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## Central States Bankruptcy Workshop

# Don't Get “Whacked” by These § 365 Lease Issues: The Necessary Tools to Bring to Your Next “Sitdown”

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**Bring the Necessary Tools to Your Next “Sitdown”: Don’t Get “Whacked” by These Section 365 Lease Issues**

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## Background

- Sections 363(b) & 365(b) of the Bankruptcy Code
- Lease negotiations occurring during postpetition sale process to maximize value for all parties-in-interest
- Applicable Parties: landlord/lessor, debtor, interested parties/bidders
- Proactive assessment by qualified professionals
- Defining Lease Terms:
  - Triple Net Lease
  - Cap Rates
  - Percentage Rate
  - Blend and Extend



## Beginning Stages of Engagement: Real Property Analysis

- How do you begin to analyze a client's real property portfolio/client's real property collateral?
- Considerations of how, when, and if to market the real property?
- Client expectations vs. market realities?
- When, if ever, would a client obtain a higher and better offer for real property outside of a chapter 11 case?
- ABC and/or receivership considerations when evaluating client's real estate?

3

## Real Property Lease Considerations

- Resurgence of Lease Transfers
  - Retail commercial real estate apocalypse never happened (vacancy rates, COVID, new construction, shopping center diversity)
  - Location dependent and geographical strongholds now becoming available (e.g., Big Lots, Party City, Jo-Ann Stores, Conns)
  - Unique leases (e.g., Rite-Aid).
  - Expenses (professionals, cure cost) vs. return

4



## Real Property Lease Considerations, *cont.*

- Negotiation Timing
  - When to reject, assume, or assume/assign
  - Counterparty debtor or third-party assignee?
  - Repair and maintenance expectations
  - Anticipated future value
- Landlord Leverage
  - Cure costs
  - Side letters
  - Court-approved lease modifications
  - If/when to file objection and coattail risk



5

## Real Property Lease Considerations, *cont.*

- Commonly Negotiated Terms
  - Use of premise
  - Going dark/continuous operations
  - Assignment effecting forfeiture/conditioned on landlord consent
  - Reasonable signage
  - Minimum sale revenue
  - Percentage rent for prorated portion of sales
  - Radius provision
- Options if negotiations are unsuccessful:
  - Rejection
  - Designee
  - Assume and continue to market

6



## Real Property Lease Considerations, *cont.*

- Unique Situations:
  - Sublease complexity (GNC)
  - Clean rooms (Azzur)
- Mechanism for assumption or rejection upon 365(d)(4) deadline
  - Majority View: Filing motion is the exclusive vehicle for assumption, assumption/assignment, rejection via Bankruptcy Rules 6006(a), 9013, and 9014.
  - Minority View: Doctrine of tacit, or informal, assumption (e.g., *In re Rite Aid Corp.*, 23-18993, 2024 WL 4715336 (Bankr. D.N.J. Nov. 6, 2024): plan supplement assumption schedule on 365(d)(4) deadline was permissible)

7

## Real Property Lease Considerations, *cont.*

- Postpetition Franchise Renegotiations (e.g., Red Lobster)
  - Section 365(c) Hypothetical Test (3<sup>rd</sup>, 4<sup>th</sup>, 9<sup>th</sup>, 11<sup>th</sup> Circuits) vs. Actual Test (1<sup>st</sup>, 5<sup>th</sup> Circuits)
  - Parent and debtor franchisee strategy
  - Landlord negotiations
  - Pressure points



8



## Real Property Lease Considerations, *cont.*

- Lessor Claim Calculations
  - Section 502(b)(6)(A): Real property lessor's damages claim is limited to:
    - (A) the rent reserved by such lease, without acceleration, *for the greater of one year, or 15 percent, not to exceed three years, of the remaining term of such lease,* following the earlier of — (i) the date of the filing of the petition; and (ii) the date on which such lessor repossessed, or the lessee surrendered, the leased property; . . . .” [Emphasis added.]
  - Time Approach: Counts the greater of 15% or three years of rent due after the petition date.
  - Rent Approach: Takes rent escalations into account by computing the greater of 15% or three years of rent over the duration of the lease.

9

## Personal Property Lease Considerations

- Abandonment/Surrender of Remaining Personal Property
  - Ability to monetize
  - Third-Party Lessor negotiations (if known)
  - Due diligence concerns
- Identification
  - Fixture or equipment (breweries)
- Associated Expenses for Removal
  - Expense classification
  - Responsible party (cash collateral or landlord)
- Restaurants (e.g., Sticky's Holdings)
- Trucking (e.g., Yellow)



