



Bankruptcy ADVISORY ■

MAY 26, 2015

Delaware Bankruptcy Court Weighs in on Limits to Landlord's Lease Rejection Damages

In *In re Filene's Basement, LLC*,¹ the United States Bankruptcy Court for the District of Delaware considered the rejection damages a landlord claimant was entitled to pursuant to Section 502(b)(6) of the Bankruptcy Code after the debtor rejected its lease as part of its reorganization plan. Section 502(b)(6) caps a landlord's damages for the rejection of a lease at "*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*" plus "any unpaid rent due under such lease, *without acceleration . . .*" (emphasis added).

The bankruptcy court recognized that determination of the proper claim amount required resolution of two issues: (1) whether the "15 percent" cap in Section 502(b)(6) refers to *time left* under the lease or *rent due* under the lease; and (2) whether claims flowing from the termination of a lease, including the costs for removal of abandoned fixtures and abandoned furniture, are encompassed in the 15 percent claim limit. The bankruptcy court held that the 15 percent limit refers to time and that claims flowing from the termination of the lease may be encompassed in the 15 percent cap rather than permissible separate claims, subject to an inquiry of whether they are properly characterized as "rent reserved."

The 15 Percent Cap Refers to Time

Courts are divided on the proper interpretation of Section 502(b)(6) and whether the 15 percent cap refers to time or rent. The Third Circuit has not yet ruled on the issue, so the bankruptcy court turned to the plain language of the statute. Citing other case law and a leading bankruptcy treatise, the bankruptcy court noted that the phrases "one year" and "not to exceed three years," which immediately precede and follow the 15 percent limiting language, are both temporal.

¹ No. 11-13511 (KJC), 2015 Bankr. LEXIS 1350 (Bankr. D. Del. Apr. 16, 2015)

The phrase “without acceleration” in Section 502(b)(6) lends further support to the “time” approach because the “rent” approach would render that phrase superfluous. Moreover, while reference to legislative history is not necessary where the language of the statute is clear, the legislative history similarly supports the time approach to the 15 percent cap. Accordingly, the bankruptcy court held that a natural reading of the language supports the time approach. Thus, the bankruptcy court capped the landlord’s damages at 15 percent of the time left on the lease rejected by the debtor.

Additional Claims Resulting from Lease Termination Are Capped

Courts are also divided on how to evaluate additional claims asserted by landlords when a debtor rejects a lease, such as those for the costs to remove abandoned property. Section 502(b)(6) provides that the claim of a lessor “for damages resulting from the termination of a lease of real property” should be disallowed to the extent they exceed the statutory cap, but courts interpret the phrase “result from termination” differently. In this case, the bankruptcy court stated that the test should be whether the damages flow from the *termination* of a lease rather than just the *rejection*. If the damages flow from the termination, then the claim is subject to the 15 percent cap.

If a claim is one for lease termination damages, the bankruptcy court held that it must then decide whether the claim is included as part of what is “rent reserved” under Section 502(b)(6)(A). To answer that, the bankruptcy court applied the test adopted in *Kuske v. McSheridan (In re McSheridan)*, 184 B.R. 91, 102 (9th Cir. B.A.P. 1995). The *McSheridan* Court held that, in order to fall within the category of “rent reserved,” the charge must (1) be designated as rent or be part of the tenant’s obligation under the lease; (2) relate to the value of the property or the lease; and (3) be classified as rent because it is a fixed, regular or periodic charge.

Applying this test to the landlord’s claim for the costs of removing property abandoned by the debtor, the bankruptcy court held that the claim was for damages resulting from the termination of the lease and subject to the limitation imposed by Section 502(b)(6). However, because the costs of removing property abandoned by the debtor were not fixed, regular or periodic charges, the costs did not qualify as “rent reserved.” Accordingly, the claim could not be included in the calculation of the claim capped by virtue of Section 502(b)(6).

Takeaways

The bankruptcy court’s holding provides additional guidance to both landlords and debtors relating to how claims flowing from the termination of leases in bankruptcy are calculated. When drafting leases, parties may want to consider whether the additional charges allocated to the lessee are fixed, regular or periodic charges such that they will be included in the 15 percent cap in the event the lessee later files for bankruptcy. This is especially true with long-term leases where a lessee’s circumstances can change over a period of years.

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