasehold Management Amendments.³⁹ These amendments attempted to “reduce the period that certain leaseholds would remain vacant . . . [and] lessen the uncertainty that landlords experience while the trustee decides whether to assume a lease.”⁴⁰ Congress anticipated that the 1984 Amendments would encourage “commercial landlords timely receipt of post-petition rent from debtors in Chapter 11 proceedings.”⁴¹

B. Remaining Ambiguity: Landlord’s Role and Tenant’s Obligation in Chapter 11

While the 1984 Amendments attempted to resolve tenant timing and performance issues,⁴² the revisions caused confusion among

³⁷ See, e.g., S. REP. NO. 98-65, at 36–38, *reprinted in* 1984 U.S.C.C.A.N. 576, 599. See generally Collier on Real Estate Transactions, *supra* note 6 (explaining that since enacting the 1978 Code, Congress has acted in response to, what it has perceived as “inappropriate burdens and risks to landlords and enhanced powers of the trustee or debtor in possession under the Code as originally enacted in 1978”); KNAPP & GOSE, *supra* note 25, at 4; Allyson R. Abel, Comment, *Whether to Assume or Reject a Lease—The Section 365 Dilemma*, 7 BANK. DEV. J. 125 (1990).

³⁸ PUB. L. NO. 98-353, 98 Stat. 333 (1984) (codified as amended in scattered sections of 5 U.S.C., 11 U.S.C. and 28 U.S.C.).

³⁹ *Id.*

⁴⁰ See generally Abel, *supra* note 37, at 125.

⁴¹ *In re Stone Barn Manhattan LLC*, 398 B.R. 359, 360 (Bankr. S.D.N.Y. 2008); see 130 CONG. REC. S8887, S8894–95 (daily ed. June 29, 1984) (statement of Sen. Hatch) (“In this situation, the landlord is forced to provide current services—the use of its property, utilities, security, and other services—without current payment . . . the bill would lessen these problems . . .”).

⁴² For an extensive discussion of the Code’s changes under the 1984 Amendments, see generally Michael A. Bloom & Bryna L. Singer, *The Revised Section 365: Lessor’s Panacea?*, 63 AM. BANKR. L.J. 199, 200 (1989).

courts, debtors, and creditors.⁴³ Moreover, the revisions arguably did not rebalance the scales for landlords.⁴⁴

Congress attempted to resolve these ambiguities and better reconcile the interests of debtors and creditors⁴⁵ through a number of additional amendments, including small changes in 1986,⁴⁶ 1988,⁴⁷ 1990,⁴⁸ 1992,⁴⁹ and 1994.⁵⁰ Congress also made larger changes aimed at strengthening Section 365 for landlords under the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (2005 BAPCPA).⁵¹ These subsequent revisions produced the current version of Section 365(d)(3), which provides:

The trustee shall timely perform all the obligations of the debtor [i.e. the tenant], except those specified

⁴³ See, e.g., *Thistlethwaite v. First Nat'l Bank of Lafayette (In re Exclusive Indus. Corp.)*, 751 F.2d 806, 807–08 n.1 (5th Cir. 1985); Timothy A. Davis, *Defining the Close Nexus: An Analysis of a Bankruptcy Court's Chapter 11 Postconfirmation Jurisdiction*, 28 EMORY BANKR. DEV. J. 419 (2012) (“The 1984 Amendments, which changed the 1978 Code’s jurisdictional scheme . . . have created confusion among the district and circuit courts as to the constitutionally permissible reach of bankruptcy jurisdiction”). For a detailed discussion of some of the problems courts encountered specifically regarding the initial implementation and interpretation of Section 365, see Jansen, *supra* note 20, at 829 (discussing how the “law on executory contracts and section 365 [following the 1984 Amendments] is riddled with uncertainty. This confused state of affairs benefits neither the debtor nor the creditor.”); Abel, *supra* note 37, at 657.

⁴⁴ See, e.g., *Burival v. Creditor Committee (In re Burival)*, 406 B.R. 548, 553 (B.A.P. 8th Cir. 2008). See generally Lichy, *supra* note 35, at 290.

⁴⁵ Levitin & Stieglitz, *supra* note 12.

⁴⁶ Bankruptcy Judges, U.S. Trustees, & Family Farmer Bankruptcy Act of 1986, PUB. L. NO. 99-554, 100 Stat. 3088, *reprinted in part* at 28 U.S.C. § 581 (2012).

⁴⁷ 11 U.S.C. § 365(n) (2012).

⁴⁸ § 365(o).

⁴⁹ §§ 365(c)(4), (d)(5)–(9), (f)(1) (regulating airport leases).

⁵⁰ §§ 365(b)(2)(D), (d)(10) (addressing curing and timing of assumption or rejection).

⁵¹ Collier on Real Estate Transactions, *supra* note 6; Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, 108 Stat. 4106 *reprinted in* 1994 U.S.C.C.A.N. 4106; Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (codified as amended in scattered sections of 11 U.S.C.).

in section 365(b)(2), arising from and after the order for relief under any unexpired lease of nonresidential real property, until such lease is assumed or rejected, notwithstanding section 503(b)(1) of this title⁵²

As amended, Section 365(d)(3) no longer requires commercial landlords to demonstrate the lease constitutes an “actual, necessary cost[] and expense[] of preserving the estate” under Section 503(b)(1).⁵³ Instead, Section 365(d)(3) imposes an “affirmative requirement on the Chapter 11 debtor,” requiring “timely payment of the postpetition obligations,” regardless of whether the tenant uses the premises, until the tenant ultimately makes a determination as to whether it will assume or reject the lease.⁵⁴

A tenant’s failure to fulfill its duties under Section 365 provides a landlord a number of means of recourse, including: (1) seeking relief from the automatic stay to evict a tenant-debtor and retake possession of the leased premises; (2) opposing the debtor’s efforts to extend the tenant’s period in which to assume or reject a lease; and (3) most, significantly, requesting “an administrative claim in the bankruptcy case for any unpaid post-petition obligations.”⁵⁵ Section 365(d)(3) also eliminates the court’s discretion to establish market rent for use and occupancy of the property, and instead fixes the amount payable for use and occupancy at the rate provided in the lease.⁵⁶

⁵² § 365(d)(3).

⁵³ § 503(b)(1)(a). *See generally* § 503(b).

⁵⁴ Hockett, *supra* note 10, at 2.

⁵⁵ Thomas J. Nehilla & John M. Coles, *Commercial Leases and Bankruptcy: A Roadmap for Landlords*, RHOADS & SINON (Jan. 2004), <http://www.rhoadssinon.com/updates-publications-60.html> [<https://perma.cc/7W2Z-DHP5>] (“[A] debtor/tenant whose lease has been properly terminated pre-petition has no further rights in that lease. The mere fact that a debtor/tenant is in default under a lease, however, does not mean that the debtor/tenant has lost its rights to assume or reject the lease for purposes of Section 365.”); e.g., *In re Nat. Oil Co.*, 80 B.R. 525 (Bankr. D. Colo. 1987) (“[A] lessor is entitled to the rent reserved in the lease as a postpetition administrative expense until the lease has been rejected under Section 365(d)(4) or with court approval.”); *In re Appliance Store, Inc.*, 148 B.R. 234 (Bankr. W.D. Pa. 1992) (holding that payment of rent owed is deferred until all other creditors are paid). *But see In re Ames Dept. Stores, Inc.*, 150 B.R. 107 (Bankr. S.D.N.Y. 1993) (holding prepetition obligation not heightened to an administrative claim merely because unpaid bill was due post petition).

⁵⁶ *In re Stone Barn Manhattan LLC*, 398 B.R. 359, 362 (Bankr. S.D.N.Y.

While the exact boundaries of Section 365(d)(3) remain in dispute,⁵⁷ this Section attempts to tip the balance back in favor of landlords in two ways. First, prior to Section 365(d)(3), landlords could be forced to provide ongoing services to tenants, including “the use of its property, utilities, security, and other services—without . . . payment.”⁵⁸ No other creditors were required to provide ongoing services with little guarantee of compensation.⁵⁹ Section 365(d)(3) seeks to remedy this problem by requiring timely payment of rent under the terms of the pre-petition contract.⁶⁰ Second, prior to Section 365(d)(3), a landlord often raised the rent for common area expenses shared among tenants to compensate for an insolvent tenant’s failure to pay rent.⁶¹ Section 365(d)(3) addresses the problem of delayed payment of rent by expressly providing landlords with standing to compel the trustee or DIP to make timely payments for post-petition obligations.⁶² Even though landlords still have the burden of moving for compensation,⁶³ Section 365(d)(3) relieves the landlord of the burden of waiting to receive payment for a debtor’s use and occupancy of its premises until assumption of the lease or confirmation of a plan.⁶⁴

2008) (citing *Ames Dept. Stores*, 306 B.R. at 68).

⁵⁷ See HON. WILLIAM L. NORTON JR. & WILLIAM L. NORTON III, 2 NORTON BANKRUPTCY LAW & PRACTICE ¶ 46:42 (3rd ed.) [hereinafter Norton on Bankruptcy] (discussing Section 365(d)(3) and various circuit splits under the provision, such as disagreement as to how rent is apportioned, how “courts are split with respect to the treatment of taxes . . . due during the interim period,” what constitutes an “obligation,” and the priority status of rent payments).

⁵⁸ H.R. REP. NO. 98-882 (1984), *reprinted in* 1984 U.S.C.C.A.N. 576, 598–99 (Conf. Rep.).

⁵⁹ *Id.*

⁶⁰ *Id.*

⁶¹ *Id.*

⁶² See *e.g.*, *In re Lansing Clarion Ltd. P’ship*, 132 B.R. 845 (Bankr. W.D. Mich. 1991).

⁶³ See *In re Pudgie’s Dev. of N.Y., Inc.*, 239 B.R. 688 (S.D.N.Y. 1999) (discussing landlord obligation after commencement of bankruptcy to pursue appropriate remedies requires, such as moving for relief from stay to evict the debtor, moving for an order compelling immediate payment, or moving for conversion).

⁶⁴ Lichy, *supra* note 35, at 291; see, *e.g.*, *In re Furr’s Supermarkets, Inc.*, 283 B.R. 60, 69 (B.A.P. 10th Cir. 2002) (“Section 365(d)(3) was enacted to require the debtor in possession or trustee to pay current rent obligations as they came due without being subject to the requirements of § 503(b).”).

With these changes, Section 365(d)(3) seeks to provide landlords with a means of more adequately ensuring payment, thereby reducing risk.

III. Stub Rent Overview

A. What is “Stub Rent”?

Even though Congress drafted Section 365(b)(3) to assist landlords, applying Section 365(b)(3) raises a number of challenges.⁶⁵ Particularly problematic is how to apply Section 365(b)(3) when a tenant files for bankruptcy mid-month, effectively “splitting the month in two” with the debtor-tenant and its assets subject to the jurisdiction of the bankruptcy court for only half of the month.⁶⁶ When a lease requires payment of rent at the beginning of the month⁶⁷ for use and occupancy for that month, and the tenant-debtor files in the middle

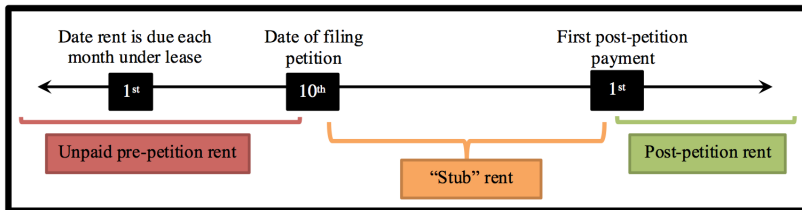
⁶⁵ See David A. Beck, *Sportsman’s Warehouse and the Latest from Delaware on Stub Rent*, 29 AM. BANKR. INST. 24 (2010) (“Courts have struggled both with how to determine when particular items under a lease ‘arise’ for purposes of § 365(d)(3) and how § 365(d)(3) interacts with § 503(b)’s general rule concerning administrative-expense status for postpetition claims that benefit the estate.”); Levitin & Stieglitz, *supra* note 12, at 1 (“Although courts generally agree on what § 365(d)(3) was designed to accomplish, they have not agreed on its application due to some ambiguities in the statutory language, giving rise to significant conflict among and within the circuits regarding the payment of stub rent and related obligations to landlords.”); Norton on Bankruptcy, *supra* note 57, at ¶ 46:42.

⁶⁶ Ira L. Herman, *Understanding Landlord’s Risks In Tenant Bankruptcy*, LAW360 (Apr. 13, 2015, 11:35 AM), <http://www.law360.com/articles/641057/understanding-landlord-s-risks-in-tenant-bankruptcy> [<https://perma.cc/42J5-7RCK>]; Written Statement of David L. Pollack, Partner, Ballard Spahr LLP: NYIC Field Hearing Before the ABI Comm’n to Study the Reform of Chapter 11, at 6 (June 4, 2013) [hereinafter Pollack Statement]; Hockett, *supra* note 10, at 2–4.

⁶⁷ Unless otherwise indicated, for the purposes of this note, stub rent will be analyzed under the presumption that the commercial lease requires payment on the first of the month for use and occupancy for that month. In reality, when rent is due as payment is often the by-product of negotiation. Nevertheless, stub rent issues can arise in a variety of alternative scenarios as long as “(1) there is a mid-monthly period filing; and (2) a lease calls for payment of rent in advance . . . and a bankruptcy filing takes place mid-month.” Herman, *supra* note 66.

of the month, the issue of how to treat stub rent appropriately under Section 365(b)(3) arises.⁶⁸

While undefined in Title 11 of the Code, “stub rent” generally refers to “the amount due to a landlord for the period of use and occupancy between the petition date and the first post-petition rent payment date.”⁶⁹ For example, consider the following scenario:



In Diagram 1, a commercial tenant with a typical month-to-month lease⁷⁰ failed to pay rent. In this case, the tenant’s rent, as dictated by the terms of the lease, was due on the first of the month. From the first through the tenth of the month, while the commercial tenant continues to use and occupy the property, the landlord may exercise its rights and attempt to cure the default by taking any number of legal actions.⁷¹ However, once a tenant files for Chapter 11 on the tenth of the month, the automatic stay under Section 362 applies, acting as an injunction that prohibits the landlord from repossessing the property or terminating the lease.⁷² Similar to other creditors, the

⁶⁸ Herman, *supra* note 66.

⁶⁹ David A. Samole, *Striking Balance Between Ch. 11 Retail Debtors, Landlords*, LAW360 (Apr. 2, 2015, 10:25 AM), <http://www.law360.com/articles/638558/striking-balance-between-ch-11-retail-debtors-landlords> [<https://perma.cc/QW2X-4KEQ>].

⁷⁰ E.g., Alan J. Taylor et al., *Understanding Landlord-Tenant Lease Agreements*, THE COMPONENTS OF A COMMERCIAL LEASE, Feb. 2016, at 12–13.

⁷¹ See 49 AM. JUR. 2D *Landlord and Tenant* § 792 (2017) (liens); § 845 (notice to quit and demand for possession); § 853 (damages); § 855 (attorney’s fees).

⁷² 11 U.S.C. § 362(a)(2) (2012) (preventing “the enforcement, against the debtor or against property of the estate, of a judgment obtained before the commencement of the case under this title”); § 362(a)(3) (providing for a stay against “any act to obtain possession of property of the estate or of property of the estate or to exercise control over property of the estate”); see also Jonathan D. Sherman, *Landlords’ Rights: Protecting Your Financial Interests When a Tenant Files for Bankruptcy*, MUCH SHELIST (Feb. 25, 2010), <https://www.muchshelist.com/knowledge-center/article/landlord-rights-when-a->

landlord may seek relief from stay to terminate the tenant's possession of the premises pursuant to Section 362(d).⁷³ Even if the bankruptcy court lifts the stay, however, the landlord will need to pursue state action and obtain an order of possession to evict the tenant and gain control of the premises.⁷⁴

Section 365 provides landlords with more direct recourse in the bankruptcy court.⁷⁵ Like other claims arising pre-petition, unpaid pre-petition rents are typically treated as an unsecured claim under Section 365(g).⁷⁶ However, Section 365(d)(3) permits landlords to seek payment of rent for *ongoing* use and occupancy of the premises.⁷⁷ Thus, when the tenant-debtor's rent becomes due on the first of the month *after* commencement of the bankruptcy, Section 365(d)

tenant-files-for-bankruptcy [<https://perma.cc/M66K-DBTK>]. However, there is an exception if the lease has been *terminated* prior to the lease, as termination extinguishes a debtor's leasehold rights, thus barring the lease from becoming "property of the estate." § 541(b)(2).

