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**EVERYTHING YOU WANTED TO KNOW ABOUT LEASES:  
PART II — SELECTED ISSUES IN LEASE NEGOTIATIONS & PROVISIONS**

**THE EFFECT OF BANKRUPTCY ON NON-  
RESIDENTIAL REAL PROPERTY LEASES**

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# THE EFFECT OF BANKRUPTCY ON NON-RESIDENTIAL REAL PROPERTY LEASES

## I. INTRODUCTION<sup>1</sup>

This paper discusses the effects of 28 U.S.C., Title 11, the United States Bankruptcy Code (the “Code”), on the rights and remedies of parties to nonresidential real property leases under which a debtor is the tenant. Different rules and procedures apply to personal property leases, to residential real property leases, and to situations in which the debtor is the landlord, none of which are addressed in this paper. The term “trustee”, as used in these materials and in the Code, includes a debtor-in-possession (or “DIP”) in a chapter 11 case. See Code § 1107(a).

## II. TERMINATING A LEASE PRIOR TO BANKRUPTCY

### A. Background and Context

If a commercial tenant is in arrears in payment of rent under a lease that has a below market rental rate, the landlord may desire to terminate the lease and enter into a new, market rate lease, usually with a new tenant. However, if the tenant files a petition under the Code, the lease may be a valuable asset which, subject to the Code’s restrictions on lease assumptions and assignments (discussed infra), may be assumed by the debtor-tenant or assumed and assigned to a new tenant. This can result in the bankruptcy estate, instead of the landlord, obtaining the benefit of the difference in value between the lease rental rate and the current fair market rent. Most landlords would like to avoid this result for obvious financial reasons, and desire to terminate such a lease prior to the filing of a bankruptcy petition.

Even where the lease rental rate is equal to or greater than the current market rate, there may be incentive to keep the lease out of the bankruptcy estate. In a reorganization under Chapter 11, the tenant may decide to discontinue operations on the property covered by the lease. However, as discussed below, the tenant has at least sixty days to assume or reject the lease. Although during this sixty day period the Code requires the trustee to make timely payments under the lease, this often does not occur. As a result, the landlord can be left with only a claim against a potentially insolvent estate.

For all these reasons, landlords often desire to terminate the lease prior to the tenant’s bankruptcy filing to keep the lease from becoming subject to the jurisdiction of the bankruptcy court. The following several sections of this paper thus deal with the concept of and procedures for effective lease termination.

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<sup>1</sup> This paper was originally prepared by Andrew Guy of Stoel Rives LLP in Seattle, Washington, whose permission for use is gratefully acknowledged. A version of the paper with current citations to applicable case law is available by emailing [dblevant@stoel.com](mailto:dblevant@stoel.com).

## **B. Pre-Bankruptcy Termination Precludes Assumption of the Lease**

Section 365(c)(3) of the Code precludes the debtor's assumption of a lease of nonresidential real property if the lease has been terminated before an "order for relief" is entered by the bankruptcy court.<sup>2</sup> (The meaning of assumption and rejection of a lease in bankruptcy is discussed infra.) Conceptually, the fact that the Code does not allow the debtor to assume a terminated lease makes sense, because there are simply no legal rights left following termination of the lease for the debtor or trustee to assume. The Code distinguishes between termination and default, and expressly allows assumption after a default has occurred. See Code § 365(b)(1). Thus, if there has been a default in payment of rent, without more, there is no termination and the trustee may still assume the lease.

## **C. Effective Termination**

A problem sometimes arises in determining whether a lease has been terminated under applicable nonbankruptcy law, thereby precluding assumption. To effect termination, if the lease provides that the landlord can terminate the lease after default by providing notice or taking other actions, then (a) such notice must be given or actions taken before the order for relief is entered, to avoid the effect of the automatic stay, and (b) the tenant or trustee must have failed to cure the defaults within any time period that might be allowed for the tenant to cure the lease default under the lease or state law, as that time may be extended by the Code (pursuant to Code § 108(b) or § 105(a)). Assuming that other Code requirements for assumption are met, the trustee may assume the lease as long as the termination process has not been completed.

