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Retail Tenant Bankruptcy and Restructuring in the COVID-19 Era: Commercial Real Estate Finance COVID-19 Impact Series

The next article in our Commercial Real Estate Finance COVID-19 Impact Series looks at landlord/tenant issues arising from the COVID-19 pandemic through the lens of our Bankruptcy and Restructuring Practice Group, providing informed and real-time guidance tailored to various sectors of commercial real estate owners. In the context of recent bankruptcy filings by national shopping center tenants, this article highlights key areas for consideration when a tenant files bankruptcy and what steps landlords can take to be proactive in these circumstances.

The first half of May resulted in several new retail tenants filing for protection under chapter 11 of the United States Bankruptcy Code, including, but not limited to, J.Crew, Gold's Gym, Stage Stores, Neiman Marcus, and most recently, JCPenney. While the number of retail tenants filing for bankruptcy has been steadily increasing since the onset of the COVID-19 pandemic, Neiman Marcus and JCPenney are the first major department stores, or anchor tenants, to file for bankruptcy. These filings present the greatest threat to shopping centers and their owners and operators to date. Landlords will need to proactively protect their interests so as not to further jeopardize the long-term success of their shopping centers. This article provides a glimpse into some of the key issues and considerations facing our shopping center clients.

Tenant's Bankruptcy and the Lease

Businesses seeking bankruptcy protection often attempt to reorganize under chapter 11 (like each of the above-mentioned tenants) and emerge with restructured debts and liabilities, as opposed to liquidating under chapter 7. If the reorganization efforts fail, the business may wind up in chapter 7 or, more often, may also liquidate through chapter 11. Regardless of whether the petition is

filed under chapter 7 or chapter 11, the bankruptcy trustee or the debtor in possession/tenant, as applicable, will have at least 120 days after the filing of the bankruptcy petition either to assume or reject the lease. This deadline is subject to a 90-day extension by order of the bankruptcy court and additional extensions with the consent of the landlord.

During a bankruptcy, a lease may be assumed, assumed and assigned, or rejected. If the lease is assumed, the debtor must be able to provide adequate assurances of its future performance under the lease and all obligations will need to be performed by the debtor going forward. Additionally, any rent and related charges will need to be cured and promptly paid to the landlord, oftentimes upon the effective date of the assumption. If the tenant rejects the lease, the landlord can obtain a court order requiring the tenant to vacate its premises and can relet the premises. Even if a debtor's assets will be liquidated in a chapter 7 filing, the bankruptcy trustee may still seek to assume the lease and assign it to a third party as there may be value in the lease if, for example, the lease provides for below market rent.

When a landlord first learns of the bankruptcy filing, the landlord should consider whether the terms and provisions of its lease(s) with that tenant are market. If the lease is market, and sales in the applicable store are good, it is reasonable to expect that the tenant may seek to assume the lease or assume and assign the lease to a third party pursuant to a bankruptcy court-supervised sale process. If the lease is not market, the tenant will be more likely to try to engage in negotiations to modify the existing lease (e.g., to provide for decreased rent). To the extent the landlord and tenant are unable to reach an agreement, the tenant may reject that lease. The uncharted territory created by the COVID-19 pandemic has led to many lease modifications already.

Many leases will contain provisions preventing the tenant from assigning its leasehold interest under the lease without landlord consent. It is not likely these anti-assignment provisions will be enforceable in bankruptcy. After assuming a lease in bankruptcy, the tenant may then seek to assign the lease to a third party, regardless of most anti-assignment provisions contained in a lease.

If retail tenants choose to assume and assign a lease to a third party, the landlord should be proactive in reviewing the lease (as well as any Declarations, REAs or CCRs) regarding permitted uses and other similar restrictions and closely monitoring what the proposed use is by the third party. The permitted uses may be narrow enough that a third party's business would violate these provisions, potentially giving the landlord the ability to object to the assumption and assignment by the tenant.