⁷³ See generally § 362(d) (providing three grounds for relief from stay, including "for cause, including the lack of adequate protection of an interest in [the] property . . ." and lack of debtor equity in the property "not necessary to an effective reorganization"); § 362(d)(22) (permitting, in some circumstances, "the continuation of any eviction, unlawful detainer action, or similar proceeding by a lessor against a debtor . . . which the lessor has obtained before the date of the filing of the bankruptcy petition, a judgment for possession of such property against the debtor").

⁷⁴ See generally Dawn Cica, *When Landlord-Tenant Law Meets Bankruptcy*, STERLING EDUC. SERV., Mar. 9, 2012, <https://www.lrrc.com/files/Uploads/Documents/When%20Landlord-Tenant%20Law%20Meets%20Bankruptcy,%20by%20Cica.pdf> [<https://perma.cc/9GVH-5CPH>].

⁷⁵ See generally § 365(d)(3).

⁷⁶ § 365(g). A "secured claim" is defined generally as "[a] claim held by a creditor who has a lien or a right of setoff against the debtor's property." *Claim*, BLACK'S LAW DICTIONARY (10th ed. 2014). An unsecured claim is defined as "[a] claim by a creditor who does not have a lien or a right of setoff against the debtor's property" or "[a] claim by a creditor to the extent that its lien on or right of setoff against the debtor's property is worth less than the amount of the debt." *Id.*; see also § 101(5) (defining the term "claim"); § 506(a) ("An allowed claim . . . is a secured claim to the extent of the value of interest in the estate's interest in such property . . . and is an unsecured claim to the extent that the value of interest is less than the amount of such allowed claim.").

⁷⁷ § 365(d)(3) (allowing the trustee to pay all debtor obligations "arising from and after the order for relief under any unexpired lease . . .").

(3) compels the tenant via court order, based upon the assets of the estate, to resume payments and timely pay rent to its landlord as an administrative priority expense.⁷⁸

Payments pursuant to Section 365(d)(3) for ongoing use and occupancy during the reorganization continue until the lease is “assumed or rejected.”⁷⁹ Pursuant to Section 365(d)(4)(A), a tenant-debtor is provided a period of “120 days after the date of the order of relief” to assume or reject an unexpired commercial lease,⁸⁰ but the court may extend this by an additional 90 days “for cause.”⁸¹

If the tenant subsequently decides to reject the unexpired lease, then the lease is considered breached as of the petition date.⁸² Upon rejection, Section 365(d)(3) ceases to apply, and claims resulting from rejection are allowed or disallowed “the same as if such claim had arisen before the filing of the [debtor’s bankruptcy] petition.”⁸³ The landlord retains its administrative priority claim pursuant to Section 365(d)(3) for post-petition, pre-rejection rent.⁸⁴ However, pre-petition

⁷⁸ “Administrative expenses . . . are based on goods or services that help in the administration of a bankruptcy estate during a bankruptcy case. . . . Holders of such claims are entitled to this priority of payments so long as the claim was for goods or services that benefitted the debtor’s estate.” Aaron L. Hammer & Michael A. Brandess, *Demystifying Administrative Expenses in Bankruptcy*, DAILYDAC (July 24, 2014), <https://www.dailydac.com/commercialbankruptcy/alternatives/articles/demystifying-administrative-expenses-in-bankruptcy> [<https://perma.cc/UT3T-XXLN>]; *In re Pettingill Enters.*, 486 B.R. 524, 532 (Bankr. D.N.M. 2013). See generally Collier on Real Estate Transactions, *supra* note 6.

⁷⁹ § 365(d)(3).

⁸⁰ § 365(d)(4)(A).

⁸¹ § 365(d)(4)(B)(i).

⁸² § 365(g); see also 3 COLLIER ON BANKRUPTCY ¶365.10 (Alan N. Resnick & Henry J. Sommer eds., 16th ed.) [hereinafter *Collier on Bankruptcy*] (“Thus, the effect of a rejection is that a breach is deemed to have occurred, which in the ordinary case will give rise to a claim for damages. Contract rejection damages then are measured as of the petition date, not as of the rejection date.”). [edies, including eviction.”]. affiliated iwth ion LLC, et al.,rchase and Saleother human waste. at stems from the environmental

⁸³ § 502(g). There is also currently a split among courts over the proper way to calculate a landlord’s rejection damage claim and the appropriate cap of these damages under Section 502(b)(6). See generally Bruce Buechler & Andrew Behlmann, *Calculating a Landlord’s Rejection Damage Claim under § 502(b)(6)*, 29 AM. BANKR. INST. J. 9 (2010).

⁸⁴ *Collier on Bankruptcy*, *supra* note 82, at ¶ 502.03 (“[Section 502(b)(6)]

rent and other damages claims arising from the tenant's breach must be pursued as unsecured claims, and are subject to statutory caps in Section 502(b)(6).⁸⁵ These unsecured claims are pooled with other unsecured claims of the estate, and upon confirmation the landlord would only collect a *pro rata* share of its claim against any remaining assets.⁸⁶ Depending on the number of other secured and unsecured creditors, often this provides unsecured creditors with mere "pennies on the dollar."⁸⁷

Alternatively, if the tenant ultimately decides to assume the lease,⁸⁸ Section 365(b) requires the debtor to cure, compensate, and provide adequate assurance of performance for any loss resulting from the initial default.⁸⁹ This generally requires the tenant to pay all pre- and post-petition rental arrearages that are due, compensate the

does not purport to limit administrative expense claims by the landlord based upon use of the premises after the filing of the petition.").

⁸⁵ § 502(b)(6); see John D. Ayer et al., *Bankruptcy Issues for Landlords and Tenants*, 23 AM. BANKR. INST. J. 8 (2004) ("The cap is the greater of (1) one year's rent or (2) the rent for 15 percent, not to exceed three years, of the remaining term of the lease.").

⁸⁶ See Rigano et al., *supra* note 6 (demonstrating that rent owed prior to filing dates are not paid out in full like rents owed after the filing date).

⁸⁷ *Id.* But see, e.g., *In re Roberds, Inc.*, 270 B.R. 702 (Bankr. S.D. Ohio 2001) (finding debtor liable for prorated rent under Section 503(b)(1)(A) for time after rejection of the lease that the tenant remained in possession).

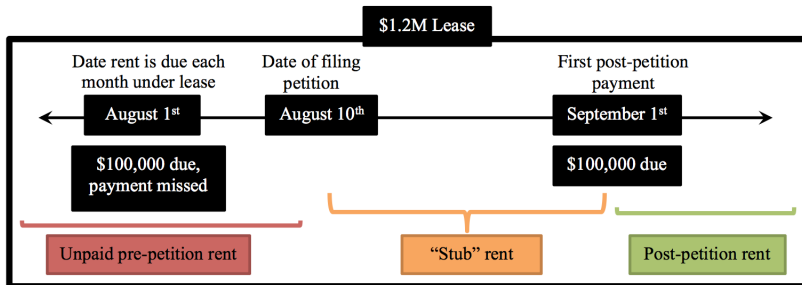
⁸⁸ Debtors have the option to assign their commercial lease to a third party after assumption to facilitate reorganization under Chapter 11. § 365(f) ("[N]otwithstanding a provision in an executory contract or unexpired lease of the debtor, or in applicable law, that prohibits, restricts, or conditions the assignment of such contract or lease, the trustee may assign such contract or lease . . ."). Primarily, assignment requires that all defaults be cured, and that the assignee offer adequate assurance of future performance. § 365(f)(2). Because the debtor's estate is usually relieved from liability after assignment, and the terms of a contract bind the assignee, any default by the assignee provides a remedy under applicable non-bankruptcy law. *E.g.*, *In re DH4, Inc.*, No. 5-32987-BKC-PGH, 2007 Bankr. LEXIS 3814 (Bankr. S.D. Fla. Nov. 2, 2007) (relieving debtor's estate of liability for assignee's post-assignment breach). Given the requirements of assignment, the analysis of stub rent issues in this note is largely focused on the distinction between tenant-debtors' obligations under lease assumption and rejection. See Collier on Bankruptcy, *supra* note 82, at ¶365.09 (discussing requirements for assumption of a contract or lease).

⁸⁹ § 365(b)(A)–(C).

landlord for “any actual pecuniary loss” resulting from the tenant’s breach, and provide the landlord with assurance of future performance of the lease by demonstrating that the tenant is current on its rent and has sufficient income to make future payments.⁹⁰

Despite this framework, questions emerge over the tenant’s obligation to pay back rent for the stub period for use and occupancy between the petition date and the first post-petition payment. Courts are divided on whether the tenant’s use and occupancy during the stub period should be classified as an administrative priority or if Section 365(d)(3) mandates only post-filing lease payments at the beginning of a new rent cycle be treated as a priority expense.⁹¹

Consider Diagram 2 below, an expansion on Diagram 1 with more concrete terms:



In Diagram 2, the tenant is operating under a one-year commercial lease, and monthly rent due is \$100,000. The tenant misses its August 1st payment of \$100,000 and files for bankruptcy on August 10th,⁹² preventing the landlord from subsequently repossessing

⁹⁰ *Id.*; Ayer, *supra* note 85; J. Henk Taylor, *Commercial Real Estate Leases in Bankruptcy*, ARIZ. BUILDINGS, Summer 2010, <https://www.lrrc.com/files/Uploads/Documents/Commercial%20Real%20Estate%20Leases%20in%20Bankruptcy.pdf> [<https://perma.cc/G73H-C5TM>] (asserting that usually it is a good thing for the landlord when a debtor assumes the lease because the landlord will be paid the arrears).

⁹¹ For a more detailed discussion of the various ways courts are split, see Norton on Bankruptcy, *supra* note 57, at ¶ 46:42 (“When rent comes due after the order for relief but includes a period extending before and after the order for relief, there is disagreement as to whether the rent must be apportioned into prepetition and postpetition periods.”). See generally § 502(b)(6).

⁹² Note that while a tenant could file for bankruptcy within ten days with the advice of counsel, the more likely scenario is that the tenant knew of their

the property.⁹³ After filing on August 10th, pursuant to Section 365(d)(3), the tenant (or trustee) must “timely perform all the obligations of the debtor . . . under any unexpired lease of nonresidential real property”⁹⁴ Thus on September 1st, the tenant must pay out of the estate as an administrative priority expense its \$100,000 rent payment for use and occupancy for the month of September.⁹⁵

Pursuant to Section 365(d)(3), \$100,000 rent payments for subsequent months will be paid to the tenant-debtor’s commercial landlord as an administrative priority expense “until [the] lease is assumed or rejected.”⁹⁶ Like other creditors, the landlord will also be able to assert a general unsecured claim for unpaid pre-petition rent and rejection damages.⁹⁷ If the tenant rejects its lease, the landlord will retain an administrative priority claim for September and any other post-petition months the tenant used and occupied the premises up to the date of rejection.⁹⁸ If the tenant eventually decides to assume the lease, the tenant will have to cure its \$100,000 default for August rent, compensate the landlord for any damages suffered by paying any fees associated with the default, and provide adequate assurance to the commercial landlord that the tenant will be able to continue to make rent payments into the future.⁹⁹

cash flow issues far earlier than the tenant’s August 1st payment, and filed for protection under the Section 362(a) Automatic Stay on August 10th after strategic planning with counsel.

⁹³ See § 362(a) (“[A] petition filed under section 301, 302, or 303 of this title, or an application filed under section 5(a)(3) of the Securities Investor Protection Act of 1970, operates as a stay, applicable to all entities . . .”).

⁹⁴ See § 365(d)(3).

⁹⁵ See *id.* (stating the trustee must perform all obligations of the debtors); Hammer & Brandess, *supra* note 78 (“Congress provided that holders of unsecured claims that arise from certain transactions that occur post-petition (that is, after the petition is filed that starts a bankruptcy case) should receive their distribution from the bankruptcy estate ahead of other general unsecured creditors.”).

⁹⁶ See § 365(d)(3) (“The trustee shall timely perform all the obligations of the debtor, except those specified in section 365(b)(2), arising from and after the order for relief under any unexpired lease of nonresidential real property, until such lease is assumed or rejected.”).

⁹⁷ See § 365(g); § 502(b)(6).

⁹⁸ Taylor et al., *supra* note 70, at 22.

⁹⁹ See § 365(b) (stating that the trustee may not assume the contract unless the trustee “cures, or provides adequate assurance that the trustee will promptly

Yet again, despite the framework above, it is unclear what happens to the claim for rent during the stub period from August 10th through September 1st, and whether this rent should be treated as a general unsecured claim, or an administrative priority expense.

B. When is Stub Rent Actually a Problem?

The issue of how to treat stub rent often arises “where a tenant occupies only a single location in a commercial office building,” or “in a large retail bankruptcy case in which the debtor has leased hundreds of retail stores.”¹⁰⁰ In either scenario, commercial tenants are often focused on ways to conserve liquidity leading up to and at the start of the bankruptcy.¹⁰¹ Liquidity is key for commercial tenants to successfully reorganize. Liquidity provides tenants with a means of paying “post-petition payments to vendors, common carriers, utility providers, employees and professionals,” and thus allows the tenant’s business to continue to operate.¹⁰² Because of the importance of liquidity, some commercial tenants, particularly retailers, refrain from making rent payments leading up to their filing date because payment may hinder their liquidity in reorganization and put them at strategic disadvantage.¹⁰³ As a result, landlords look to the Code for ways to recover unpaid rent, including stub rent.¹⁰⁴

While stub rent issues emerge in almost every bankruptcy involving a commercial lease, stub rent claims are rarely contested and inconsistently litigated.¹⁰⁵ The decision to litigate a stub rent issue largely relates to the size and nature of the contested claim.¹⁰⁶ For

cure, such default 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”).

¹⁰⁰ Kuney, *supra* note 1, at 17.

¹⁰¹ See Beck, *supra* note 65.

¹⁰² Am. Bank. Inst. Annual Spring Meeting, *SOS for Retail: Only the Strongest Survive*, 040109 ABI-CLE 411 (2009).

¹⁰³ Beck, *supra* note 65; Rigano et al., *supra* note 6 (“The debtor rarely files for bankruptcy on the day before rent is due.”).

¹⁰⁴ See § 365(d)(3).

¹⁰⁵ *Circuit Splits in Consumer and Business Bankruptcy*, A.B.A. (Jan. 27, 2015), http://www.americanbar.org/groups/young_lawyers/events_cle/circuit_splits_consumer_and_biz_bankruptcy.html [<https://perma.cc/MK8A-W7XG>].