If there is any provision in the lease or under applicable law that would permit the tenant to reinstate, the trustee will have the opportunity to assume the lease (provided that other prerequisites to assumption are met). For example, in In re Waterkist Corp., 775 F.2d 1089, 1091 (9th Cir. 1985), the tenant breached by failing to pay annual rent but filed a petition under the Code while still in possession of the leasehold property. The Ninth Circuit held that there was still a lease which could be assumed because the landlord would have to bring an unlawful detainer action to regain possession, the tenant would lose more than \$1,000,000 in tenant improvements if the forfeiture of the lease were confirmed, and under Alaska law forfeitures are disfavored and must be determined on the equities relative to each party. 775 F.2d at 1091.

Even when the landlord has properly served the tenant with a notice of termination pursuant to the terms of the lease or applicable state law, if the lease or applicable law allows the tenant to avoid termination of the lease by curing the default(s) within a specified time, and that time has not expired before the order for relief is entered, the trustee is entitled to cure within the first sixty days, and perhaps longer if the court were to be persuaded to extend the time for cure pursuant to § 105(a).

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<sup>2</sup> The "order for relief" is entered automatically upon the filing of the petition in a voluntary case. See Code § 301. An order for relief may be entered in accordance with the prayer of an involuntary petition in bankruptcy following either a default by the debtor in responding to the involuntary petition or after a hearing in which the court has determined that the Code's requirements for filing an involuntary petition have been met. See Code § 303(h).

Some bankruptcy courts have held that termination of an executory contract can be waived, thereby allowing for assumption. There is also some authority for the proposition that termination of a lease can be avoided as a fraudulent conveyance or preference under certain circumstances.

#### **D. Certain Contract Termination Provisions Not Recognized in Bankruptcy**

A landlord's rights under lease provisions that give the landlord the right to terminate the lease upon the occurrence of certain events may not be exercised after the order for relief is entered. Code § 365(e)(1) bars enforcement of provisions that base the right to terminate on the insolvency or financial condition of the debtor, the commencement of a case under the Code, or the appointment of a receiver or other pre-bankruptcy "custodian". (Such provisions are commonly called "ipso facto" clauses.) Section 365(b)(2) further makes clear that the trustee does not have to cure defaults based on such clauses in order to assume the lease.

Note that the Code does not declare ipso facto clauses to be unlawful or unenforceable outside of bankruptcy or against parties other than the debtor. Such clauses remain enforceable if they are exercised to terminate the lease under state law prior to a case being commenced under the Code. They also may be enforceable after the bankruptcy is dismissed, or against non-debtor guarantors during the pendency of the tenant's bankruptcy case.

### **III. EVICTING THE DEBTOR AFTER THE BANKRUPTCY PETITION IS FILED**

The automatic bankruptcy stay of Code § 362(a) generally precludes actions against debtors following the filing of the bankruptcy petition. However, specifically excepted from the stay is

any act by a landlord to the debtor under a lease of nonresidential real property that has terminated by the expiration of the stated term of the lease before the commencement of or during a case under this title to obtain possession of such property . . . .

Code § 362(b)(10). Thus, if the leasehold interest expires pursuant to the lease terms, the landlord may commence unlawful detainer proceedings if necessary to evict the tenant/debtor, without first obtaining an order from the bankruptcy court granting relief from stay. This assumes that the landlord has not agreed to extend the term of the lease.

The landlord's acceptance of rent after the lease term has expired may be deemed to evidence an intention to allow extension of the lease term and, under the provisions of many commercial leases, may create a month-to-month tenancy that would be part of the tenant's bankruptcy estate, and would subject any eviction or enforcement action to the automatic stay. Unless the case fits squarely within the exception of § 362(b)(10), it is prudent to move for relief from stay to obtain a bankruptcy order authorizing eviction before the landlord takes steps to evict the tenant.