New Challenges in the COVID-19 Era

In the wake of the COVID-19 pandemic, many retail tenants find themselves unable to reorganize or restructure and are therefore unable to emerge from a chapter 11 bankruptcy as a reorganized company. Retail tenants frequently rely on the chapter 11 process, and specifically on going-out-of-business sales ("GOB Sales") to finance liquidation and to pay off and/or make distributions to their creditors. Without GOB Sales, retail tenants have no way to finance their liquidation and potentially obtain funds to distribute to creditors. If the bankruptcy estate cannot be funded by GOB Sales, the options for the tenant (and its creditors) are limited. Either the bankruptcy proceedings can be delayed to buy time until stores are open (assuming that re-opening stores in a worsened economy will even yield enough sales to be worthwhile) or the retail tenants may face complete liquidation. Converting to chapter 7 is exactly what happened with [Art Van Furniture, LLC](#). The company initially filed chapter 11 in early March with the intention of conducting GOB Sales. However, with the mandated store closures, Art Van Furniture, LLC was unable to conduct its GOB Sales and ultimately had to convert to chapter 7 just one month after its initial chapter 11 filing.

While stores remain closed, or open at reduced capacity but with no guarantee that the sales will pick up in the near future, landlords should expect tenants to request relief from the bankruptcy court allowing them to remain in possession of their premises without paying rent. Debtors in possession are generally required to pay all monetary obligations, including rent, that are due and owing in the ordinary course of such debtor's business, until and to the extent such lease is assumed and assigned to a third party or rejected.

Unfortunately, there is no guarantee that a landlord will be able to recoup these costs, especially if that tenant ultimately converts to chapter 7, as in the case of Art Van Furniture, LLC.

Are Shopping Centers at Risk?

As an increasing number of retail and restaurant tenants file for bankruptcy, this could result in a more permanent effect on malls and shopping centers generally. Many malls were already trending towards becoming “lifestyle centers;” how will increased tenant bankruptcies accelerate this trend, combined with the fact that many experiential tenants like Top Golf and movie theaters are unable to open (at least at anywhere near to full capacity)? Will some malls be forced to close altogether? Without paying tenants, mall and shopping center owners risk defaulting to their own lenders, potentially continuing the cycle of closures and bankruptcies. In addition to closely monitoring the proceedings for any of its tenants which have filed for bankruptcy, landlords should also closely examine any mortgage loan documents secured by their affected shopping centers. In a forthcoming article, we will examine key areas for consideration in mortgage loan documents when tenants file for bankruptcy.

A Day (or Weekend) in the Life of a Bankruptcy Attorney

In anticipation of tenants with a large national presence (e.g., JCPenney) filing for bankruptcy protection, we keep in close contact with clients who would be impacted by such filings and closely monitor any news updates. In the days and weeks leading up to the JCPenney filing, we started gathering diligence items such as leases to get a head start on reviewing relevant terms. Once a debtor files its bankruptcy petition, the wheels start turning quickly. JCPenney filed its petition on Friday, March 15. The first day hearing was held on a Saturday (not the following business day). The hours leading up to that first hearing are fast-paced and filled with drafting Notices of Appearance and *Pro Hac Vice* Motions, engaging local counsel when necessary, reviewing initial debtor filings and leases in conjunction therewith, and of course, constant

communication with clients. Getting up to speed as quickly as possible is essential and, given the number of tenants filing for bankruptcy protection as of late, this is just another one of the unprecedented challenges facing the retail industry following the start of the COVID-19 pandemic. We all anticipate additional trying days (and weekends) ahead for landlords and their bankruptcy attorneys as we work to respond to these filings.

For more information, please contact [Ronald Gold](#), [A.J. Webb](#), [Erin Severini](#) or [Kendal Hardison](#) of the [Bankruptcy & Restructuring](#) or the [Shopping Center & Retail Development](#) at Frost Brown Todd.

To provide guidance and support to clients as this global public-health crisis unfolds, Frost Brown Todd has created a [Coronavirus Response Team](#). Our attorneys are on hand to answer your questions and provide guidance on how to proactively prepare for and manage any coronavirus-related threats to your business operations and workforce.

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