¹⁰⁶ See *id.*

a commercial landlord without either a high-value or retail lease, pursuing a claim that represents only a portion of one month's rent is usually not worth the litigation costs.¹⁰⁷ But, in circumstances where unpaid rent far exceeds the cost of litigation, pursuit of stub rent claims becomes economically justifiable.¹⁰⁸

Stub rent becomes financially significant for both creditors and debtors in two key scenarios. First, stub rent tends to be financially significant for commercial landlords that lease multiple properties to the same entity that later seeks bankruptcy relief, such as regional or national retail chains.¹⁰⁹ Second, stub rent also proves significant for commercial landlords leasing high-value commercial real estate.¹¹⁰ In these scenarios, even though the court is only considering the value of a fraction of one month under the lease, millions of dollars could be at stake for the commercial landlord, tenant, and estate.¹¹¹ When the monetary significance of stub rent does matter, non-uniformity in the application of Section 365(d)(3) encourages a variety of practices the Code seeks to avoid, including “prepetition planning . . . forum shopping, and . . . higher litigation costs.”¹¹²

IV. Courts Weigh In: Circuit Split and Stub Rent Treatment

Ambiguity in Section 365(d)(3) has led to a number of circuit and district splits regarding the treatment of claims for stub rent.¹¹³

¹⁰⁷ *Id.*

¹⁰⁸ *See id.*

¹⁰⁹ *See e.g., In re Goody's Family Clothing Inc.*, 610 F.3d 812, 815 (3d Cir. 2010) (“[L]eases for nonresidential real property in various shopping venues around the country.”); *In re Circuit City Stores Inc.*, 447 B.R. 475 (Bankr. E.D. Va. 2009) (“The unpaid Stub Rent for Advance Leases is approximately \$20 to \$25 million.”); Peter S. Goodman, *RadioShack Bankruptcy To Have Unique Effects On Landlords*, LAW360 (Feb. 13, 2015, 10:47 AM), <http://www.law360.com/articles/620795/radioshack-bankruptcy-to-have-unique-effects-on-landlords> [<https://perma.cc/N6CA-BMXA>] (“For RadioShack’s landlords, the bankruptcy filing poses unique

CHALLENGES not necessarily faced by other creditors.”).

¹¹⁰ *See In re Oreck Corp.*, 506 B.R. 500 (Bankr. M.D. Tenn. 2014) (“Lessors assert that prorated stub rent of \$31,505.25 for the 25 postpetition days in May is an administrative expense.”).

¹¹¹ Stulman, *supra* note 14, at 657–58.

¹¹² Vron, *supra* note 11. For a more in-depth discussion of the implications of inconsistent stub rent solutions, see discussion *infra* Part V.

¹¹³ For a detailed accounting of the court’s fragmented approach when dealing

Courts have applied either (1) an “accrual” or “proration” approach (collectively, accrual approach), or (2) a “billing date” approach to stub rent claims.¹¹⁴ Both methods attempt to clarify the obligations of commercial landlords and tenants and define the extent to which stub rent is a debtor’s “obligation that arises ‘from and after’ the petition date, such that it would fall within section 365(d)(3).”¹¹⁵

A. Accrual Approach

The Seventh¹¹⁶ and Tenth¹¹⁷ Circuits, along with a number of district bankruptcy courts,¹¹⁸ including the Southern District of New

with stub rent issues up to 2011, see Stulman, *supra* note 14, at 661 (discussing how courts are split over various issues in their application of Section 365(d)(3), including “(1) whether the statute is ambiguous; (2) whether proration is appropriate under section 365; (3) whether proration is appropriate under section 503; (4) whether ‘timely’ means ‘immediate,’ at confirmation, or some time in between; and (5) whether section 365 applies to both stub rent and taxes pursuant to the lease”) (citations omitted); Levitin & Stieglitz, *supra* note 12 (“To add to the confusion, district and bankruptcy court judges are similarly split on the issue, sometimes within the same district.”); Norton on Bankruptcy, *supra* note 57, at ¶ 46:42 (indicating courts are split on issues such as when the “obligation to pay ‘stub’ rent ‘arises’” or “with respect to the treatment of taxes which become due during the interim period”).

¹¹⁴ Norton on Bankruptcy, *supra* note 57, at ¶ 46:42 (indicating the billing date approach holds the “obligation to pay ‘stub’ rent ‘arises’ when they become due” versus the proration approach which holds the obligation arises when the rent accrues).

¹¹⁵ 11 U.S.C. § 365(d)(3) (2012) (“The trustee shall timely perform all the obligations of the debtor . . . arising from and after the order for relief under any unexpired lease of nonresidential real property”); Vron, *supra* note 11.

¹¹⁶ See *In re Handy Andy Home Improvement Ctrs., Inc.*, 144 F.3d 1125 (7th Cir. 1998) (affirming lower court decisions holding that taxes required under the lease should be prorated between the prepetition period and postpetition period, even though taxes were due postpetition). *But see* Lichy, *supra* note 35, at 304 (“The Seventh Circuit occupies a middle position—applying the billing date approach to claims brought by landlords seeking to recover unpaid rental obligations and the proration approach to claims brought by landlords seeking to recover unpaid tax obligations.”); *HA-LO Indus., Inc. v. CenterPoint Props. Tr.*, 342 F.3d 794 (7th Cir. 2003) (affirming lower court decisions holding that the tenant, in rejecting a lease that was not yet expired, was required to pay monthly rent as it became due).

¹¹⁷ *In re Furr’s Supermarkets, Inc.*, 283 B.R. 60, 70 (B.A.P. 10th Cir. 2002).

¹¹⁸ *In re Stone Barn Manhattan LLC*, 398 B.R. 359 (Bankr. S.D.N.Y. 2008)

York,¹¹⁹ utilize the accrual approach. In accrual jurisdictions, the court “prorates the rent for the month straddling the petition date into the prepetition and postpetition portions”¹²⁰ In these jurisdictions, stub rent is treated as a post-petition obligation that must be timely paid under Section 365(d)(3).¹²¹ As a result, a debtor who files in an accrual jurisdiction is “obligated to pay stub rent *immediately* under the requirements of § 365(d)(3) for the period of occupancy during the first partial month after the petition date.”¹²²

Continuing with the same scenario outlined in Diagram 1 and 2, consider Diagram 3:

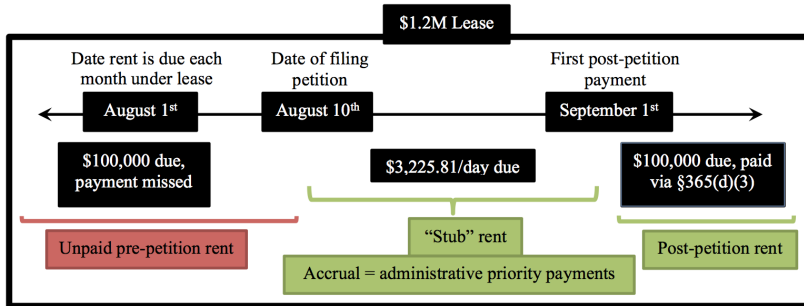
(concluding it appropriate to apply a proration approach for unpaid rent); *In re Ames Dep’t Stores, Inc.*, 306 B.R. 43 (Bankr. S.D.N.Y. 2004) (finding that landlords were entitled rent only up to the date the leases were rejected, thus applying a proration approach); *In re All for a Dollar, Inc.*, 174 B.R. 358 (Bankr. D. Mass. 1994) (finding that the debtor owed the landlord prorated tax obligations in rejecting the lease).

¹¹⁹ *In re Stone Barn*, 398 B.R. 359. Like the District of Delaware, the Southern District of New York is particularly significant given the volume of commercial bankruptcy cases litigated in the district. See Jay M. Goffman et al., *Trends in Chapter 11 Filings, Venue and Proposed Reforms*, SKADDEN (Jan. 2015), <https://www.skadden.com/insights/trends-chapter-11-filings-venue-and-proposed-reforms> [https://perma.cc/893S-82J7].

¹²⁰ Vron, *supra* note 11.

¹²¹ “*Timely* is not a defined term in the Bankruptcy Code.” *In re Circuit City Stores, Inc.*, 447 B.R. 475, 509 (Bankr. E.D. Va. 2009). However, “timely” can be generally defined as “within the time required by statute, court rules or contract.” *Timely*, THEFREEDICTIONARY: LEGAL DICTIONARY (Oct. 15, 2016), <http://legal-dictionary.thefreedictionary.com/timely> [https://perma.cc/W9HJ-4VXX]. Notably, bankruptcy courts are split over whether “timely” performance of obligations in Section 365 means immediate performance, performance at confirmation, or performance at some other time between. See Stulman, *supra* note 14, at 664 n.49 (citing cases from Illinois and Delaware to show a difference in courts’ interpretations of the term); Vron, *supra* note 11 (describing the statute as one that “requires debtor-tenants to timely pay rent postpetition”).

¹²² Hockett, *supra* note 10, at 2 (emphasis added).



In an accrual jurisdiction, when a commercial tenant files for Chapter 11, despite the tenant's non-payment of rent pre-petition, the landlord is immediately entitled to payment of rent during the stub period at a *pro rata* rate according to the terms of the lease for the debtor's continued use and occupancy.¹²³ In this example, even though the tenant failed to pay rent on August 1st, once the tenant files bankruptcy on August 10th, the landlord will begin receiving proportional payments for the remainder of the property's use and occupancy from August 10th through August 31st. For a \$100,000 per month lease, each of the thirty-one days from August to September costs approximately \$3,225.81. Thus, in an accrual jurisdiction, the commercial landlord would be entitled, upon the tenant filing on August 10th, to an administrative priority claim of \$67,7242.01 based on a *pro rata* calculation of rent due for the remainder of August.¹²⁴ The landlord would also be entitled to another administrative priority claim of \$100,000 on September 1st under the terms of the lease.¹²⁵

¹²³ *Id.*

¹²⁴ The math associated with this part of the example is as follows: (\$3,225.81 rent per day) x (21 days) = \$67,742.01. *See generally* 11 U.S.C. § 365(d)(3) (2012); § 503(b)(1) (stipulating that certain administrative expenses may be allowable, such as "actual, necessary costs and expenses of preserving the estate" or taxes "incurred by the estate"); Vron, *supra* note 11.

¹²⁵ *See Hockett, supra* note 10, at 1 ("Typically, service providers and others doing business with the debtor postpetition are entitled to administrative expense treatment."); § 365(d)(3) ("The trustee shall timely perform all the obligations of the debtor . . . arising from and after the order for relief under any unexpired lease of nonresidential real property . . .").

B. Billing Date Approach

Alternatively, Third,¹²⁶ Sixth,¹²⁷ Seventh,¹²⁸ Eighth,¹²⁹ and Ninth¹³⁰ Circuit courts, along with a number of district bankruptcy courts,¹³¹ have adopted the billing date method. Under this “bright line test,” courts look at the date rent becomes due and payable under the

¹²⁶ See *In re Montgomery Ward Holding Corp.*, 268 F.3d 205, 211 (3d Cir. 2001) (rejecting proration because “an obligation arises under a lease for purposes of § 365(d)(3) when the legally enforceable duty to perform arises under that lease”). *But see id.* at 213, 215 (Mansmann, J., dissenting) (“While I agree that the terms of the lease determine the obligation, the statute says nothing about how to determine when the obligation arises Although, as the majority suggests, Congress clearly intended to change prior practice when it enacted § 365(d)(3), I can find no indication of a specific intent to displace proration with the billing date approach. Rather it seems clear that the statute was aimed at providing landlords with current pay for current services and relieving them from the ‘actual and necessary’ analysis required under § 503(b)(1).”); *In re Goody’s Family Clothing Inc.*, 610 F.3d 812 (3d Cir. 2010).

¹²⁷ *In re Koenig Sporting Goods, Inc.*, 203 F.3d 986 (6th Cir. 2000).

¹²⁸ See *HA-LO Indus., Inc. v. CenterPoint Props. Tr.*, 342 F.3d 794 (7th Cir. 2003). *But see In re Handy Andy Home Improvement Ctrs., Inc.*, 144 F.3d 1125 (7th Cir. 1998) (affirming lower court decisions holding that taxes required under the lease should be prorated between the prepetition period and postpetition period, even though taxes were due postpetition). See generally Lichy, *supra* note 35, at 304.

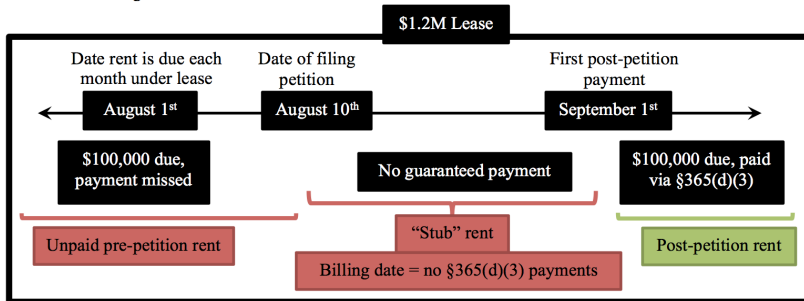
¹²⁹ See *In re Burival*, 406 B.R. 548 (B.A.P. 8th Cir. 2009).

¹³⁰ See *In re Cukierman*, 265 F.3d 846 (9th Cir. 2001).

¹³¹ See, e.g., *In re Oreck Corp.*, 506 B.R. 500, 506 (Bankr. M.D. Tenn. 2014) (stating “that § 365(d)(3) is not ambiguous in the context of a monthly lease payable in advance . . . [and it] requires timely performance of lease obligations that arise from and after the petition date”); *In re Imperial Beverage Grp., LLC*, 457 B.R. 490, 501 (Bankr. N.D. Tex. 2011) (opining that the court rejected the proration approach, instead finding that the “billing theory offers the better approach”); *In re Comdisco, Inc.*, 272 B.R. 671 (Bankr. N.D. Ill. 2002) (ruling that the date the lease was rejected was the effective date, despite the debtor allegedly continuing to occupy the premises, and thus the debtor was not responsible for rent that came due after the order for relief); *In re F&M Distribs., Inc.*, 197 B.R. 829, 832 (Bankr. E.D. Mich. 1995) (stating that the legislature “could have used the term ‘accrual’ as would more clearly point the way,” but did not do so, and therefore the court would not read it into the language of the statute).

terms of the valid, preexisting lease.¹³² If the date rent is due falls before the petition date, then stub rent is not considered an obligation “arising from and after” the petition date.¹³³ Instead, stub rent is treated as a pre-petition, unsecured claim under Section 502(b)(6).¹³⁴

Consider Diagram 4, which applies the same example as above, but in a billing date jurisdiction:



When a commercial tenant files for Chapter 11 in the middle of the month in a billing date jurisdiction, the first administrative expense payment a landlord would be entitled to under Section 365(d)(3) is “the rental payment for the month *following* the bankruptcy filing date,” which in this case is the first of the next month.¹³⁵ In this example, where the tenant files on August 10th, in a billing date jurisdiction the landlord is only entitled to payments under Section 365(d)(3) starting September 1st. In contrast to accrual jurisdictions, landlords would not be entitled to Section 365(d)(3) claims for stub rent from August 10th through August 31st. It is irrelevant whether the

¹³² Vron, *supra* note 11.

¹³³ 11 U.S.C. § 365(d)(3) (2012); Vron, *supra* note 11 (“If the date is prior to the petition date, then the stub rent is a prepetition, unsecured claim and is not an obligation that arises “from and after” the petition date.”).

¹³⁴ § 502(b)(6)(A)(i) (stating limitations on a lessor’s claim for damages “resulting from the termination of a lease of real property”); Vron, *supra* note 11 (explaining if the billing date “is prior to the petition date, then stub rent is a prepetition, unsecured claim”). However, recall that assumption under Section 365(b) requires a debtor to “cure,” “compensate,” or “provide adequate assurance of future performance” for any loss resulting from the initial default. § 365(b)(1)(A)–(C) (imposing requirements on the trustee in the event “there has been a default in an executory contract or unexpired lease of the debtor” and the trustee intends “to assume such contract or lease”).

¹³⁵ Hockett, *supra* note 10 (emphasis added).

tenant files on the 2nd of August or the 10th of August. What matters is that the tenant-debtor's next lease payment is due *after* it filed for bankruptcy. In a billing date jurisdiction, rent normally due on September 1st would be the first required payment as an administrative priority claim under Section 365(d)(3), and the landlord would be left merely with a general unsecured claim for any unpaid stub rent.