#### **IV. THE DEBTOR'S DUTY TO PERFORM LEASE OBLIGATIONS PRIOR TO ASSUMPTION**

Section 365(d)(3) of the Code provides:

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

This section further provides that the Court may extend the time for performance of such obligations that arise within the first sixty days of the case, but the time for performance itself may not extend beyond the sixty-day period. Id. Thus, within these parameters, landlords of nonresidential real property have the right to insist that the trustee pay lease obligations as they accrue under the lease. Section 365(b)(4) does not specify what consequences flow from a debtor's failure to timely perform under the lease. A landlord can best protect itself during the sixty-days, or any extended period, by filing a motion to compel the payment of any lease obligations which become delinquent during that period, or, in the alternative, for relief from stay for cause. A request for payment need not be limited to rent, because the statute requires the trustee to timely perform all obligations arising under the lease.

#### **V. LANDLORD'S RIGHT TO WITHHOLD SERVICES AND SUPPLIES AFTER DEFAULT AND PRIOR TO ASSUMPTION, ABSENT PAYMENT FOR SAME**

Notwithstanding any other provision of Code § 365, if the tenant has defaulted under the terms of an unexpired lease, the trustee may not require the landlord to provide services or supplies incidental to the lease (e.g., janitorial service, trash hauling, etc.) before the trustee assumes the lease, unless the landlord is compensated pursuant to the terms of the lease for any services and supplies provided under the lease. See Code § 365(b)(4).

The language in § 365(b)(4) effectively imposes a duty on the landlord to provide such services upon receiving payment, even in the face of a default that otherwise might relieve the landlord of providing such services. Section 365(b)(4) also indicates that payment will be made pursuant to the terms of the lease, rather than upon terms approved by the court under the circumstances then existing. Although this provision no doubt is intended primarily to protect the landlord, it also precludes the landlord from demanding cash payment as a condition to providing services or supplies if the lease provides for payment on delayed payment terms (such as within a certain number of days following submission of an invoice or statement for services or supplies provided during the previous month).

#### **VI. ASSUMPTION OR REJECTION OF THE NONRESIDENTIAL LEASE BY THE DEBTOR**

##### **A. Time for Assumption or Rejection—Existing Law**

The trustee must assume or reject an unexpired lease of nonresidential real property within sixty days after the order for relief is entered or within such additional time period as the court may

allow. Code § 365(d)(4). If the trustee does not assume or reject the lease within the 60-day deadline or any extension thereof, the lease is deemed rejected, and the trustee must surrender the property to the landlord immediately. Rejection of the lease before the 60-day period expires requires an order of the Court. The non-debtor party to the lease may waive the right to have the lease deemed rejected at the end of the 60-day period.

If the motion to assume a lease is made within the 60-day period, the statutory time requirement may be satisfied in some circuits even if the court does not hear the motion or approve the assumption until after the 60-day deadline. This interpretation of the time period applies equally to a motion for extension of the time in which to assume or reject the lease, provided that before the 60-day period expires, the cause for extension exists and the request has been made. Moreover, the court may grant multiple extensions under the existing law, if cause justifying each extension exists and the request is made before the prior extension expires.

**B. Standard for Allowing Extension of the 60-Day Period to Assume or Reject Lease—Existing Law**

The “cause” that warrants an extension of time to assume or reject a lease is not specified in the Code. Therefore, a finding of cause is within the discretion of the court. This issue primarily arises in chapter 11 cases or in the rare chapter 7 case where the court has entered an order authorizing the trustee to continue operating the debtor’s business. Courts usually look to a series of factors, such as the following, in determining if cause exists for granting an extension:

