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Landlords Beware: Court Finds Debtor May Assume, Then Assign Lease

'Kodak' reduces landlord-friendly benefits.

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The Bankruptcy Court for the Southern District of New York recently issued an opinion that expands the authority and flexibility for a debtor to determine whether (and when) to assign executory contracts and unexpired leases. In *In re Eastman Kodak Company*, 495 B.R. 618 (Bankr. S.D.N.Y. 2013), the court found, in an apparent matter of first impression, that assumption and assignment of an unexpired lease pursuant to §365 of the Bankruptcy Code

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does not necessarily have to occur at the same time. More specifically, while the Bankruptcy Code provides for a specific time period for a debtor to explicitly assume a lease or else it is deemed rejected, the court found that there is no equivalent time period or deadline for a debtor to assign an assumed lease. This opens a much larger window for debtors

to strategically assign contracts and leases at any time through plan confirmation, even when assumption may have occurred earlier in the case.

Kodak expands the time for a debtor to determine whether keeping or assigning an assumed lease is in the best interest of the debtor's estate. *Kodak* also reduces certain of the landlord-friendly benefits granted by Congress in the Bankruptcy Abuse Prevention and Consumer Privacy Act of 2005 (BAPCPA). Prior to BAPCPA, a debtor was entitled to request an unlimited amount of extensions of the period to assume or reject a lease "for cause," which often were granted through plan confirmation. However, the BAPCPA amendment to §365(d)(4) provided for a hard and fast deadline¹

to affirmatively assume unexpired lease that culminated in automatic rejection if a decision was not timely made. Certain parties have argued that this drop-dead date to assume a lease has significantly burdened debtors that may not have finalized their business plans or determined if their leases have value. Based on *Kodak*, however, a debtor who timely assumes a lease under §365 may subsequently decide to assign it for strategic reasons, for a profit or because it is no longer beneficial to the debtor.

Factual Background

Eastman Kodak Company (Kodak or the debtor) filed for bankruptcy protection on Jan. 19, 2012. Kodak was a party to a non-residential lease (the Lease) with ITT Space Systems (ITT) for approximately 2,200 square feet. The lease was in effect until September 2050. Kodak was required to pay \$100 per month as rent, to be adjusted every five years based on the consumer price index. The lease prohibited Kodak from assigning the Lease without prior written consent of ITT.

The original deadline set by §365(b)(4)(A) of the Bankruptcy Code for Kodak to assume or reject the Lease was May 18, 2012. On May 10, 2012, the court entered an order extending Kodak's time to assume or reject the Lease through Aug. 16, 2012. This was the maximum extension permitted under §365(d)(4)(B).

On July 17, 2012, Kodak filed a motion seeking to assume several unexpired leases, including the Lease (the assumption motion). The proposed order provided:

Nothing included in or omitted from the motion or this order, nor as a result of any payment made pursuant to this order, shall impair, prejudice, waive or otherwise affect the rights of the debtors and their estates, sub-

ject to appropriate notice and a hearing and this court's approval unless otherwise agreed to by the parties, to assign any of the assumed leases pursuant to, and in accordance with, the requirements of §365 of the Bankruptcy Code.

ITT did not object, or otherwise respond, to the assumption motion or the proposed order approving the assumption motion. On Aug. 15, 2012, the court entered an order approving the assumption motion and Kodak's assumption of the Lease (the assumption order), which contained the same reservation of rights language as the proposed order.

Several months after the entry of the assumption order, Kodak decided to sell the business that related to the Lease. Accordingly, on Dec. 21, 2012, Kodak entered into an asset purchase agreement (the APA) with RED-Rochester (the assignee), providing for the assignee's purchase of certain assets of Kodak and Kodak's assignment of the Lease to assignee. Kodak requested the court's approval of the APA and the proposed assignment of the Lease to assignee. ITT objected to the proposed assignment of the Lease because (i) Kodak failed to seek to assign the Lease at the time it sought to assume the Lease, (ii) pursuant to §365(d)(4), the time had already expired to assign the Lease, and (iii) the Lease prohibited the proposed assignment.

The Court's Decision in 'Kodak'

The court in *Kodak* overruled ITT's objection and approved the assignment of the Lease. The court noted that the Bankruptcy Code is silent as to whether assumption and assignment must occur contemporaneously. The court in *Kodak* noted that the question of whether assumption and assignment must occur at the same time involves the interaction of three provisions of

the Bankruptcy Code:

- Section 365(f)(3), which allows a debtor to assign executory contracts and unexpired leases notwithstanding any contractual prohibitions on assignment.

- Section 365(d)(4), which requires nonconsensual assumption to occur no later than 210 days after the petition date (an initial 120 days plus a single 90-day extension).

- Section 365(f)(2), which allows a debtor to assign contracts and leases if they are assumed in accordance with §365 and the assignee provides adequate assurance of future performance (which was not in dispute in *Kodak*).

ITT raised several arguments in support of its position that while the Bankruptcy Code permits a debtor to assume and assign a contract or lease, the assumption and assignment must, in fact, occur at the same time.