C. Section 503 Administrative Expenses

Landlords unable to secure stub rent, often due to the application of the billing date method in their jurisdiction,¹³⁶ may not be entirely without recourse. Even if stub rent does not fall within Section 365(d)(3), landlords may be able to recover under Section 503(b)(1)(A), which allows a landlord to claim that stub rent payments should be treated as a general administrative expense because the rent constitutes an “actual, necessary cost[] and expense[] of preserving the [bankruptcy] estate.”¹³⁷

¹³⁶ Interestingly, the billing date approach was originally touted as the best means of protecting landlord interests, in light of the 1984 Amendments. *See, e.g., In re Koenig Sporting Goods, Inc.*, 203 F.3d 986, 989 (6th Cir. 2000) (“The debtor argues that policy considerations, equity, and ‘common sense’ compel adoption of the proration method in this context. We disagree. The debtor alone was in the position to control [the landlord’s] entitlement to payment of rent for December. If the debtor had rejected the lease effective November 30, 1997, rather than December 2, it would not have been obligated to pay rent for December under 11 U.S.C. § 365(d)(3). Instead, an election was made to reject the lease effective December 2, one day *after* the debtor’s monthly rent obligation would arise. In this case, involving a month-to-month, payment-in-advance lease, where the debtor had complete control over the obligation, we believe that equity as well as the statute favors full payment to [the landlord].”) (emphasis in original). However, an “unintended consequence” of the billing date approach, is that Section 365(d)(3)—“a provision intended to be extremely prolandlord—is now commonly regarded as debtor tenants’ ‘crack-whip.’” Lichy, *supra* note 35, at 298. *Compare* *Koenig Sporting Goods*, 203 F.3d 986, 989 (holding that, despite debtor’s rejection of the lease on December 2, 1997, the landlord was entitled to full payment of the rent for December), *with In re Oreck Corp.*, 506 B.R. at 501 (holding “lessors’ stub rent claim is a prepetition debt that is not within the scope of § 365(d)(3), and is not entitled to administrative expense priority under § 503(b)(1)”).

¹³⁷ Herman, *supra* note 66. *See generally* § 503(b) (providing allowance for administrative expenses, including “the actual, necessary costs and expens-

For landlords, there are a number of reasons why pursuing stub rent claims under Section 503 is not ideal. First, courts are split on whether Section 365(d)(3) supersedes Section 503(b) with respect to rent claims, and thus, whether Section 503(b) is even applicable to landlord rent payments.¹³⁸ Second, Section 503(b)(1)(A), unlike Section 365(d)(3), imposes further burdens on creditors, including an affirmative duty on landlords to show that stub rent payments are an “actual, necessary cost[] and expense[.]”¹³⁹ Because the court exercises discretion in evaluating Section 503(b) claims,¹⁴⁰ in some courts the requirements of Section 503(b)(1)(A) are difficult to satisfy.¹⁴¹ Third,

es of preserving the estate”). Notably, Section 503(b)(1)(A), unlike Section 365(d)(3), imposes a duty on landlords to show that stub rent payments are an “actual, necessary cost[] and expense[.]” § 503(b)(1)(A); *see e.g., In re ZB Co., Inc.*, 302 B.R. 316, 320 (Bankr. D. Del. 2003) (rejecting the use of Section 365(d)(3) to prorate stub rent, but stating that the landlord was nevertheless entitled to a *pro rata* portion of the rent owed under the pre-petition lease because there is “no prohibition against prorating these administrative expenses in section 503(b)(3)”).

¹³⁸ Vikki R. Harding, *United States: Landlord Stub Rent Claim: Administrative Priority Or Not?*, MONDAQ (May 9, 2014), <http://www.mondaq.com/unitedstates/x/312522/Insolvency+Bankruptcy/Landlord+Stub+Rent+-Claim+Administrative+Priority+Or+Not> [<https://perma.cc/YT7R-KU6S>]; *see In re Stone Barn Manhattan LLC*, 398 B.R. 359, 367 (Bankr. S.D.N.Y. 2008) (“If there is one point that the proration and billing date courts all accept, it is that Congress intended § 365(d)(3) to nullify the requirement of § 503(b) that a creditor prove benefit to the estate before it can obtain administrative expense status for a post-petition rent claim. That is exactly what § 365(d)(3) states; it applies “notwithstanding section 503(b)(1) of this title.”).

¹³⁹ § 503(b)(1); *see, e.g., In re Imperial Beverage, LLC*, 457 B.R. 490, 502 (Bankr. N.D. Tex. 2011) (citing *In re Sportsman’s Warehouse, Inc.*, 436 B.R. 308, 315 (Bankr. D. Del. 2009)).

¹⁴⁰ *See In re HQ Global Holdings, Inc.*, 282 B.R. 169, 173 (Bankr. D. Del. 2002).

¹⁴¹ *See, e.g., In re White Motor Corp.*, 831 F.2d 106, 110 (6th Cir. 1987) (requiring that, in order to qualify for payment as administrative expense, the debt must directly and substantially benefit the estate). *See generally* Collier on Bankruptcy, *supra* note 82, at ¶503.06 (While “[a] few courts have made the ‘benefit’ requirement [under Section 503(b)(1)(A)] difficult to satisfy by finding that the benefit must be ‘substantial’ and ‘direct,’” “[t]he question of how much ‘benefit’ must be shown prior to the allowance of an administrative expense . . . is not often raised”). For example, while the court presumes the “fair and reasonable” value for use and occupancy is the rate provided in

while Section 365(d)(3) claims are paid immediately,¹⁴² Section 503(b)(1) administrative priority claims are usually paid at the conclusion of the bankruptcy upon confirmation of a plan of reorganization.¹⁴³ As a result, landlords face the heightened risk that “the case will be administratively insolvent and that [the landlord] will be paid less than 100 percent of its allowed claim.”¹⁴⁴

V. *Implications of Each Stub Rent Solution on Landlords and Tenants*

There are a number of goals and policies that underlie the Code.¹⁴⁵ At its core, bankruptcy is a collective creditor remedy designed to maximize creditor recovery.¹⁴⁶ Without a bankruptcy process, non-bankruptcy rules of debt collection dictate how debtor resources are allocated.¹⁴⁷ However, these non-bankruptcy rules are not designed to handle circumstances where the debtor is unable to pay its creditors

the lease, the presumption is rebuttable such that landlords run the risk of not receiving the full value of their lease under Section 503(b)(1). *See, e.g., In re Thompson*, 788 F.2d 560, 563 (9th Cir. 1986) (“The rent reserved in the lease is presumptive evidence of fair and reasonable value, but the presumption may be rebutted by demonstrating that the reasonable worth of the lease differs from the contract rate.”) (internal citations omitted).

¹⁴² § 365(d)(3).

¹⁴³ Robert L. LeHane et al., *Stub Rent and the Way Around Montgomery Ward*, 28 AM. BANKR. INST. J. 20 (2009) (“[S]tub rent is generally payable immediately under § 365(d)(3) . . . § 503(b)(1) claims are usually paid at the end of the case, alongside other administrative claims.”).

¹⁴⁴ *Id.*; *see also In re Goody's Family Clothing Inc.*, 610 F.3d 812 (3rd Cir. 2010) (“§ 365(d)(3) does not supplant § 503(b) and the landlords are entitled to stub rent as an administrative expense”).

¹⁴⁵ *See generally* Jason J. Kilborn, *Bankruptcy Law*, in 1 GOVERNING AMERICA: MAJOR POLICIES AND DECISIONS OF FEDERAL, STATE, AND LOCAL GOVERNMENT 41 (Paul J. Quirk & William Cunion, eds., New York: Facts on File 2011), <https://www.researchgate.net/publication/228229136> [<https://perma.cc/2WUU-AK68>].

¹⁴⁶ BARRY E. ADLER ET. AL., BANKRUPTCY: CASES, PROBLEMS, AND MATERIALS 21–30 (4th ed. 2007) (discussing the goals of bankruptcy law, including the ability for “diverse creditors to work together” and allowing each creditor “to establish both how much it is owed and the priority its claim enjoys without engaging in a destructive and expense race”); *see, e.g., In re Daufuskie Island Properties, LLC*, 431 B.R. 626, 640 (Bankr. D.S.C. 2010). *See generally* Kilborn, *supra* note 145.

¹⁴⁷ ADLER, *supra* note 146, at 21.

in full, and where instead creditors compete against each other in an expensive and destructive “race to the assets.”¹⁴⁸ As a result of this expensive and destructive process, the insolvent business’s going concern value is in jeopardy of being destroyed.¹⁴⁹

The Code operates as a mechanism to counter this destructive race by providing an orderly means of either liquidation or reorganization of the debtor and its assets.¹⁵⁰ In Chapter 11, the Code functions as a means of ensuring the survival of a business in financial distress where the business may nevertheless remain economically viable.¹⁵¹ For creditors, allowing a debtor to continue to operate preserves the business’s going concern that would otherwise be destroyed by liquidation.¹⁵² Equally important, the Code provides debtors a means of rehabilitation if the debtor can successfully reorganize its financial structure.¹⁵³ Thus, for those businesses that are economically viable,

¹⁴⁸ *Id.*

¹⁴⁹ *Id.* (“Some of the corporations that cannot pay their creditors in full nevertheless should survive as going concerns. Nonbankruptcy rules provide no way of permitting this while respecting the rights of the various investors in the firm.”); *see also* Collier on Bankruptcy, *supra* note 82, at ¶ 1100.01 (“Chapter 11 embodies a policy that it is generally preferable to enable a debtor to continue to operate and to reorganize or sell its business as a going concern rather than simply to liquidate a troubled business.”).

¹⁵⁰ *See* 12-156 BUSINESS ORGANIZATIONS WITH TAX PLANNING § 156.04 (LexisNexis 2017) (“At its core, bankruptcy is a collective creditor remedy designed to maximize the recovery of the creditors as a whole when the debtor’s assets are insufficient to satisfy all of its obligations. Thus, one goal of bankruptcy is to protect the creditors of a debtor – first by providing a mechanism for the efficient collection of assets, and then the equitable distribution of those assets.”). *See generally* 11 U.S.C. § 701 et. seq. (2012); § 1102 et. seq. (2012).

¹⁵¹ ADLER, *supra* note 146, at 677.

¹⁵² *But see id.* at 670–78 (discussing how changes in the economy, industry, and even creditors have led to the reduction or “disappearance” of growing concern value, thus “reduc[ing] the benefits that can be had through a traditional reorganization”).

¹⁵³ 12-156 BUSINESS ORGANIZATIONS WITH TAX PLANNING § 156.04 (LexisNexis 2017) (discussing how Chapter 11 facilitates debtor rehabilitation). Note that for *individual* debtors, the driving policy consideration is that reorganization should afford debtors a “fresh start.” *Id.* (“[T]he incentive effects on companies making investment and asset-deployment decisions . . . will affect how they meet their environmental cleanup obligations, whether they can fund their pension plans, and how many jobs they will continue to support.”); C. RICHARD McQUEEN & JACK F. WILLIAMS, TAX ASPECTS OF BANKRUPTCY LAW

Chapter 11 seeks to provide a process to more efficiently reallocating the debtor's limited and finite economic resources by emphasizing cooperation and rehabilitation, instead of competition, as the means of maximizing the business's value.¹⁵⁴

However, as explored below, the varying approaches to student do not always provide a simple solution for all parties, and the result often runs counter to Chapter 11's general goals.

A. Forum Shopping and Manipulative Filing Practices

In addition to facilitating business reorganization, one of the core policies ingrained in the Code is that the bankruptcy process should be uniformly administered.¹⁵⁵ Given the impact of state law

AND PRACTICE ¶ 1.3 (3rd ed., Westlaw updated 2016) (“[For individual debtors,] bankruptcy permits an individual through the use of exemptions of property, the right to a discharge, and the exclusion of future income from the estate, to begin anew his or her economic life. Thus, certain property that is exempt under the Bankruptcy Code may be put aside by an individual so that there will be a future economic life.”); *see also* *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934) (discussing how the “fresh start” policy seeks to provide honest debtors with a “new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt”).

¹⁵⁴ *Protecting Employees and Retirees in Business Bankruptcies Act of 2007: Hearing on H.R. 3652 Before the Subcomm. on Commercial and Admin. Law of the H. Comm. on the Judiciary*, 110th Cong. 115 (2008) (statement of Michael L. Bernstein, Partner, Arnold & Porter, LLP) (“Chapter 11 of the Bankruptcy Code is intended to enable a financially troubled business to restructure its operations and obligations so that it is able to remain a going concern, and to emerge from bankruptcy as a viable and competitive enterprise. A debtor that achieves this objective benefits its creditors, suppliers, customers, employees, local communities, and other constituencies.”).

¹⁵⁵ *See* U.S. CONST. art. I, § 8, cl. 4 (authorizing Congress to “establish . . . uniform Laws on the subject of Bankruptcies throughout the United States”); 8A C.J.S. *Bankruptcy* § 2 (2016) (discussing how other goals include “prevent[ing] creditors from taking unfair advantage of a debtor . . . provid[ing] the debtor with a fresh start . . . distribut[ing] the debtor’s assets equitably among his or her creditors . . . centraliz[ing] disputes over the debtor’s assets and obligations in one forum . . . [and] secur[ing] a prompt and effectual administration and settlement of the estates . . .”) (footnote omitted). *But see* Daniel A. Austin, *Bankruptcy and the Myth of “Uniform Laws”*, 42 SETON HALL L. REV. 1081, 1083 (2012) (“There are three reasons for the lack of uniformity in bankruptcy. First, certain sections of the Bankruptcy Code ex-

on bankruptcy proceedings,¹⁵⁶ the mere fact that debtors and creditors in different states may receive different treatment is not per se unconstitutional.¹⁵⁷ Nevertheless, uniform application of bankruptcy law remains a crucial policy of the Code.¹⁵⁸ Uniformity helps expedite

pressly incorporate state law, which is often different from state to state. Second, courts in different jurisdictions interpret the same sections of the Code differently. Third, bankruptcy courts and trustees are authorized to establish many of their own separate rules and policies, resulting in wide variances in key aspects of bankruptcy practice.”); Tabb, *supra* note 18, at 46 (discussing how uniformity is problematic because: “(i) most laws governing the substance of relationships between debtor and creditors are state laws; (ii) these state laws are incorporated into and applied in the federal Bankruptcy Code; and (iii) these state laws are not necessarily uniform”).

¹⁵⁶ Beyond varying interpretation of bankruptcy law among federal courts, the application of relevant state law on bankruptcy practice often results in non-uniform results. However, the court has held that application of non-uniform state law is nevertheless permissible. *See generally* CHARLES J. TABB, *LAW OF BANKRUPTCY* 56–60 (4th ed. 2016) (discussing how uniform application of bankruptcy law is “problematic” given the significant impact of state law, but further discussing how the court has ruled that non-uniform state law impacting the bankruptcy process may nevertheless be held permissible); *Hanover Nat.’l Bank v. Moyses*, 186 U.S. 181, 190 (1902) (requiring “geographical uniformity,” not personal uniformity, and finding geographical uniformity satisfied “when the trustee takes in each state whatever would have been available to the creditor if the bankruptcy law had not been passed”).

¹⁵⁷ Erwin Chemerinsky, *Constitutional Issues Posed in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, 79 AM. BANKR. L. J. 571, 592–95 (2005) (“[A] bankruptcy law may be ‘uniform’ even though it incorporates state law so that there are different results in different States.”); *Railway Labor Execs.’ Ass’n v. Gibbons*, 455 U.S. 457, 469–73 (1982) (“The uniformity requirement is not a straitjacket that forbids Congress to distinguish among classes of debtors, nor does it prohibit Congress from recognizing that state laws do not treat commercial transactions in a uniform manner. . . . [U]niformity does not require the elimination of any differences among the States in their laws governing commercial transactions. . . . The uniformity requirement, however, prohibits Congress from enacting a bankruptcy law that, by definition, applies only to one regional debtor. To survive scrutiny under the Bankruptcy Clause, a law must at least apply uniformly to a defined class of debtors.”).