1. Whether the lease is a primary asset of the bankruptcy estate;
2. Whether the landlord has a reversionary interest in any buildings built by the debtor on the landlord’s property;
3. Whether the debtor has had sufficient time to intelligently appraise its financial situation and the potential value of its assets in terms of the formulation of a chapter 11 plan;
4. Whether the landlord continues to receive rental payments and whether the debtor fails to pay the rent reserved in the lease;
5. Whether the landlord will be damaged beyond compensation available under the Bankruptcy Code due to the debtor’s continued occupation;
6. Whether the case is exceptionally complex and involves a large number of leases;
7. Whether need exists for judicial determination of whether the leases is a disguised security agreement;
8. Whether the debtor has failed or is unable to formulate a plan when it has had more than enough time to do so; and

9. Any other factors bearing on whether the debtor has had a reasonable amount of time to decide to assume or reject the lease.

The debtor's failure to keep current on postpetition rental obligations weighs heavily in favor of limiting extensions of time to assume or reject a lease.

### **C. Time for Deciding Whether to Assume or Reject Under the 2005 Amendments**

Section 365(d)(4) of the Code was substantially changed by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 to limit the time within which a debtor can decide whether to assume or reject a nonresidential real property lease. The amendment will become effective in October 2005, but existing law will continue to apply to all bankruptcy cases commenced prior to the effective date of the amendments.

Amended Section 365(d)(4) provides:

(4) (A) Subject to subparagraph (B), an unexpired lease of nonresidential real property under which the debtor is the lessee shall be deemed rejected, and the trustee shall immediately surrender that nonresidential real property to the lessor, if the trustee does not assume or reject the unexpired lease by the earlier of—

(i) the date that is 120 days after the date of the order for relief; or

(ii) the date of the entry of an order confirming a plan.

(B) (i) The court may extend the period determined under subparagraph (A), prior to the expiration of the 120-day period, for 90 days on the motion of the trustee or lessor for cause.

(ii) If the court grants an extension under clause (i), the court may grant a subsequent extension only upon prior written consent of the lessor in each instance.

The amendment to Section 365(d)(4) does not appear to change the time for filing a motion or the standard of "cause" for determining whether to grant an initial 90-day extension of the debtor's time to decide whether to assume or reject an unexpired lease.

### **D. Standard for Deciding Whether to Assume or Reject**

The trustee's decision to assume or reject a lease is a matter of business judgment, and courts have rejected the view that the trustee may reject a lease only if it is burdensome. However, if rejection will damage the non-debtor party to the lease more than it will benefit the general unsecured creditors, there is some authority that the court may deny rejection, though most courts have rejected the idea that the Code permits a balancing of equities between the debtor tenant and landlord.

## **E. Necessity of Court Approval for Assumption or Rejection**

A lease assumption can be made only upon approval of the court, Code § 365(a), and the trustee may not assume a lease simply by continuing to observe its terms, or reject a lease without approval of the rejection by the Court. In circumstances where the landlord has apparently accepted a rejection of the lease, however, there is authority in some circuits for the rejection to be given retroactive effect in the Court's order approving the lease rejection.

## **F. Standards for Allowance of Assumption**

### **1. Basic Rules**

If there is a default under the lease, the trustee may not assume the lease unless, at the time of the assumption, the trustee cures the default or provides "adequate assurance" of prompt cure, compensates or provides adequate assurance of prompt compensation of the landlord for any actual pecuniary loss the landlord has suffered as a result of the default, and provides adequate assurance of future performance under the lease. Code § 365(b).

### **2. The Concept of "Prompt Cure"**

Prompt cure of a default is not defined in the Code and varies according to the circumstances of each case. Although it is unusual for a cure period of greater than one year to be considered prompt, the Court may allow cure to be delayed if the landlord has acquiesced to defaults over a lengthy period of time.