10



# Faculty

**Hon. David D. Cleary** is a U.S. Bankruptcy Judge for the Northern District of Illinois in Chicago, appointed in December 2019. Previously, he chaired Greenberg Traurig LLP's Business Reorganization & Financial Restructuring Practice in Phoenix, where he focused his practice on business restructuring and reorganizations, distressed-asset dispositions and financings, debt restructurings and workouts, and litigation. He regularly represented distressed companies, financial institutions, secured and significant creditors, noteholders and bondholders, hotel/resort owner/operators, boards of directors, debtors, official and ad hoc committees, and insurance and surety portfolios. Judge Cleary is a Master with the Arizona Inns of Court, past co-chair of the American Bar Association's Litigation Section of its Bankruptcy and Insolvency Committee, past chair of the Chicago Bar Association's Rules Sub-Committee of its Bankruptcy Committee, and past co-chair of ABI's Asset Sales and Health Care Committees. He was listed in *The Best Lawyers in America* and in *Southwest Super Lawyers*, and he was a member of the winning team for The M&A Advisor's "Restructuring of the Year (Over \$500mm to \$1 Billion)" award in 2015 for the restructuring of FriendFinder Networks. He is also rated AV-Preeminent by Martindale-Hubbell. Judge Cleary was admitted to practice in Arizona and Illinois, before the U.S. Courts of Appeals for the Ninth and Seventh Circuits, and before the U.S. District Courts for the District of Arizona and the Northern District of Illinois. He received his B.A. *cum laude* from Arizona State University in 1984 and his J.D. with honors from DePaul University College of Law in 1987, where he was an article and note editor for the *DePaul Law Review*.

**Ebba Gebisa** is counsel in the Chicago office of Latham & Watkins LLP and serves on Latham's Recruiting Committee. She advises both company-side and creditor clients on complex restructurings and bankruptcies, both in and out of court. Ms. Gebisa's practice focuses on chapter 11 and out-of-court restructurings, and includes advising clients in all aspects of complex corporate restructurings across a wide array of industries. Specifically, she helps clients navigate chapter 11 proceedings; prepackaged, prearranged and involuntary bankruptcies; § 363 sales; cross-border bankruptcies; out-of-court restructurings; and distressed mergers and acquisitions. Ms. Gebisa is a member of the Turnaround Management Association's Network of Women (NOW) Global Committee. She received her B.B.A. with honors in 2005 from the University of Wisconsin-Madison and her J.D. in 2008 from the University of Chicago Law School.

**Greg Giordano** is a director at Alvarez & Marsal Restructuring & Turnaround in New York. He previously was a director of Turnaround and Restructuring at EY-Parthenon. Mr. Giordano received his undergraduate degree in finance from Wake Forest University.

**Leslie C. Heilman** is a partner in the Litigation Department and Bankruptcy, Reorganization and Capital Recovery Group of Ballard Spahr LLP in Wilmington, Del. She concentrates her practice on commercial restructuring and bankruptcy, specializing in representing commercial landlords of shopping centers and other commercial properties, among other creditors, in all aspects of chapter 11 bankruptcy cases and nonbankruptcy workouts across the country, including in such high-profile retail cases as *24 Hour Fitness*, *Chuck E. Cheese*, *Ascena*, *Lord & Taylor*, *J.C. Penney*, *Hertz*, *Pier 1 Imports*, *Forever 21*, *Sears*, *Toys R Us*, *Gymboree*, *Payless Shoes*, *Linens 'N Things*, *RadioShack* and



*Sports Authority*. She is also experienced in bankruptcy-related litigation, including claims administration, avoidance actions and other adversary proceedings. Ms. Heilman is a long-time member of the International Council of Shopping Centers (ICSC) and sits on the board of the Delaware Network of the International Women's Insolvency & Restructuring Confederation (IWIRC). She is a frequent writer and speaker on bankruptcy and landlord issues. Ms. Heilman received her B.A. *magna cum laude* in 1994 from Cedar Crest College and her J.D. *magna cum laude* in 2004 from Widener University School of Law, where she served as a research editor of the *Delaware Journal of Corporate Law*, received the Honorable Helen S. Balick Award for excellence in the study of bankruptcy or creditors' rights, received the Donald E. Pease Best Student Article Award for the *Delaware Journal of Corporate Law*, and was a nominee for the American College of Bankruptcy's Distinguished Bankruptcy Law Student Award.

**David Levy, CAI, CCIM** is head of the Chicago office of Summit Investment Management and Keen-Summit Capital Partners. He is responsible for all aspects of business development and execution in connection with the combined company's real estate brokerage and auction, investment banking, and lease modification and restructuring services, plus distressed-debt acquisitions and opportunistic credit transactions. Mr. Levy has more than 17 years of experience in real estate advisory and transaction experience, with particular expertise in workout, bankruptcy and other special situations. He is a Special Projects Leader for ABI's Real Estate Committee with responsibility for producing webinar programs. Mr. Levy is one of less than 50 professionals in the U.S. to hold both Certified Commercial Investment Member (CCIM) and Certified Auctioneers Institute (CAI) designations. He also is a frequent speaker and moderator on real estate restructuring programs. Mr. Levy received his M.B.A. from Miami University in Oxford, Ohio.