

PAYMENT OF “STUB RENT” IN COMMERCIAL TENANT BANKRUPTCY CASES

by Brian W. Hockett¹

Upon the filing of a bankruptcy case by a tenant, one of the first issues to face landlords and debtors with respect to an unexpired lease of non-residential real property is the payment of postpetition rent.

The law requires tenant debtors to perform the obligations under their commercial real property lease pursuant to 11 USC § 365(d)(3), including the payment of rent due after the filing of the case. Section 365(d)(3) of the Bankruptcy Code imposes a duty on tenant-debtors with respect to unexpired leases of nonresidential real property. Specifically, this section provides that a bankruptcy trustee or chapter 11 debtor-in-possession “shall timely perform all obligations of the debtor . . . arising from and after the order for relief under any expired lease of nonresidential real property, until such lease is assumed or rejected, notwithstanding § 503(b)(1).”

Prior to the enactment of section 365(d)(3) in 1984, landlords had to rely on section 503(b)(1) of the Bankruptcy Code for payment of administrative postpetition rent and courts had to determine the benefit to the estate from the continued use and occupancy of the premises instead of simply looking to the rent stated in the lease. Typically, service providers and others doing business with the debtor postpetition are entitled to administrative expense treatment. Section 503(b)(1) of the Bankruptcy Code provides that allowed administrative expenses include “the actual, necessary costs and expenses of preserving the estate.” Section 503(b)(1) requires that the creditor file a motion requesting allowance and payment of its administrative claim and

¹ Brian Hockett is a senior associate at the law firm Thompson Coburn LLP in St. Louis, Missouri, where he practices in the area of Business Bankruptcy, Financial Restructuring and Creditors’ Rights. To learn more about Brian Hockett, go to <http://www.thompsoncoburn.com/people/find-a-professional/brian-hockett.aspx>. For information about Thompson Coburn LLP, go to www.thompsoncoburn.com

the creditor bears the burden of establishing that its services provide a benefit to the estate. Section 503(b)(1) also does not specify when such claims would be paid. Unlike section 503(b)(1), section 365(d)(3) imposes an affirmative requirement on the chapter 11 debtor that is an exception to the usual rule that obligations arising post-filing meet the more stringent standards for payment of administrative expense claims set out in section 503(b)(1), and requires timely payment of the postpetition obligations as provided under the terms of an unexpired lease.

It is rare that a case will be filed on the day before a rent payment is due, so the question facing the parties is whether or not the debtor must pay the landlord a prorated amount for the period after the bankruptcy petition date until the first postpetition rent payment is due. The amount of rent corresponding to the period of occupancy of real property between the petition date and the first postpetition rental payment due date is often referred to as “stub rent.” If the lease calls for the payment of rent on the first day of each month and the petition date falls on the fifth day of the month, the stub period would be from the fifth day of the month through the last day of the month. Must a debtor timely perform the obligation to pay rent for this “stub rent” period under section 365(d)(3)?

The bankruptcy courts have differed on their application of § 365(d)(3) with respect to stub rent. There are generally two approaches adopted by the courts in determining the application of the phrase “all obligations of the debtor . . . arising from and after the order for relief” from section 365(d)(3). The approach applied will largely depend on the circuit in which the debtor’s bankruptcy case is pending.

Some courts have held that § 365(d)(3) requires a proration analysis under which the debtor is obligated to pay stub rent immediately under the requirements of § 365(d)(3) for the period of occupancy during the first partial month after the petition date. *See In re Handy Andy*