### **3. The Concept of Adequate Assurance**

The term "adequate assurance" is also not defined in the Code, and its meaning has also been determined based on the particular facts and circumstances of each case. The following cases illustrate how courts have determined whether assurance of future performance is adequate:

a. In Richmond Leasing Co. v. Capital Bank, N.A., 762 F.2d 1303 (5th Cir. 1985), the court held that it was not error for a bankruptcy court to credit testimony of debtor's witnesses regarding future profitability rather than creditor's witnesses.

b. The court in Buchakian v. Musikahn Corp., 69 B.R. 55 (E.D.N.Y. 1986), concluded that adequate assurance was provided where the bankruptcy court found that proceeds from sales at a store on leased premises would be sufficient to pay rent, and proceeds were earmarked to pay rent before going into general corporate coffers.

c. Assumption was denied in In re Physique Forum Gym, Inc., 27 B.R. 691 (Bankr. D. Md. 1982), where the debtor was unable to establish that it could generate sufficient funds to pay rent or to give the landlord a security deposit.

d. In In re Alipat, Inc., 36 B.R. 274 (Bankr. D. Mo. 1984), the assurance provided by an assignee was adequate where (a) the assignee demonstrated financial resources sufficient to meet rental payments, (b) the nature of the business would remain

substantially unchanged, and (c) the assignee demonstrated the ability to operate business successfully and comply with other lease terms.

e. In determining whether adequate protection has been shown, the court must consider the extent and history of defaults and the debtor's record of making prior payments in addition to considering the current source of payment. In re Westview 74th Street Drug Corp., 59 B.R. 747 (Bankr. S.D.N.Y. 1986).

f. In In re R.H. Neil, Inc., 58 B.R. 969 (Bankr. S.D.N.Y. 1986), the court held that adequate assurance was provided by the debtor's improved financial condition, where the debtor had instituted economies of operation and sales had increased since the petition was filed.

g. Factors considered in In re Bygaph, Inc., 56 B.R. 596 (Bankr. S.D.N.Y. 1986), as being of chief importance in determining whether there has been a showing of adequate assurance of future performance were (a) whether rent will be paid, (b) the personal financial resources of the proposed assignee, (c) the assignee's willingness to devote funding to the new restaurant, and (d) the past success of the assignee in the restaurant business.

h. In Matter of Bronx-Westchester Mack Corp., 20 B.R. 139 (Bankr. N.Y. 1982), the assignee's financial status and its assumption of the debtor's ongoing obligations constituted adequate assurance of future performance.

i. Not surprisingly, the court in In re Hub of Military Circle, Inc., 19 B.R. 460 (Bankr. E. D. Va. 1982), held that payment of rent in advance constituted adequate assurance of future performance.

Adequate assurance of future performance is required only where there has been a default, and the court does not have authority to require a deposit from a debtor as a condition of assumption of a lease in the absence of default. Moreover, the requirement of adequate assurance may not be interpreted to require the debtor to put the landlord in a better position than the landlord enjoyed before the default.

## **G. Assumption of Burdens as well as Benefits of the Lease**

If a trustee elects to assume a lease, the assumption includes the burdens as well as the benefits of the lease. The debtor thus may not "cherry pick" the desirable lease provisions and leave others behind. There can be difficult issues, however, whether multiple leases or related agreements are separate for assumption and rejection purposes, or if they are different parts of a single integrated agreement that must be assumed or rejected as a whole.

## **H. Consequences of Assumption**

### **1. Existing Law**

Under existing law, once the lease has been assumed by the trustee, the estate is liable for performance, and a subsequent breach entitles the landlord to an administrative claim under Code § 503(b) for both prepetition and postpetition claims. This had the effect of making an

improvident lease assumption extremely damaging to a debtor, and discouraged the Bankruptcy Courts from compelling debtors to assume leases prior to the confirmation of a plan of reorganization.

## 2. 2005 Amendment

In connection with the amendment of Section 365(d)(4) discussed above on page 6, Congress enacted new Section 503(b)(7), which limits the amount of a landlord's administrative claim under Code § 503(b) to a period of two years following the later of the lease rejection date or the date of actual turnover of the premises. All amounts in excess of such administrative cap are subject to a claim that is further limited by Section 502(b)(6) of the Code (see below, part IX.C.).

