



Weighing the Benefits of Terminating a Lease Before Bankruptcy

Hinckley Allen Retail Real Estate Newsletter

March 1, 2017

Prominent retailers, including Sports Authority and Eastern Mountain Sports, filed for bankruptcy in 2016. Other retailers likely will follow in 2017. This article examines the benefits a landlord may realize by terminating a lease before a tenant files for bankruptcy.

Once a tenant files for bankruptcy, a landlord cannot terminate a lease without approval of the Bankruptcy Court, and the Court is unlikely to grant such relief if the tenant continues to pay rent while determining its reorganization plan. If, however, a landlord has cause to terminate a lease before the tenant files for bankruptcy, the landlord can recover the premises, retain control over the space and avoid the bankruptcy process.

The advantages of pre-bankruptcy termination include:

- The landlord immediately can lease the space to a more attractive, financially secure tenant.
- The landlord avoids the waiting game that often results when a tenant files for bankruptcy and then considers, over a period of many months, whether to assume or reject the lease.
- Frequently, a debtor will assume a lease only to assign it to a completely new entity. If the landlord terminates the lease pre-bankruptcy, the landlord will not be in a position of having to accept the tenant's choice of assignee for the lease. Rather, the landlord controls future use of the space.
- If the debtor ultimately liquidates, the landlord avoids the disruption and negative impression of a going out of business sale in the mall space.
- The landlord does not have to incur the cost of monitoring the bankruptcy proceedings and taking legal action to enforce its rights against the debtor.

A lease termination by the landlord should adhere to the terms of the lease, including compliance with required notice and opportunity to cure. If the landlord terminates the lease without complying with the lease provisions, the tenant may claim that the termination was not effective. A Bankruptcy Court may find that an improperly terminated lease remains in effect as property of the tenant's bankruptcy estate.

Pre-bankruptcy termination is not without risk. If the tenant makes a payment to the landlord as part of the termination, the payment may be voidable as a preference if the tenant then files for bankruptcy within ninety days. In addition, the payment may be considered a fraudulent transfer if the tenant did not receive "reasonably equivalent value" in exchange for the payment. A landlord may mitigate these risks, for example, by the effect of the termination until the ninety day period passes, by obtaining an opinion of value, or by requiring the tenant's board to represent that the tenant is receiving reasonably equivalent value in exchange for the termination.

A landlord who properly terminates a lease prior to a bankruptcy regains control over the use of the premises. By acting quickly on the rumored demise of a retailer, the landlord can avoid the uncertainty and disturbance that a bankruptcy frequently entails.

Jen is a partner in our corporate & business group and focuses her practice on business law, with an emphasis on privately held businesses, commercial transactions, and creditors' rights . If you have questions regarding this particular topic or other matters, contact her at jdoran@hinckleyallen.com.

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