ITT first argued that based on the plain reading of the statute, any assignment must occur simultaneous with the assumption because the Bankruptcy Code in §365(f)(2) only permits assignment if "the trustee *assumes* such contract or lease," which is stated in the present tense. However, the court found that courts have construed §365(f)(2) to mean that assumption must occur prior to assignment, not necessarily simultaneously. Furthermore, the court noted that other parts of §365 clearly indicate that assumption and assignment are "independent concepts" that could likewise take place at different times.

Next, the court noted that unlike the 210-day deadline (after filing for bankruptcy) to assume an unexpired lease, there is no parallel deadline in §365(d)(4) to assign. The 210-day deadline was added by Congress in 2005 to "limit the discretion of judges to extend time to assume or reject certain commercial contracts and to provide landlords with greater certainty as to such tenancies."

The court explained that permitting post-assumption assignment of unexpired leases is consistent with the goals of the Bankruptcy Code. Conversely, the court found that “[c]onstruction of §365(d)(4) to cut off assignment rights would shift the balance in favor of landlords beyond what Congress provided and improperly undermine the policy of §365 that gives a debtor broad rights to benefit from beneficial contracts and thereby maximize the value of the estate.”

In addition, the court noted that similar to §365(k)2, which relieves the estate from any post-assignment liability, “post-assumption assignment allows a Chapter 11 debtor to avoid accruing administrative claims under a contract whose assumption, necessary because of the deadline in §365(d)(4), proves to be improvident either because of issues with the contract or because the reorganization fails.” Accordingly, the court found that assignment of the Lease would enable Kodak to avoid accruing additional unnecessary administrative expenses, which is consistent with §365(k).

ITT also argued that while the Bankruptcy Code discusses a subsequent rejection of an assumed contract in §503(b)(7), there is no corollary discussion regarding a subsequent assignment of a previously assumed contract. Thus, ITT argued that the absence of any such provision gives a negative inference that an assignment cannot take place after assumption. The court disagreed and found that when Congress provided a 210-day deadline to assume a contract, but explicitly did not provide for a deadline to assign a contract, Congress permitted the assignment to take place even after the 210-day assumption deadline.

The court also rejected ITT’s argument that permitting assignment to take

place well after assumption is unfair to landlords. The court noted that “[e]ven if it were unfair, the disruption of non-debtors’ expectations of profitable business arrangements is common in bankruptcy proceedings.” Furthermore, the court noted that “ITT has alleged no cognizable harm from the assignment in this case beyond the fact that the [lease] will continue in effect with its present terms. In other words, ITT’s alleged harm derives from perceived deficiencies in the terms of the [lease] rather than any uncertainty regarding the tenancy.” In addition, there was no dispute that the assignee could provide adequate assurance of future performance. Moreover, the court found that ITT cannot argue it was surprised by the proposed assignment because the assumption order explicitly reserved the right to subsequently assign the Lease and ITT failed to object to the proposed order of the assumption motion which contained the reservation of rights language.

Lastly, ITT argued that once Kodak assumed the Lease it was assumed cum onere, meaning the Lease was assumed with all of its burdens and obligations, including the provision prohibiting the assignment of the Lease without ITT’s prior consent. Thus, once the Lease was assumed with the anti-assignment provision, Kodak lost the right and power to subsequently assign the Lease. The court rejected this argument by noting that one of the benefits a debtor under bankruptcy protection is provided is the ability to assume a contract notwithstanding an anti-assignment clause pursuant to §365(f)(3). Accordingly, the court found that “the power to assign and override an anti-assignment clause is an important right that carries out one of the main purposes of §365 of the Bankruptcy Code—to allow debtors to maximize value for

the benefit of their creditors.”

Possible Implications

Kodak is a wake-up call to lease counter-parties and landlords that there remains a possibility that a debtor may seek to assign a previously assumed lease outside of the 210-day period set by §365(d)(4) notwithstanding any anti-assignment language in the lease. From a debtor’s standpoint, *Kodak* provides additional flexibility for debtors to determine whether an unexpired lease is in the best interest of the debtor’s estate and to make that decision with more certainty.

Although a party may distinguish *Kodak* based on the explicit reservation of rights included in the court’s order allowing for the subsequent assignment of the Lease, based on the analysis of *Kodak*, it appears that other courts may apply the same reasoning even without the reservation of rights language. Accordingly, while *Kodak* is an additional benefit for all debtors, it appears to eliminate, or at least reduce, certain benefits provided to landlords by Congress in the 2005 BAPCPA amendments to the Bankruptcy Code.



1. Section 365(d)(4)(A) of the Bankruptcy Code provides that a debtor must assume an unexpired lease within the earlier of 120 days after the petition date or upon plan confirmation. Section 365(d)(4)(B) provides that a court may extend the period for an additional 90 days “for cause.” No further extensions are permitted without the landlord’s consent.

2. Section 365(k) of the Bankruptcy Code provides that “[a]ssignment by the trustee to an entity of a contract or lease assumed under this section relieves the trustee and the estate from any liability for any breach of such contract or lease occurring after such assignment.”