## **VII. ASSIGNMENT OF LEASES IN BANKRUPTCY**

### **A. Limitations on Assignability**

Most unexpired leases may be assigned by the trustee without regard to prohibitions against or restrictions on assignment contained in the lease. Code § 365(f)(1). The only limitations on lease assignments are: (a) situations where (i) applicable law excuses a non-debtor party to the lease from accepting performance from or rendering performance to anyone other than the debtor (such as contracts for personal services), and (ii) the other party does not consent to assumption or assignment of the lease, (b) contracts for financial accommodations to or for the benefit of the debtor, and (c) nonresidential leases of real property that have been terminated under applicable nonbankruptcy law before the order of relief is issued. Code §§ 365(f)(1), (c). The intent of § 365(c) is to limit nonassignability to instances in which a contract or lease would not be enforced under nonbankruptcy law regardless of restrictive language in the contract or lease.

### **B. The Requirement of Assumption Prior to Assignment**

As a prerequisite to the assignment of an unexpired lease, the trustee must assume the lease. Code § 365(f)(2)(A). As noted above, assumption requires that any default in the lease must be cured at the time of assumption, and pecuniary losses caused by such default must be compensated (or adequate assurance of prompt cure and compensation must be given). Code § 365(b)(1). Thus, the only leases that may be assigned are those whose defaults have been brought current or where adequate assurance of prompt cure and compensation has been provided.

### **C. Adequate Assurance of Future Performance Required**

In the event of assignment, regardless of whether there has been a default in the lease, the assignee must provide adequate assurance that future obligations will be performed. Code § 365(f)(2)(B). The landlord may require a deposit or security, the same as would be required upon an initial leasing to a tenant similar to the assignee. Code § 365(l). The requirement of adequate assurance of future performance from an assignee regardless of whether there has been a default is fair because, under Code § 365(k), upon assignment of an assumed lease, the trustee and the estate are relieved of any liability for any breach that occurs after the assignment. Even if the trustee wishes to sublet rather than assign an unexpired lease, the trustee must give adequate assurance of future performance.

## **VIII. SPECIAL PROVISIONS RELATING TO SHOPPING CENTER LEASES**

Because interrelationships often exist among shopping center tenants, and because of the existence of provisions such as percentage rent and use restrictions in most shopping center leases, Code § 365(b)(3) imposes special requirements regarding adequate assurance of future performance which must be met by a trustee seeking to assume or assume and assign a lease in a shopping center. For shopping center leases, the Code specifies that adequate assurance of future performance must include adequate assurance: (a) of the source of rent and any other considerations due under the lease, and that the financial condition and operating performance of any assignee and its guarantors will be similar to that of the debtor and its guarantors at the time the debtor became the tenant, (b) that percentage rent due will not decline substantially, (c) that the assumption or assignment is subject to all provisions of the lease and will not breach provisions of other leases, financing agreements, or the master agreement relating to the shopping center, and (d) that the assumption or assignment will not disrupt the tenant mix or balance in the shopping center. Code § 365(b)(1)(3).

## **IX. CALCULATION OF THE LANDLORD'S CLAIMS AGAINST THE BANKRUPTCY ESTATE**

### **A. Secured versus Unsecured Status of Landlord's Claim**

To the extent the landlord is holding a cash security deposit or has a properly perfected security interest in other collateral for the tenant's performance under the lease, the landlord is a secured creditor. On the other hand, Code §§ 545(3) and (4) specifically give the trustee the power to avoid any statutory lien for rent or for distress for rent. Thus, unless the landlord has obtained a contractual security interest in some collateral, the landlord's claim will be unsecured. The claim may be a general unsecured claim or a priority expense of administration claim or a combination of both, depending upon the circumstances.