¹⁵⁸ *See In re Anderson*, 553 B.R. 221, 234 (S.D.N.Y. 2016); Austin, *supra* note 155, at 1135 (“Lack of uniformity in national bankruptcy law is bad policy. . . . There are sound reasons why bankruptcy law in the United States should be uniform.”).

the reorganization process and disincentivizes forum shopping among debtors.¹⁵⁹ Moreover, uniform and consistent application of the Code encourages other broader bankruptcy policies including administrative efficiency, transparency, and fairness in bankruptcy proceedings.¹⁶⁰

A corporate debtor¹⁶¹ has a wide range of venue options, which include its place of incorporation,¹⁶² the location of its principal assets, and its principal place of business.¹⁶³ Given that commercial debtors often have various locations where they can file for bankruptcy relief, the split of authority over the stub rent issue encourages forum shopping, which the Code otherwise seeks to avoid.¹⁶⁴ Forum

¹⁵⁹ See *Holland Am. Ins. Co. v. Succession of Roy*, 777 F.2d 992, 999 (5th Cir. 1985).

¹⁶⁰ Austin, *supra* note 155, at 1138–40.

¹⁶¹ Individuals typically seek relief under Chapter 13 or Chapter 7, and individual Chapter 11 filings are relatively infrequent. See *Chapter 7—Bankruptcy Basics*, U.S. COURTS, <http://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-7-bankruptcy-basics> [https://perma.cc/84XB-P5CB]. Individuals who file for bankruptcy relief must file in the district in which they reside, which leaves far fewer options than corporations have. 28 U.S.C. § 1408 (2012) (“[A] case under title 11 may be commenced in the district court for the district- (1) in which the domicile, residence, principal place of business . . .”).

¹⁶² § 1408; Lynn M. LoPucki & William C. Whitford, *Venue Choice and Forum Shopping In The Bankruptcy Reorganization of Large, Publicly Held Companies*, 1991 WIS. L. REV. 11, 16 (1991) (“Considering that a corporation’s ‘residence’ or ‘domicile’ for the purpose of this statute is arguably in the jurisdiction where it is incorporated . . .”).

¹⁶³ § 1408; see Samir D. Parikh, *Modern Forum Shopping in Bankruptcy*, 46 CONN. L. REV. 159, 165 (2013) (“The permissive venue rules in bankruptcy afford a corporate debtor virtually unlimited venue options. From those options, the corporate debtor can choose the venue that it believes will be most favorable to ownership, management, insiders, or lenders depending on which party exercises the most control and leverage over the decision-making process. There is almost no transparency in this process and, as explained below, once the decision is made, it is extremely difficult to undo.”). note 92Provisions from 5, 6, and 7iated iwth ion LLC, et al.,rchase and Saleother human waste. at stems from the environmental note 92Provisions from 5, 6, and 7iated iwth ion LLC, et al.,rchase and Saleother human waste. at stems from the environmental

¹⁶⁴ Pollack Statement, *supra* note 66, at 7; see Vron, *supra* note 11 (“The uncertainty as to which approach a particular court will use in determining whether stub rent is payable is harmful to both landlords and debtor-tenants

shopping consists of making a strategic decision about where to file for reorganization, so that “one’s case [is] heard in the forum where it has the greatest chance of success.”¹⁶⁵

Assuming stub rent is a significant factor, the jurisdiction and corresponding approach to stub rent is strategically important because the tenant-debtor may be able to utilize a forum that renders a more financially favorable decision.¹⁶⁶ For example, consider the same scenario used above in Diagrams 2 through 4. However, in Diagram 5 the tenant has not yet filed for bankruptcy. Instead, the tenant is deciding where and when it would be most advantageous to file their petition:

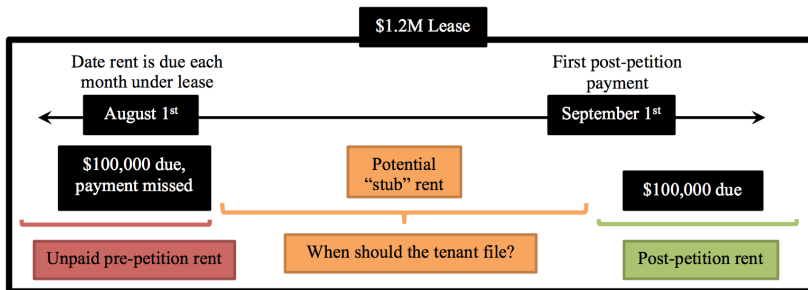


Diagram 5 presents a situation in which the tenant stopped paying rent and is weighing the option of filing in an accrual or billing date jurisdiction. If the tenant files in an accrual jurisdiction, it would be most advantageous for the tenant to wait as long as possible after the its missed payment to file.¹⁶⁷ Only when it becomes clear that the tenant may lose the property would it make sense to file a bankruptcy petition asking the court to impose the automatic stay pursuant to Section 362(a) to protect the estate from the landlord’s efforts to

– it hinders prepetition planning, encourages forum shopping, and leads to higher litigation costs.”).

¹⁶⁵ LoPucki & Whitford, *supra* note 162, at 14 (drawing a distinction between forum shopping as an “ethically questionable activity” and “venue choice” meaning “situations in which petitioners have the statutory right to file in more than one district”).

¹⁶⁶ *Id.* at 34.

¹⁶⁷ As a general proposition, waiting to file for relief and deferring the bankruptcy filing will limit the accrual of all administrative expenses. However, the example above presumes that the tenant will file for relief sometime in the month of August.

cure non-payment of rent. Strategically, the longer the tenant can fend off its commercial landlord and avoid filing for bankruptcy, the smaller the debtor's initial *pro rata* administrative priority payment to their commercial landlord.¹⁶⁸ Moreover, delaying the accrual of administrative expenses by deferring the bankruptcy filing will provide the debtor with additional liquidity to negotiate with other creditors.¹⁶⁹ Thus, in an accrual jurisdiction, if the tenant can fend off its commercial landlord's efforts to repossess the property, the tenant would ideally wait and file as close to August 31st as possible.¹⁷⁰

On the other hand, if the debtor also has the option to file in a billing date jurisdiction, it is more strategic for it to defer filing its petition until the day after rent is due under the lease. In the scenario presented in Diagram 5, it would make sense for the tenant to file after it has missed its \$100,000 August 1st payment, and as close to August 2nd as possible.¹⁷¹ Filing right after the tenant's missed payment means

¹⁶⁸ *Id.*

¹⁶⁹ See Pollack Statement, *supra* note 66, at 7 (explaining that a debtor is not responsible for paying the real-estate taxes, or other expenses, post-petition which had arose or accrued pre-petition); *In re Linens Holding Co.*, No. 08–10832(CSS), 2009 WL 2163235 (Bankr. D. Del. June 12, 2009) (finding that the corporate debtors were given an unsecured, interest-free loan from their landlords of in excess of \$20 million because they were not held responsible for rent since they filed on the second day of the month); Samole, *supra* note 69 (discussing how the billing method “ignores the actual use and occupancy of the property post-petition and looks strictly to when the bill for that given month comes due”).

¹⁷⁰ If longer is better, then why would the tenant not just wait until September 1st or 2nd? Remember, in an accrual jurisdiction, the tenant would ultimately be on the hook for stub rent. Thus, it makes sense to file as close to the end of the payment period as possible (*e.g.*, for our hypothetical rent dates, August 31st, September 31st).

¹⁷¹ Note that filing *immediately* after a missed payment (*e.g.*, on August 2nd in Diagram 5) is not always advisable for the tenant-debtor. Some courts have held debtors liable for rent payments for an *entire* month when filing is close to the date payment of rent is due. *E.g.*, *In re Koenig Sporting Goods, Inc.*, 203 F.3d 986, 989 (6th Cir. 2000) (“If the debtor had rejected the lease effective November 30, 1997 [when rent was due December 1], rather than December 2, it would not have been obligated to pay rent for December under 11 U.S.C. § 365(d)(3). Instead, an election was made to reject the lease effective December 2, one day *after* the debtor's monthly rent obligation would arise. In this case, involving a month-to-month, payment-in-advance lease, where the debtor had complete control over the obligation, we believe

the landlord's \$100,000 claim for past-due August rent will simply be classified as a general unsecured claim,¹⁷² effectively allowing the tenant to avoid paying rent as an administrative expense for that entire month.¹⁷³ Because the tenant is not compelled to pay rent under Section 365(d)(3) for part of August, after filing August 2nd the tenant has essentially gained "an unsecured, interest free loan" from the landlord in the amount of unpaid stub rent that provides the tenant-debtor with liquidity at the onset of the reorganization.¹⁷⁴ The tenant-debtor has also secured its ability to use and occupy the premises undisturbed under the automatic stay.¹⁷⁵ Thus, if stub rent is significant and commercial tenants have the option to file in either an accrual or billing date jurisdiction, commercial debtors will choose to file shortly after the lease's required payment date in a billing date jurisdiction because of the financial flexibility it provides the tenant-debtor.¹⁷⁶

that equity as well as the statute favors full payment to [the landlord]."). However, the benefits of filing in a billing date jurisdiction are still applicable if the tenant-debtor files relatively close to the missed payment date (*e.g.*, on August 4th or 5th).

¹⁷² Pollack Statement, *supra* note 66, at 7 ("As an example, in the *Linens 'n Things* bankruptcy, the debtors filed on the second of the month in a 'Billing Date' jurisdiction. Having done so, the debtors avoided having to pay rent for that month, thereby resulting in an unsecured, interest free loan from their landlords of in excess of \$20 Million . . . Many Landlords have lost their properties to their lenders because the tenant was able to defer the payment of rent due. *Linens 'n Things* is not a unique case. In the oft-cited Circuit City matter the debtors were also able to initially avoid paying 'stub rent' resulting, again, in an interest-free, unsecured loan of in excess of \$20 Million.").

¹⁷³ *Id.*

¹⁷⁴ *Id.*

¹⁷⁵ *Id.*

¹⁷⁶ In addition to the financial incentive forum selection provides tenant-debtors, forum selection is problematic for smaller creditors, because it can present a physical and logistical bar to representation. *See* LoPucki & Whitford, *supra* note 162, at 25–40 ("Smaller creditors, landlords, labor unions and other interested parties may want to participate in a case . . . they have a real interest in securing a venue for the case that is convenient for them . . . It is not an easy or inexpensive matter for such an entity to obtain a lawyer in a distant city. Nonetheless, for such entities a venue fight in a large case is not likely to be cost effective . . . [these parties] probably were not unduly prejudiced when the case proceeded in a distant forum. But with regard to [] issues, such as lifting the automatic stay, obtaining adequate protection, determining the amounts of claims, reclaiming possession of property, or

B. Varying Approaches to Stub Rent Encourages Non-Uniform Treatment of Landlord-Creditors

The split in authority over the stub rent issue also leads to a second broad implication—non-uniform treatment of landlord-creditors in different jurisdictions. Even though the Code is statutorily the same in all districts, varying interpretations of how to treat stub rent can result in very different payouts for landlords.¹⁷⁷ If the tenant can file for relief in different venues with different interpretations of Section 365(d)(3) and can predict whether the court will apply the accrual or billing date approach for stub rent, the tenant-debtor can strategically secure beneficial results.¹⁷⁸

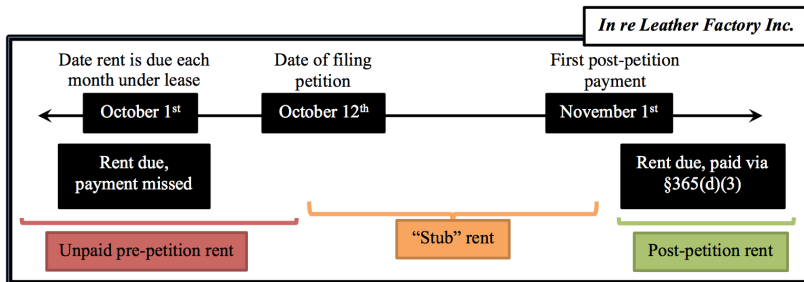
Various real-world bankruptcies illustrate how differing approaches to the stub rent issue can result in starkly different outcomes for landlord-creditors. For example, in *In re Leather Factory, Inc.*, one of the issues the court faced was how to properly treat the Leather Factory, Inc.'s (Leather Factory) manufacturing and retail furniture

resolving a myriad of other kinds of contested matters, the parties had to arrange for individual representation. When the case proceeded in a distant forum, the effect probably was to reduce participation on these issues.”). For a more general discussion of why venue selection is important for debtors and creditors, see generally Marcus Cole, “*Delaware is Not a State*”: *Are We Witnessing Jurisdictional Competition in Bankruptcy?*, 55 VAND. L. REV. 1845 (2002) (listing a number of factors which explain why a debtor would choose a particular forum, including predictability, legal precedent, judicial sophistication, geographic convenience, and the realization of attorneys’ fees); Laura N. Coordes, *The Geography of Bankruptcy*, 68 VAND. L. REV. 381 (2015); Parikh, *supra* note 163, at 193–97 (“[C]orporate debtors and other key decision makers are shopping for favorable law . . . are particularly sensitive to the perceived experience, knowledge, and personality of the judges in any given district . . . [and] are drawn to a district for perceived procedural/administrative benefits.”).

¹⁷⁷ Pollack Statement, *supra* note 66, at 6.

¹⁷⁸ See *id.* at 7 (“Such actions by debtors secure for themselves extremely beneficial results while denying the landlords payment for the current use of their properties.”). However, note that stub rent does not always result in a windfall, but may also help the landlord. See, e.g., *In re Koenig Sporting Goods, Inc.*, 203 F.3d 986, 989 (6th Cir. 2000) (finding that the debtor was obligated to pay rent to the landlord, and this would not constitute a windfall, as debtor claimed, but rather what the landlord was entitled to receive under Section 365(d)(3)).

store leases across California.¹⁷⁹ Leather Factory failed to pay its rent due on October 1st and subsequently filed for Chapter 11 on October 12th, 2005.¹⁸⁰ While some leases were rejected as early as December 2005, Leather Factory continued to use several properties until its case was converted to Chapter 7 on March 9th, 2007.¹⁸¹ The landlords sought payment of stub rent between October 12th and November 1st as an administrative priority expense under Section 365(d)(3).¹⁸² Assuming the trustee started making timely payment of rent on November 1st, Diagram 6 represents the Leather Factory's circumstances:¹⁸³



Adopting the accrual approach, the court held “[R]ent for the days after the filing of the petition until the next lease payment is due are an administrative claim under § 365(d)(3) in a *prorated* amount of a full monthly lease payment To rule otherwise would reward the estate to the detriment of the landlord, which was not the intent of Congress.”¹⁸⁴ In terms of landlord treatment, in accrual jurisdictions landlords get an administrative expense claim for a portion of the unpaid rent. At the same time, commercial landlords may have to be more aggressive in pursuing non-bankruptcy, pre-petition remedies.¹⁸⁵ Failure to pursue the commercial tenant for non-payment of rent when there are warning signs of an imminent reorganization will allow the

¹⁷⁹ *In re Leather Factory, Inc.*, 475 B.R. 710, 711 (C.D. Cal. 2012).

¹⁸⁰ *Id.* at 710.

¹⁸¹ *Id.* at 711.

¹⁸² 11 U.S.C. § 365(d)(3) (2012).

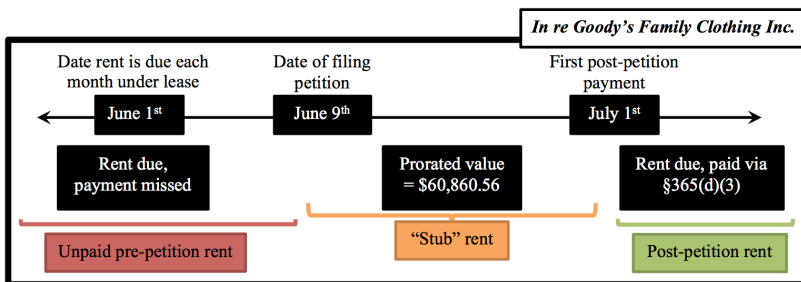
¹⁸³ Note that given the complexity of *In re Leather Factory*, Diagram 6 is a representation of the facts without the actual monetary figures.

¹⁸⁴ *In re Leather Factory*, 475 B.R. at 714 (emphasis added).