### **B. The Landlord's Claim for Rent Pending Assumption or Rejection**

If the tenant remains in possession of the leased premises following the filing of the bankruptcy petition, the bankruptcy estate is liable to the landlord for the full amount of the rent as it becomes due pursuant to the lease for the time the tenant remains in possession. The landlord's claim for rent accruing postpetition normally has administrative expense priority, pursuant to Code § 503(b). The circuits are split concerning the treatment of rent due in the month when a debtor files for bankruptcy, and whether the amount of rent for the portion of the month in which the bankruptcy is filed should be entitled to administrative expense priority status on a pro rata basis.

### **C. The Landlord's Claim Resulting from Rejection Where There has been no Prior Assumption**

Rejection of a lease constitutes a breach under the Code, and the landlord is left with a claim against the bankruptcy estate. See Code § 365(g). If the lease has not been previously assumed by the debtor or trustee, the claim is deemed effective as of the date before the filing of the petition. See Code § 365(g)(1). This leaves the landlord with a general unsecured claim against the estate for prepetition lease obligations.

Following rejection, the landlord is entitled to assert a general unsecured claim subject to the limitation imposed under Code § 502(b)(6). This “cap” includes all of the rent that became due before the bankruptcy case was commenced or the date when the landlord repossessed the property (if such a repossession took place), whichever occurred earlier. Additionally, the landlord may include one year’s rent reserved under the lease (without any acceleration of future rent that might be allowed under the lease terms), or fifteen percent of the total rent for the remaining term of the lease, provided that the claim may not exceed the amount of rent that would accrue over three years.

A three-part test is used by most courts to determine if a charge constitutes “rent reserved by such lease” under § 502(b)(6)(A):

1. The charge must: (a) be designated as “rent” or “additional rent” in the lease; or (b) be provided as the tenant’s obligation in the lease;
2. The charge must be related to the value of the property or the lease thereon; and
3. The charge must be properly classifiable as rent because it is a fixed, regular, or periodic charge.

The Section 502(b)(6) cap limits future damages and not a statutory liquidated damages clause. State law, under the particular circumstances of the lease termination, will control whether the claim is allowable to the maximum under the statute.

#### **D. The Landlord’s Claim for Rejection or Breach Following Assumption**

##### 1. Existing Law

Under existing law, if a lease is rejected or breached following its assumption, the landlord has an administrative claim against the estate (rather than an unsecured claim without priority) for any damages that are occasioned thereby, without any limit on the amount of the claim under the Bankruptcy Code. As a result, such claims can dramatically reduce the recovery by other creditors in the case, as compared to the result if the lease had been rejected in the first instance.

##### 2. 2005 Amendment

New Section 503(b)(7) limits the amount of a landlord’s administrative priority claim to a period of two years following the later of the lease rejection date or the date of actual turnover of the premises. This cap does not apply, however, to amounts received from an entity (such as a guarantor or letter of credit issuer) other than the debtor. All amounts in excess of such administrative cap are subject to a claim that is further limited by the cap on the landlord’s unsecured claim under Section 502(b)(6) of the Code.

**X. OBTAINING LEASE PAYMENTS OR EVICTING IF THE DEBTOR BREACHES AFTER ASSUMING THE LEASE**

As noted above, if the debtor fails to make lease payments following assumption of the lease, the landlord has an administrative claim for lease payments. However, rather than waiting to receive payment on such claim, the landlord may bring a motion to recover the payments due as an administrative expense, under § 503(b). In the alternative, the landlord may file a motion seeking to evict the tenant from the leased premises or for relief from stay to allow eviction proceedings to commence, on the grounds that the debtor has failed to live up to the adequate assurance of payment.

**XI. THE LANDLORD'S REMEDIES IF THE TRUSTEE HOLDS OVER AFTER REJECTION**

The debtor's possessory interest in the nonresidential real property lease terminates upon rejection of the lease. Code § 365(d)(4) specifies that the trustee must "immediately surrender" the nonresidential real property to the landlord following rejection of such a lease.