¹⁸⁵ See 49 AM. JUR. 2D *Landlord and Tenant* § 792 (2017) (liens); § 845 (notice to quit and demand for possession); § 853 (damages); § 855 (attorney's fees).

tenant to delay filing, subsequently reducing the commercial landlord's Section 365(d)(3) claims.¹⁸⁶

Commercial landlords are also treated differently when courts look to Section 503(b)(1) instead of Section 365(d)(3) in handling stub rent claims.¹⁸⁷ In *In re Goody's Family Clothing, Inc.*,¹⁸⁸ the debtor Goody's Family Clothing, Inc. (Goody's) was an apparel chain with over 282 stores across twenty states throughout the Southeast.¹⁸⁹ Goody's was current on its rent obligations up through May 2008, but missed its June 1st, 2008 payment.¹⁹⁰ Goody's filed for Chapter 11 on June 9th and continued to use the properties while it liquidated its inventory.¹⁹¹ Goody's resumed making rent payment in accordance with Section 365(d)(3) on July 1st, 2008. However, Goody's landlords filed suit to collect \$60,860.56 unpaid stub rents, prorated from June 9th through June 30th.¹⁹² The stub rent issue in Goody's can be diagrammed as follows in Diagram 7:



Instead of seeking payment for stub rent under Section 365(d)(3), the commercial landlords filed administrative expense

¹⁸⁶ See note 167–70 and accompanying text.

¹⁸⁷ See discussion *supra* Part IV.C.

¹⁸⁸ *In re Goody's Family Clothing Inc.*, 610 F.3d 812 (3d Cir. 2010).

¹⁸⁹ Brad Dorfman, *Retailers Gottschalks and Goody's File for Bankruptcy*, REUTERS (Jan. 14, 2009), <http://www.reuters.com/article/us-usa-retail-bankruptcy-idUSTRE50D5AC20090114> [<https://perma.cc/4FXM-SQ5V>].

¹⁹⁰ *In re Goody's Family Clothing*, 610 F.3d at 815.

¹⁹¹ *Id.*

¹⁹² *Mountaineer Property Co. II v. Goody's Family Clothing, Inc. (In re Goody's Family Clothing, Inc.)*, 401 B.R. 656, 661 (D. Del. 2009), *aff'd sub nom. In re Goody's Family Clothing*, 610 F.3d 812 (3d Cir. 2010) ("The unpaid stub rent, that is, the rent for the 21-day period from the Petition Date through June 30, is: \$22,305.56 for Appellee Eastgate; \$19,855 for Appellee Stafford; and \$18,700 for Appellee Mountaineer.").

claim under Section 503(b)(1) for unpaid stub rent, characterizing the rent as “unpaid, post-petition rent that was an actual, necessary cost and expense of preserving the estate.”¹⁹³ The court found that the commercial landlords could file both Section 365(d)(3) and Section 503(b)(1) claims for stub rent, and ultimately awarded the landlords stub rent payments under Section 503(b)(1).¹⁹⁴ Notably, allowing landlords to utilize Section 503(b) as a means of claiming unpaid stub rent is an example of non-uniform treatment across jurisdictions. Allowing commercial landlords to claim unpaid stub rent under Section 503(b) may benefit commercial landlords by affording them two opportunities to seek stub rent, under Section 365(d)(3) and Section 503(b).¹⁹⁵ Nevertheless, because Section 503(b) imposes additional expenses and requirements on creditors, such burdens may ultimately make it unlikely or economically impractical for commercial landlords to receive stub rent that would otherwise be accessible in a jurisdiction that permits stub rent payment under Section 365(d)(3).¹⁹⁶

Finally, consider the drastically different outcome for commercial landlords in billing date jurisdictions.¹⁹⁷ In *In re Oreck Corp.*¹⁹⁸ the court was tasked with determining how to treat the lease of Oreck Corporation’s (Oreck) headquarters.¹⁹⁹ Oreck signed a lease

¹⁹³ *In re Goody’s Family Clothing*, 610 F.3d at 815.

¹⁹⁴ *Id.* at 817 (“Put simply, § 365(d)(3) does not supplant or preempt § 503(b)(1).”).

¹⁹⁵ *See, e.g., In re Oreck Corp.*, 506 B.R. 500, 502 (Bankr. M.D. Tenn. 2014).

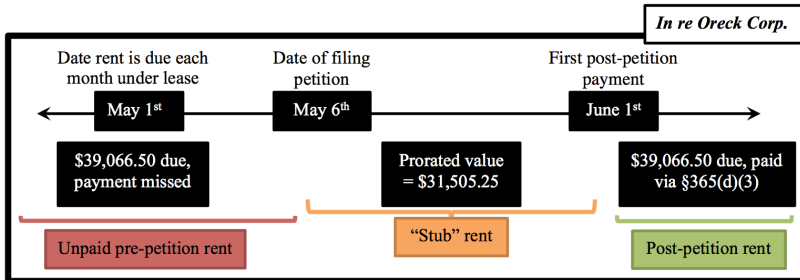
¹⁹⁶ *See* discussion *supra* Part IV.C; *In re Goody’s Family Clothing*, 610 F.3d at 818 (“For a commercial lessor’s claim to get administrative expense treatment under § 503(b)(1), the debtor’s occupancy of the leased premises must confer an *actual* and *necessary* benefit to the debtor in the operation of its business . . . Proving this is the *lessor’s burden* . . . Thus, [under Section 503(b)(1),] Landlords ‘must . . . carry the heavy burden of demonstrating that the stub rent for which they seek payment provided an actual benefit to the estate and that incurring stub rent was necessary to preserve the value of the estate assets.’”) (internal citation omitted) (internal quotations omitted).

¹⁹⁷ Interestingly, early on the billing date approach resulted in a windfall for the landlord, not the tenants. *See, e.g., In re Koenig Sporting Goods, Inc.*, 203 F.3d 986, 989 (6th Cir. 2000).

¹⁹⁸ 506 B.R. 500, 501 (Bankr. M.D. Tenn. 2014) note 92 Provisions from 5, 6, and 7iated iwth ion LLC, et al.,rchase and Saleother human waste. at stems from the environmental .

¹⁹⁹ Oreck is renowned for its vacuum cleaners, carpet steamers, air purifiers, and other cleaning tools. *See About Oreck*, ORECK, <http://www.oreck.com/>

that ran from April 1, 2013, to May 31, 2015.²⁰⁰ Under the terms of the lease, Oreck's rent was \$39,066.50 per month, "due and payable" in advance on the first of each month.²⁰¹ Oreck failed to pay its rent on May 1, 2013, and subsequently filed for Chapter 11 on May 6, 2013.²⁰² After filing, Oreck continued to use and occupy its headquarters, and resumed payments on its lease that became due after May 1, 2013.²⁰³ Oreck's circumstances are represented in Diagram 8 below:



Adopting the billing date approach, the court found that Oreck's commercial landlord was not entitled to *any* stub rent payments.²⁰⁴ Despite continued use and occupancy, the court found that neither Section 365(d)(3) nor Section 503(b)(1) provided the commercial landlord with an administrative priority claim, as the landlord's claim for stub rent arose on May 1, which was *before* the May 6 petition, and thus did not arise "from and after the order for relief."²⁰⁵

Non-uniform treatment of commercial landlords between jurisdictions is very clear when comparing the outcomes of *In re Leather Factory, Inc.* and *In re Oreck Corp.* Commercial landlords in accrual jurisdictions do not necessarily need to seek non-bankruptcy remedies with the same sense of urgency as those in billing state jurisdictions.²⁰⁶ Section 365(d)(3) provides commercial landlords with

company-history.html [https://perma.cc/3FB5-KY5Q].

²⁰⁰ *In re Oreck*, 506 B.R. at 501.

²⁰¹ *Id.*

²⁰² *Id.* at 501–02.

²⁰³ *Id.*

²⁰⁴ *Id.* at 508–09 ("Lessors' stub rent claim is not within the scope of § 365(d)(3), and is not entitled to administrative expense priority under § 503(b)(1).").

²⁰⁵ *Id.* at 502–08.

²⁰⁶ Unless, of course, it appears that the tenant will be withholding rent without filing for reorganization for more than one month.

only an unsecured claim for stub rent in billing date jurisdictions.²⁰⁷ Non-payment for use and occupancy during the stub period, based merely on the jurisdiction in which a commercial tenant files for bankruptcy, seems a far cry from many of the Code's general policies. While varying jurisdictional options may help facilitate the tenant-debtor's reorganization by making bankruptcy more attractive, non-uniformity in the application of Section 365(d)(3) to stub rent payments usually works to the detriment of the commercial landlord.²⁰⁸

C. Non-Uniform Treatment of Landlords Leads to Non-Uniform Treatment of Other Creditors

Non-uniform treatment of commercial landlords becomes an even more significant concern when considering how it may impact other creditors. By direct implication, awarding an administrative priority claim reduces the payout available to other unsecured creditors.²⁰⁹ For example, consider an estate worth only \$150,000. In this example, all secured creditors have been paid. The landlord's post-stub period Section 365(d)(3) claims have also been paid. All that

²⁰⁷ 11 U.S.C. § 365(g) (2012) (providing that “the rejection of an executory contract or unexpired lease of the debtor constitutes a breach of such contract or lease”).

²⁰⁸ See RICHARD F. HAHN & JASMINE BALL, OBJECTIVES OF CHAPTER 11 ¶1.02 *in* COLLIER GUIDE TO CHAPTER 11: KEY TOPICS AND SELECTED INDUSTRIES (2016) (“Two policy goals undergird chapter 11: (1) rehabilitation . . . [and] (2) equitable treatment [of similarly-situated] creditors . . .” and even though the twin goals are often “in tension, and occasionally in conflict,” Chapter 11 attempts to “balance[] these goals”).

²⁰⁹ See Collier on Bankruptcy, *supra* note 82, at ¶503.05 (“In general, all claims allowable under section 503(b) as administrative expenses share equally as second priority claims, without sub-priorities. However, section 507(b) of the Code grants a ‘superpriority’ to certain administrative expense claims of secured creditors that arise if there is a shortfall between the adequate protection ordered by the court under section 362, 363 or 364 and the actual loss in value of the property in which the secured creditor has a lien. A claim enjoying this ‘superpriority’ has priority over all other unsecured claims, including those entitled to administrative priority under section 507(a)(2). Courts have required professionals to disgorge interim fee awards in order to satisfy superpriority claims under section 507(b).”); Michael L. Bernstein & Jonathan Friedland, *Priorities*, 23 AM. BANKR. INST. J. 6 (2004) (“Section 507(a)(1) gives a first priority to ‘administrative expenses allowed under §503(b).’”).

remains are three \$100,000 unsecured creditor claims of equal priority and \$50,000 in stub rent.

In an accrual jurisdiction, the commercial landlord's \$50,000 claim would be treated as an administrative priority expense under either Section 365(d)(3) or 503(b)(1).²¹⁰ In either case, the commercial landlord's \$50,000 claim would be subtracted before the three \$100,000 unsecured claims, resulting in a remaining estate balance of \$100,000.²¹¹ The unsecured creditors would be left to divide the \$100,000 balance, resulting in payment of approximately \$33,333 each.

Alternatively, in a billing date jurisdiction, the commercial landlord's \$50,000 claim would be consolidated at the end of the case with the other three \$100,000 unsecured claims, resulting in an outstanding balance of \$350,000 due to all unsecured creditors. Assuming stub rent is not treated as a priority claim under either Section 365(d)(3) or 503(b)(1), all four unsecured creditors (now also including the commercial landlord) must divide the full remaining balance of the estate, \$150,000, based proportionately on the size of their unsecured claims. The commercial landlord's proportionate claim of the \$350,000 is approximately 14.29 percent, while the other three unsecured creditors each have a 28.57 percent claim. As a result, the commercial landlord would only receive approximately \$21,435, while each of the other unsecured creditors would receive approximately \$42,855.

In an accrual jurisdiction, the three unsecured creditors would only receive a return of approximately \$0.33 per dollar. In contrast, in a billing jurisdiction, the three unsecured creditors would receive a return of \$0.43 per dollar. This may be an oversimplified example because payouts would change based on a myriad of factors including the size of the estate, number of secured and unsecured creditors and the relative size of their claims, and the amount of stub rent at issue. Nevertheless, the problem is that there is discrepancy in how courts treat stub rent that ultimately impacts not only commercial landlords, but also other creditors in the bankruptcy estate.

²¹⁰ See discussion *supra* Part IV.A & IV.C.

²¹¹ Recall that if the landlord is paid under Section 365(d)(3), the debtor's liquidity at the onset of the bankruptcy is also reduced, thus threatening the debtor's ability to reorganize. See *generally* discussion *supra* Parts III.B, V.B–C.

D. Varying Treatment of the Stub Period Impacts Other Areas of Bankruptcy Practice

Interpreting Section 365(d)(3)'s requirement that the trustee timely perform the debtor's obligations "from and after the order for relief" in the context of debts incurred during the stub period has invited even further interpretation in the Code.²¹² For example, as with the ambiguity presented over how to treat unpaid stub rent, courts struggle with how to properly treat unpaid property taxes during the stub period under Section 365(d)(3).²¹³ Some courts also disagree over whether pre-rejection rent should be given "ordinary" priority or "superpriority" status where funds may be insufficient to pay all administrative claims.²¹⁴ Lastly, in some jurisdictions, Section 365(d)(3) is interpreted even more broadly, and some courts suggest that the trustee's obligation to timely perform the debtor's "obligations" is sufficiently broad to include nonmonetary obligations.²¹⁵ Finding a

²¹² See generally Norton on Bankruptcy, *supra* note 57 ("Code § 365(d)(3) calls for the trustee or debtor-in-possession to perform 'all the obligations of the debtor.'").

²¹³ Compare *In re Handy Andy Home Improvement Ctr., Inc.*, 144 F.3d 1125 (7th Cir. 1998) (following an accrual approach to taxes due during the stub period, and holding that Section 365(d)(3) requires the debtor to pay only taxes that pertain to the postpetition, prerejection period as an administrative expense), with *In re Consolidated Indus. Corp.*, 234 B.R. 84 (Bankr. N.D. Ind. 1999) (following a billing-date approach to dealing with taxes during the stub period, and holding that *In re Handy Andy* does not govern where debtor's obligation to pay taxes is triggered on the date they become payable and due).

²¹⁴ Compare *In re Rare Coin Galleries of Am., Inc.*, 72 B.R. 415 (D. Mass. 1987) (discussing how Section 365(d)(3) gives a special administrative claim priority), and *In re Telesphere Commc'ns, Inc.*, 148 B.R. 525 (Bankr. N.D. Ill. 1992), with *In re PYXSYS Corp.*, 288 B.R. 309 (Bankr. D. Mass. 2003), and *In re Pudgie's Dev. of N.Y., Inc.*, 239 B.R. 688 (S.D.N.Y. 1999) (allowing landlord claim for postpetition, prerejection rent to be paid immediately, but holding payment subject to disgorgement in event of administrative insolvency).

²¹⁵ *In re Magness*, 972 F.2d 689 (6th Cir. 1992) (stating that obligations under Section 365(d)(3) are not limited to rent payments); see, e.g., *In re BH S&B Holdings LLC*, 401 B.R. 96 (Bankr. S.D. N.Y. 2009) (discussing trustee's obligation to keep property free of mechanics' liens or encumbrances); *In re Atlantic Container Corp.*, 133 B.R. 980 (Bankr. N.D. Ill. 1991) (discussing lessee's obligation to maintain property and timely make repairs during continued use of premises). But see *In re Teleglobe Commc'ns Corp.*, 304 B.R.

uniform approach to dealing with stub rent thus not only would resolve ambiguity for landlords and tenants, but also provide clarity in regard to the proper interpretation of other Section 365(d)(3) terms that may undermine many of the Code's policies discussed above.

VI. Stub Rent Solutions

A. The Merits of the Accrual Approach

Proponents of proration, often landlord-creditors, argue that there are a number of reasons why the accrual approach is the proper means for resolving stub rent uncertainties arising from Section 356(d)(3).²¹⁶ Perhaps the most convincing argument is predicated upon fairness and achieving uniform results. The Code does not prohibit treating differently situated creditors differently.²¹⁷ However, as discussed by the Supreme Court in *Reading Co. v. Brown*,²¹⁸ one “decisive, statutory objective” in bankruptcy is “fairness to all persons having claims against an insolvent.”²¹⁹ The accrual approach appears to produce consistent results by affording both commercial landlords and tenants the opportunity to get what they bargained for under the pre-petition lease—use and occupancy for a mutually agreed upon rate.²²⁰ The accrual approach also prevents debtors from obtaining a windfall at the expense of the commercial landlord that is unable to evict or seek other non-bankruptcy remedies because of the automatic stay.²²¹ In

79 (D. Del. 2004) (“In the present case, any liability associated with removing improvements and alterations to the Leased Premises could not arise prior to rejection.”).

²¹⁶ See, e.g., ABI COMMISSION REPORT *supra* note 15, at 129–35 (providing proposed principles to reform Chapter 11).

²¹⁷ Compare 11 U.S.C. § 503 (2012) (providing for an allowance of administrative expenses), with § 507 (governing priorities).

²¹⁸ 391 U.S. 471 (1968).

²¹⁹ *Id.* at 477 (providing an administrative priority claim against the estate to petitioner for damages resulting from negligence of a receiver acting within scope of his authority as receiver).

²²⁰ *In re Stone Barn Manhattan LLC*, 398 B.R. 359, 364 (Bankr. S.D.N.Y. 2008) (noting proration “produces equitable results as it allows both landlords and tenants to get what they bargained for—current service for current payment—at the rate agreed to in the lease”).

²²¹ *Id.* (discussing the different approaches the courts have taken in regard to proration); see Pollack Statement, *supra* note 66 (discussing the problems associated with 365(d)(3)).

addition, the accrual approach avoids the seemingly “absurd” scenario in which strategic forum selection and timing can result in thousands or millions of dollars in savings for the estate.²²² Moreover, even some courts that have adopted the billing date approach begrudgingly acknowledge that the billing date approach is inherently unfair.²²³ Thus, it seems “only fair that, like almost everyone else, landlords should be paid on an ongoing basis for use of their property.”²²⁴

Proponents also argue that the accrual approach is the best way to promote simplicity, uniformity, and predictability in the Code.²²⁵ The billing approach presents administrative challenges by raising more questions than answers, forcing courts to reconcile other real estate valuation practices, such as “yearly versus monthly leases, arrears versus in advance payment, and taxes versus rent obligations.”²²⁶ Moreover, the billing date approach can be downright confusing in its application among courts.²²⁷ Practically speaking, the accrual approach is easy to determine and “simple to apply” as it only

²²² *In re Stone Barn Manhattan*, 398 B.R. at 366; *In re Ames Dept. Stores, Inc.*, 306 B.R. 43, 71 (Bankr. S.D.N.Y. 2004); see Stulman, *supra* note 14, at 672; Pollack Statement, *supra* note 66.

²²³ *E.g.*, *In re Montgomery Ward Holding Corp.*, 268 F.3d 205, 211 (3d Cir. 2001) (“We reach the conclusion that § 365(d)(3) is unambiguous with some reluctance given that one sister court of appeals and a number of other courts have reached the opposite conclusion and have opted for a proration approach . . . Nevertheless, we find ourselves unpersuaded by the contentions that have led them to their conclusion. We acknowledge that there are aspects to a proration approach that Congress might have found desirable. It is not our role, however, to make arguably better laws than those fashioned by Congress.”).

²²⁴ Pollack Statement, *supra* note 66, at 9.

²²⁵ *Id.* (“In the long run this approach will simplify the determination of the debtor’s post-petition obligations, will allow for the uniform application of Subsection 365(d)(3) and will take forum shopping and ‘filing date holding’ out of the bankruptcy petition equation.”).

²²⁶ Stulman, *supra* note 14, at 673. note 92Provisions from 5, 6, and 7iated iwth ion LLC, et al.,rchase and Saleother human waste. at stems from the environmental

²²⁷ *Compare In re Koenig Sporting Goods, Inc.*, 203 F.3d 986, 989 (6th Cir. 2000) (adopting billing date approach, and allowing landlord’s priority administrative expense claim for stub rent where tenant filed for bankruptcy on second of month after missing payment on first), *with In re Oreck Corp.*, 506 B.R. 500 (Bankr. M.D. Tenn. 2014) (adopting billing date approach, and not allowing landlord’s administrative priority claim for stub rent where tenant filed for bankruptcy after missing rent payment).

requires a quick *pro rata* calculation of rent due based on how much of the month remains.²²⁸ If ambiguity over a proration practice arises and the Code is unhelpful, courts can look to both pre-Section 365(d)(3) common law,²²⁹ and the court's continued use of proration in other areas of bankruptcy, for guidance.²³⁰

Finally, the accrual approach "is consistent with other provisions of the Bankruptcy Code, such as [Sections] 365(g) and 502(g)," providing landlords an "enhanced right to timely performance under a commercial lease" that merely provides a mechanism to measure when obligations arise and terminate.²³¹ While adopting the accrual approach will undoubtedly give rise to additional interpretation questions, "in the long run [the accrual] approach will simplify the determination of the debtor's post-petition obligations, will allow for the uniform application of Subsection 365(d)(3) and will take forum shopping and 'filing date holding' out of the bankruptcy petition equation."²³²

B. The Merits of the Billing Date Approach

Other courts highlight a number of reasons why the billing date method is the correct interpretation of Section 365(d)(3).²³³

²²⁸ *In re Stone Barn Manhattan LLC*, 398 B.R. 359, 364 (Bankr. S.D.N.Y. 2008).

²²⁹ *See id.* (stating that accrual "is consistent with the long-standing, pre-amendment practice of prorating lease obligations pending rejection" and "neither the statute nor its legislative history indicates proration is precluded"); *In re Child World, Inc.*, 161 B.R. 571, 575–76 (S.D.N.Y. 1993) (discussing the court's "long-standing practice . . . of prorating debtor-tenants' rent to cover only the postpetition, prerejection period").

²³⁰ *See, e.g., In re Revco D.S., Inc.*, 111 B.R. 626 (Bankr. N.D. Ohio 1989).

²³¹ *In re Stone Barn Manhattan*, 398 B.R. at 364 (citing *In re Ames Dept. Stores, Inc.*, 306 B.R. 43, 68–80 (Bankr. S.D.N.Y. 2004)); Levitin & Stieglitz, *supra* note 12 ("Not only is it consistent with the general principle that a debtor must timely pay its postpetition obligations, it is easy and practical to apply, and it is also fair and equitable to debtors and landlords. The proration approach gives debtors the benefit of bankruptcy for any prefiling stub period, while at the same time protecting and compensating landlords for the postfiling stub period."); *see also* Lichy, *supra* note 35, at 303.

²³² Pollack Statement, *supra* note 66, at 9.

²³³ *See e.g., In re Burival*, 406 B.R. 548, 552 (B.A.P. 8th Cir. 2009), *aff'd*, 613 F.3d 810 (8th Cir. 2010) ("[A]ny obligation of the debtor under the lease which becomes due after the entry of the order for relief under the Bankrupt-

Primarily, proponents look to the plain language of Section 365(d)(3), noting that it states:

The trustee shall timely perform all the obligations of the debtor [i.e. the tenant], except those specified in section 365(b)(2), *arising from and after the order for relief* under any unexpired lease of nonresidential real property, until such lease is assumed or rejected, notwithstanding section 503(b)(1) of this title.²³⁴

Advocates of the billing method argue that the language in Section 365(d)(3) is “clear.”²³⁵ Under the billing approach, “any obligation of the debtor under the lease which becomes due *after* the entry of the order for relief under the Bankruptcy Code” or which becomes due “before the lease is assumed or rejected,” as in “*arising*” from the order for relief, “must be paid or otherwise fulfilled when due.”²³⁶ A landlord’s unpaid rent “arising” from the order for relief would be covered by Section 365(d)(3) as an administrative priority claim.²³⁷ Yet, by extension, contractual obligations that have not “*aris[en] from and after the order for relief*,” disputably the unpaid stub rent, are *not* governed by Section 365(d)(3).²³⁸ Because Section 365(d)(3) does not govern these claims, the commercial landlord is not necessarily able to prove stub rent payments constitute an administrative priority claim.²³⁹ Accordingly, while Section 365(d)(3) serves as a mechanism to ensure payment of contractually due rent as an administrative priority expense, it only covers payments that have become due under the lease after the tenant has filed for the protection of the bankruptcy court.²⁴⁰

cy Code and before the lease is assumed must be paid or otherwise fulfilled when due.”).

²³⁴ 11 U.S.C. § 365(d)(3) (2012) (emphasis added).

²³⁵ *In re Burival*, 406 B.R. at 552.

²³⁶ *Id.* (emphasis added).

²³⁷ *Id.* note 92. Provisions from 5, 6, and 7 related to ion LLC, et al., purchase and Sale of other human waste. at stems from the environmental

²³⁸ § 365(d)(3) (emphasis added).

²³⁹ *See Vron*, *supra* note 11 (“Accordingly, debtors often contest whether a particular obligation falls within the section 365(d)(3) requirement.”).

²⁴⁰ *Id.* (discussing how section 365(d)(3) permits payment only when a “rent obligation . . . becomes contractually due”); *see also In re Goody’s Family Clothing, Inc.*, 443 B.R. 5, 12 (Bankr. D. Del. 2010) (“[A]n obligation only

Advocates of the billing method also argue that other courts' willingness to read the statute broadly is the source of the uncertainty that has led to undesirable bankruptcy practices.²⁴¹ Adhering to the plain language of the statute and adopting the billing method would lead to certainty and consistency.²⁴² While the accrual approach and all its benefits are enticing,²⁴³ since arguably there is no ambiguity in the statute, proponents of the billing method contend that courts should not look to interpret the statute when it is not necessary.²⁴⁴

Finally, some proponents even contend that the billing date approach is exactly what was intended under various bankruptcy amendments, in that it provides a debtor with liquidity at the onset of the reorganization and the opportunity to "catch its breath and fund its operations."²⁴⁵ Simply, Congress could have utilized words to indicate that rent should be prorated,²⁴⁶ but instead failed to do so in Section 365(d)(3).²⁴⁷ Thus, allowing landlords to recuperate these costs would be in stark contrast to the actual intent of Section 365(d)(3).

arises when a party becomes legally obligated to perform it.").

²⁴¹ See Vron, *supra* note 11 (outlining how the *Oreck* court read this view and followed the line of thought that reads 365(d)(3) and 503(b)(1) unambiguously).

²⁴² *Id.*

²⁴³ See *In re Montgomery Ward Holding Corp.*, 268 F.3d 205, 210–11 (3d Cir. 2001) (explaining that even though there may be some desirable aspects to the proration approach, the unambiguous reading and accrual application are what Congress intended).

²⁴⁴ *Id.* at 211 ("It is not our role, however, to make arguably better laws than those fashioned by Congress.").

²⁴⁵ Pollack Statement, *supra* note 66, at 7.

²⁴⁶ Compare *In re Handy Andy Home Improvement Ctr., Inc.*, 144 F.3d 1125 (7th Cir. 1998) (proration of taxes between the prepetition period and postpetition period, even though taxes were due postpetition) with *Ha-Lo Indus., Inc. v. Centerpoint Props. Tr.*, 342 F.3d 794 (7th Cir. 2003) (rejecting proration of rent, and under the accrual approach denying stub rent). See generally Steven Wilamowsky, *Understanding The Calculation Of Bankruptcy Claims*, LAW360 (Dec. 4, 2013, 1:27 PM), <https://www.law360.com/articles/490430/understanding-the-calculation-of-bankruptcy-claims> [https://perma.cc/F2GL-DLKD] (discussing how various claims are calculated, including when accrual practices are utilized for calculating some claims).

²⁴⁷ 11 U.S.C. § 365(d)(3) (2012) (declining to prorate rent).

C. The ABI Weighs In

In December 2014, following three years of comprehensive evaluation of financially distressed businesses under existing U.S. reorganization laws, the ABI's Commission to Study the Reform of Chapter 11 (Commission) released its *Final Report and Recommendations* summarizing the state of Chapter 11.²⁴⁸ The report acknowledged a growing consensus among practitioners that business reorganization laws were in need of evaluation, and called for perhaps the largest statutory overhaul since 1978.²⁴⁹ The report also discovered and explored a number of perceived barriers to successful reorganization under Chapter 11, including "challenges to financing chapter 11 cases, uncertainty and costs associated with the bankruptcy process, delays built into the process, and insufficient value available to support a restructuring."²⁵⁰ Such barriers, the Commission noted, have led to the growth of alternative restructuring options such that Chapter 11 has become increasingly impractical and irrelevant for businesses.²⁵¹ After gathering data, hearing testimony, and soliciting participation from "[o]ver 250 corporate insolvency professionals,"²⁵² the Commission unanimously approved and released its 400-page report, which detailed extensive recommended changes to the commencement, administration, and completion of a Chapter 11 case.²⁵³

While the Commission's findings do not have binding legal effect, the report contained a number of "recommended principles"

²⁴⁸ See generally ABI COMMISSION REPORT, *supra* note 15.

²⁴⁹ *Id.* at 2.

²⁵⁰ *Id.* at 20.

²⁵¹ *Id.* at 20–21 ("Some witnesses suggested that these perceived barriers may cause companies to forego the chapter 11 process entirely. Anecdotal evidence likewise indicates that distressed companies are increasingly turning to state law remedies (e.g., receiverships and assignments for the benefit of creditors) and equity receivership law with more frequency now than in the past 75 years. Moreover, there is no meaningful way to discern how many distressed companies that could have used chapter 11 simply closed their doors instead of pursuing alternatives through the reorganization process. The Commission was very mindful of these considerations in reviewing issues relating to the filing, financing, and initial steps of a chapter 11 case. The principles in this section strive to address several of these issues.").

²⁵² *Id.* at 13.

²⁵³ *Id.* at 3.

submitted for congressional consideration that include an extensive list of suggestions for statutory changes.²⁵⁴ The recommendations included changes to how the courts treat real property.²⁵⁵ Representing an apparent attempt to “rebalance . . . the relationship” of landlords and Chapter 11 debtors, the Commission suggested various modifications that would shift bankruptcy practice in favor of either the tenant or the landlord.²⁵⁶

To help commercial tenants reorganize, the Commission first recommended giving debtors additional time to assume or reject commercial real leases.²⁵⁷ Currently, Section 365(d)(4) requires a DIP to assume or reject any nonresidential lease within 120 days after the petition date with one additional ninety-day extension of that deadline allowed for cause.²⁵⁸ However, the DIP generally is given until plan confirmation to assume or reject executory contracts and other types of leases.²⁵⁹ The Commission’s recommended principle removes Section 365(d)(4)’s 120-day “check-in” requirement, and instead provides tenants a full 210 days to decide how they want to proceed under their lease.²⁶⁰

Second, the Commission recommended imposing an explicit, “formal” duty on landlords to mitigate damage from debtor’s non-payment of rent.²⁶¹ The requirement acknowledges the use of non-bankruptcy mitigation, and states that “any mitigation or cover received by, or security deposit held by, the landlord should reduce the landlord’s prepetition claim for purposes of calculating the section 502(b)(6) claim.”²⁶²

²⁵⁴ Eric R. Goodman & Tatiana Markel, *Will Congress Finally Act? The ABI Commission on Business Bankruptcy Reform: Secured Lenders*, BAKERHOSTETLER (May 15, 2015), <https://www.bakerlaw.com/alerts/will-congress-finally-act-the-abi-commission-on-business-bankruptcy-reform-secured-lenders> [<https://perma.cc/8CS5-VWVV>] (observing that “[i]t remains to be seen whether Congress will act on the unanimous proposals in the documents”).

²⁵⁵ See ABI COMMISSION REPORT, *supra* note 15, at 129–35 (recommending changes to the treatment of real property leases).

²⁵⁶ See Samole, *supra* note 69.

²⁵⁷ See 11 U.S.C. § 365(d)(4) (2012).

²⁵⁸ *Id.*

²⁵⁹ ABI COMMISSION REPORT, *supra* note 15, at 131.

²⁶⁰ *Id.* at 133.

²⁶¹ *Id.* at 130.

²⁶² *Id.*

Lastly, the Commission recommended limiting a commercial landlord's claim for unperformed obligations under Section 365(d)(3) to monetary obligations, and clarified that such claims would not be granted superpriority treatment.²⁶³ These claims would instead be treated as an administrative claim payable under Section 507(a)(2).²⁶⁴

The Commission hoped that two key changes would better balance the interests of landlord-creditors.²⁶⁵ First, Section 502(b)(6)'s reference to "rent" would be defined more broadly as "*any* recurring monetary obligations of the debtor under the lease" including "monthly payments for occupying the property (including base rent, additional rent, percentage rent), common area maintenance charges, taxes, and insurance."²⁶⁶ Thus, nonrejection-type damages under the lease, such as damage to the property, would not be subject to Section 502(b)(6)'s cap on damages.²⁶⁷

Second, and most relevant to this note, the Commission proposed a resolution to the stub rent issue, stating:

The calculation of postpetition rent under a real property lease should be calculated under the accrual method, allowing the trustee to treat rent accrued prior to the petition date as a prepetition claim and rent accrued on and after the petition date as a postpetition obligation. The trustee should be required to pay any such postpetition rent obligation on or before 30 days after the petition date or date of the order for relief, whichever is later. The trustee should pay all subsequent rent obligations accruing postpetition but prior to any rejection of the lease on a timely basis in accordance with the terms of the lease.²⁶⁸

²⁶³ *Id.* at 129 ("A landlord's claim for unperformed obligations under section 365(d)(3) should apply only to monetary obligations. Such claim for unperformed monetary obligations should not receive superpriority treatment, but should instead constitute an administrative claim under section 503(b)(1) that is payable under section 507(a)(2).").

²⁶⁴ *Id.*

²⁶⁵ *Id.* at 134–35.

²⁶⁶ *Id.*

²⁶⁷ Samole, *supra* note 69.

²⁶⁸ ABI COMMISSION REPORT, *supra* note 15, at 129.

Underlying the ABI Commission's recommendation to adopt the accrual approach and resolve the stub rent issue is a number of policies and goals. One of the broadest objectives the entire report seeks to promote is the reinforcement of Chapter 11 as a means of achieving a "soft landing" from reorganization in which creditors and debtors can better "minimize . . . disruptions" and "develop a feasible restructuring strategy that benefits all stakeholders."²⁶⁹ The Commission also focused in large part on creating processes that would be "more efficient and cost-effective."²⁷⁰ To help promote efficiency and reduce costs, the Commission was motivated to find "first and foremost, a uniform standard" that would settle the stub rent issue once and for all.²⁷¹ The ultimate goal was that such changes would reduce cost-prohibitive practices that had discouraged businesses from pursuing Chapter 11 in the past, by "avoid[ing] debates over billing mechanisms, delays, [and] built-in soft extensions."²⁷² The Commission believed that adopting the accrual method was the fairest way to achieve these underlying goals and the best means of promoting the policies of Section 365(d)(3).²⁷³

VII. Stub Rent in a Post-ABI Commission World

A. Implications and Unforeseen Consequences

Adopting the Commission's recommendation to prorate stub rent seems to provide a simple solution to the stub rent problem. As discussed above, uniform application of the treatment of stub rent claims appears to facilitate reorganization by promoting predictability and easing the administration of the estate, which should, in turn, promote efficiency by reducing costs.²⁷⁴ Consistent application of Section 365(d)(3) should also combat one of the biggest problems discussed above—forum shopping.²⁷⁵

However, the efficiency theoretically gained from the uniform application of the accrual approach will not necessarily be translated into savings for tenants or landlords. While the accrual approach

²⁶⁹ *Id.* at 20.

²⁷⁰ *Id.* at 59.

²⁷¹ *Id.* at 134.

²⁷² Samole, *supra* note 69.

²⁷³ ABI COMMISSION REPORT, *supra* note 15, at 134.

²⁷⁴ See discussion *supra* Part VI.C.

²⁷⁵ See discussion *supra* Part IV.D.

will help ensure that the landlord eventually gets paid for stub rent, expanding the landlord's administrative claim will reduce debtor liquidity at the onset of the tenant's reorganization. Given Chapter 11 attempts to preserve the debtor's growing concern, reducing debtor liquidity at the beginning of the bankruptcy would undermine the potential for reorganization by reducing debtor's financial flexibility and ability to maintain key vendor relationships.²⁷⁶ Moreover, reducing debtor liquidity would also inherently raise the cost of reorganization itself.²⁷⁷

Additionally, debtors, cognizant that jurisdictions would only use proration, would continue to be strategic in when and how they file.²⁷⁸ For example, with the billing date approach rejected, tenants would have little incentive to file close to the date of their missed payment. The tenant's failure to pay rent may lead to uncertainty among landlords about their responsibilities under the Code to attain unpaid rent. Assuming Congress also adopts the Commission's principle mandating landlord mitigation of missed payments, the landlord may also have to commence some sort of non-bankruptcy

²⁷⁶ JAMES L. GARRITY & CHÉRIE L. SCHAIBLE, SHEARMAN & STERLING LLP, CHAPTER 11 PLAN, EXCLUSIVITY AND ITS TIMING, AS WELL AS OTHER SIGNIFICANT REORGANIZATION ASPECTS AFFECTED BY THE NEW AMENDMENTS TO THE BANKRUPTCY CODE 1 (2005), http://www.shearman.com/~media/Files/NewsInsights/Publications/2005/10/Chapter-11-Plan-Exclusivity-and-its-Timing-as-we_/Files/View-Full-Text/FileAttachment/BR_fall2005.pdf [https://perma.cc/6Z6T-JGEG] (discussing generally the Chapter 11 process, and how the “precipitating event for the most corporate bankruptcies in the United States is a lack of sufficient liquidity to fund ongoing operations or otherwise pay debts as they come due”).

²⁷⁷ See SKADDEN, SCARCE LIQUIDITY MAKES CHAPTER 11 EMERGENCE DIFFICULT, BUT YIELDS OPPORTUNITIES FOR DISTRESSED INVESTORS, https://www.skadden.com/sites/default/files/publications/Publications1620_0.pdf [https://perma.cc/KD9T-XKXS].

²⁷⁸ Debtors have long found ways to be strategic in their reorganization. See Debra L. Baker, *Bankruptcy—the Last Environmental Loophole?*, 34 S. TEX. L. REV. 379 (1993) (discussing environmental-related bankruptcy loopholes); Diane L. Dick, *Bankruptcy's Corporate Tax Loophole*, 82 FORDHAM L. REV. 2273 (2014) (discussing corporate tax loopholes in bankruptcy process); Shaun Mulreed, *In Re Blair Misses the Mark: An Alternative Interpretation of the BAPCPA'S Homestead Exemption*, 43 SAN DIEGO L. REV. 1071 (2006) (discussing the “mansion loophole”).

self-help remedy²⁷⁹ “through the claims objection deadline or the date of the order allowing the claim, whichever is earlier.”²⁸⁰

Therefore, uniformity under the accrual approach may threaten to raise the cost of reorganization for creditors and debtors in direct contradiction to the general goals of the ABI Commission and Chapter 11. While the accrual approach may be the most inviting and accessible solution, surely more evaluation of the consequences of amending Section 365(d)(3) to provide for proration is needed.²⁸¹

B. Lesser-Known Alternatives: Better Balancing the Interests of All Parties?

If the billing date approach improperly provides tenant-debtors an unsecured loan, and adopting the accrual method creates adverse incentives, are there any other alternatives? The following discussion solely serves to exemplify the importance of the stub rent issue garnering greater attention by Congress and bankruptcy courts, and offers suggestions to show that the solution may appear in changing or clarifying other aspects of the stub rent equation.

One solution may lie in guaranteeing stub rent along with all other post-petition, pre-rejection rents, but only in the context of the assets of the entire estate. More specifically, perhaps the accrual method should be adopted, but with additional qualifications permitting payment at the conclusion of the bankruptcy, similar to how other administrative priority claims under Sections 503 and 507 are paid.²⁸²

²⁷⁹ See e.g., 49 AM. JUR. 2D *Landlord and Tenant* § 792 (2017) (liens); § 845 (notice to quit and demand for possession); § 853 (damages); § 855 (attorney’s fees).

²⁸⁰ ABI COMMISSION REPORT *supra* note 15, at 130.

²⁸¹ Alternatively, perhaps what is needed is a reconsideration of how to better implement landlord mitigation. However, mitigation and its benefits and complications is beyond the scope of this inquiry. For a comprehensive overview of mitigation during bankruptcy, see generally Michael J. Lichtenstein, *Calculating A Landlord’s Claim in Bankruptcy*, 32 REAL EST. L.J. 131 (2003) (“Whether or not a landlord whose tenant is in bankruptcy has a duty to mitigate damages also remains an open issue.”); Christopher Vaeth, Annotation, *Landlord’s duty, on Tenant’s Failure to Occupy, or Abandonment of, Premises, to Mitigate Damages by Accepting or Procuring Another Tenant*, 75 A.L.R. 5th 1 (2016) (discussing landlord’s duty to mitigate damages by accepting an alternate tenant).

²⁸² 11 U.S.C. § 503(b) (2012) (describing the allowance of administrative expenses); § 507 (outlining the order of claim priority); LeHane, *supra* note

For example, some courts have allowed a *pro rata* payment of rent only if the estate has sufficient assets to fully cover administration claims.²⁸³ If all other administration claims cannot be paid in full, the landlord would instead be paid on a *pro rata* basis with the other creditors holding administrative claims.²⁸⁴ Such an approach makes sense considering the statute does not contain “explicit superpriority language . . . that would catapult the landlord’s claim for rent in front of other administrative expenses,” and because of “the availability of a number of effective remedies” available to a landlord.²⁸⁵ Or, landlords could conceivably be guaranteed payment of all unpaid rent, including a *pro rata* portion of all stub rents as specified in the lease, but could be required to disgorge a portion of their administrative claim if the estate proves administratively insolvent.²⁸⁶ While tenant-debtors could no longer rely on stub rent as a source of liquidity at the beginning of the bankruptcy, this could help ensure bankruptcy relief remains a viable option.

Alternatively, perhaps the solution lies in clarifying the definition of “timely” payment under Section 365. For example, in *In re Circuit City Stores, Inc.*,²⁸⁷ unpaid stub rent totaled between \$20 and \$25 million, and the debtors emphasized that “immediate payment . . . would result in financial hardship . . . and endanger their continued operations and successful restructuring.”²⁸⁸ The debtor argued that Section 365 does not create a new artificial date in which administrative payments should be made, but rather such payments should be made at the conclusion of the bankruptcy, with other administrative priority claims.²⁸⁹ The court concluded:

143, at 69.

²⁸³ Herman, *supra* note 66.

²⁸⁴ *Id.*

²⁸⁵ *Id.* (noting remedies such as “a motion to compel payment of rent, a motion to require the bankrupt to surrender the premises, a motion to lift the automatic stay to allow the landlord to proceed with an eviction action, and a motion to convert the case to Chapter 7”).

²⁸⁶ *Id.*

²⁸⁷ 447 B.R. 475 (Bankr. E.D. Va. 2009).

²⁸⁸ *Id.* at 510 (denying Lessors motions “to compel immediate payment of the postpetition rent due from the Debtors for the period from November 10, 2008, through November 30, 2008 pursuant to 365(d)(3) of the Bankruptcy Code.”).

²⁸⁹ *See id.*

[T]he Lessors hold a claim for Stub Rent that is entitled to administrative expense priority under 507(a)(2) of the Bankruptcy Code [and that Section 365(d)(3) changes] the obligation of the Debtor to pay Stub Rent into an administrative claim, but it does not change the temporal element of the lease term regarding payment—the time for performance of the payment obligation [T]he obligation to pay Stub Rent is the same as for all other administrative expense claims upon confirmation of the plan pursuant to 11 U.S.C. § 1129(a)(9)(A). Section 365(d)(3) does not provide a separate remedy to effect payment. If a debtor fails to perform its obligations under 365(d)(3), all a Lessor has is an administrative expense claim under 365(d)(3), not a claim entitled to super-priority.²⁹⁰

Clarification of both the nature of the claim, and the time in which repayment is required, could therefore be a part of the stub rent solution.

Finally, perhaps Congress should reevaluate Chapter 11's alternative means of granting administrative claims under Sections 503 and 507. While Section 365(d)(3) created a unique method of obtaining rent payments, clearly it has created a host of unique problems for landlords. The solution may lie in reevaluating how administrative priority claims are allocated so that Sections 503(b)(1) and 365(d)(3), or their progeny, harmoniously help landlords while not entangling the rights of other creditors.

²⁹⁰ *Id.* at 510–11. For a discussion of the pros and cons of the court's treatment of stub rent in *In re Circuit City Stores*, see Symposium, *Clean-up on Aisle 5: Retail Industry Reorganizations and Liquidations*, 27 AM. BANKR. INST. 6 (2009) ("For debtors, the *Circuit City* stub rent decision represents the best of both approaches; avoid paying any charges that accrue pre-petition while providing significant liquidity boost by delaying the obligation to pay stub rent until confirmation. In contrast, aside from the finding that stub rent is entitled to priority as an administrative claim under § 503(b), this decision is not a favorable development for landlords.").

VIII. Conclusion

When a commercial tenant with an unexpired lease files for Chapter 11 relief, the tenant's landlord generally seeks ways to protect its commercial property during the bankruptcy. While the landlord may have some difficulty recuperating any unpaid pre-petition rent as an unsecured claim against the estate, Section 365(d)(3) provides the landlord with significantly greater protection.²⁹¹ Payments made pursuant to Section 365(d)(3) provide the landlord with an administrative priority expense for the tenant-debtor's ongoing use and occupancy, and provide the landlord with greater assurance that it will be paid at least until the tenant-debtor subsequently assumes, rejects, or assigns the lease.²⁹²

But despite attempts to protect landlord-creditors, Section 365(d)(3) and other areas of the Code fail to clearly address the appropriate treatment of stub rent. This uncertainty has given rise to the accrual method approach, billing date approach, and various hybrids.²⁹³ For commercial landlords with high-value real estate, and retail landlords with various properties linked to one tenant, inconsistent treatment of stub rent is particularly problematic.²⁹⁴ Non-uniform treatment of stub rent fosters forum shopping and manipulative filing practices among tenant-debtors, and can lead to different restructuring payouts for landlord-creditors.²⁹⁵

²⁹¹ See generally 11 U.S.C. § 365 (2012).

²⁹² See Harding, *supra* note 138 ("Congress intended § 365(d)(3) to nullify the requirement of § 503(b) that a creditor prove benefit to the estate before it can obtain administrative expense status for a post-petition rent claim. That is exactly what § 365(d)(3) states; it applies "notwithstanding section 503(b) (1) of this title.").

²⁹³ See generally Herman, *supra* note 66.

²⁹⁴ See McBride, *supra* note 4.

²⁹⁵ See Parikh, *supra* note 163 ("The permissive venue rules in bankruptcy afford a corporate debtor virtually unlimited venue options. From those options, the corporate debtor can choose the venue that it believes will be most favorable to ownership, management, insiders, or lenders depending on which party exercises the most control and leverage over the decision-making process. There is almost no transparency in this process and, as explained below, once the decision is made, it is extremely difficult to undo.").

Because of the significance of stub rent for certain landlord-creditors, the stub rent issue demands legislative or Supreme Court clarification that will identify one solution. Given the ABI Commission's recent recommendation that the accrual method be adopted, legislative action appears to be on the, albeit distant, horizon. However, the solution may not be as simple as adopting the accrual approach, and a uniform solution under the accrual method may not be without its flaws. If and when an approach is adopted to resolve the stub rent issue, careful consideration should be given to the benefits afforded to landlord-creditors, the implications for tenant-debtors, and whether such action will reinforce or frustrate the Code's underlying policies.