Home Improvement Centers, Inc., 144 F.3d 1125 (7th Cir. 1998) (proration of taxes between the prepetition period and postpetition period even though taxes were due postpetition); *In re Furr's Supermarkets, Inc.*, 283 B.R. 60 (10th Cir. BAP 2002); *Newman v. McCrory Corp. (In re McCrory Corp.)*, 210 B.R. 934, 939-40 (S.D.N.Y. 1997) (proration of real estate taxes); *In re Stone Barn Manhattan LLC*, 398 B.R. 359 (Bankr. S.D.N.Y. 2008) (proration of stub rent for first month after petition date); *In re Ames Dep't Stores, Inc.*, 306 B.R. 43, 67-70 (Bankr. S.D.N.Y. 2004) (holding that section 365(d)(3) is ambiguous and adopting a proration approach to determine the amount of obligations, rather than a billing date approach to final month's obligations upon rejection of lease); *In re All For a Dollar, Inc.*, 174 B.R. 358 (Bankr. D. Mass. 1994) (applying "proration" approach to tax obligations). Under the proration approach, the debtor in the example would be obligated to pay stub rent for the period from the fifth day of the month through the last day of the month.

Other courts have held that § 365(d)(3) requires a bright line test in which stub rent is not permitted. See *In re Goody's Family Clothing Inc.*, 610 F. 3d 812, 816-17 (3rd Cir. 2010); *HA-LO Industries v. CenterPoint Properties Trust*, 342 F.3d 794, 798-800 (7th Cir. 2003) (applying "billing date" approach to month during which lease is rejected); *CenterPoint Props. v. Montgomery Ward Holding Corp. (In re Montgomery Ward Holding Corp.)*, 268 F.3d 205, 209-10 (3rd Cir. 2001) (holding that debtor was required to pay prepetition taxes that came due during the pre-rejection period); *Koenig Sporting Goods, Inc. v. Morse Road Co. (In re Koenig Sporting Goods, Inc.)*, 203 F.3d 986, 989 (6th Cir. 2000) (holding that the debtor was liable for all of the rent for the month during which the lease was rejected because the due date for paying that month's rent preceded the rejection date); *In re Burival*, 406 B.R. 548 (B.A.P. 8th Cir. 2009). This is referred to as the "billing date" rule. The "billing date" rule requires the payment of

obligations only that become due and payable upon or after the filing of the petition for bankruptcy. Under the billing date approach, the debtor in the aforementioned example would not have to make payment of the stub rent for the period from the fifth day of the month through the last day of the month. Instead, the first administrative expense payment required under 11 U.S.C. § 365(d)(3) would be the rental payment for the month following the bankruptcy filing date.

In the event that the debtor assumes a lease, the debtor must pay all past due rents for both the postpetition and prepetition period by operation of section 365(b)(1)(A), which conditions the assumption of an unexpired lease the cure of defaults. Under either approach to stub rent, upon assumption, not only the stub rent period must be paid, but the debtor must also pay for all prepetition rents and obligations. If, however, the debtor rejects a lease, pursuant to section 502(d), claims from the rejected unexpired lease will be treated as if they arose prior to the petition date as general unsecured claims. Courts following the billing date approach could render the “stub rent” a general unsecured claim under section 502(d) in the event the lease is ultimately rejected.

Just because a debtor is not required to make payment of postpetition rent for the stub rent period under the “billing date” approach, does not mean that the landlord cannot recover stub rent on a priority basis. Section 365(d)(3) may not be the exclusive basis for recovery of stub rent from a debtor on a priority basis. Where a debtor actually occupies a premises postpetition, landlords may be able to recover stub rent if they demonstrate that the premises provided an actual benefit to the estate and that the stub rent payment was necessary to preserve the value of the estate’s assets under 11 U.S.C. § 502(b)(1). *See In re Goody’s Family Clothing Inc.*, 610 F.3d 812 (3d Cir. 2010) In *Goody’s*, the court determined that the occupancy of retail

stores in various shopping centers by the debtor's liquidation agent benefited the estate where the debtor was able to obtain a 105% recovery from the store closing sales. *Id.* at 819. In that case, the landlords were entitled to reasonable stub rent as an actual and necessary expense for the benefit of the estate under section 502(b)(1) because the store closing sales were an integral part of the bankruptcy proceedings. *Id.* A landlord may be able to recover stub rent even in districts applying the billing date approach if the landlord can qualify for administrative expense treatment under section 503(b)(1) of the Bankruptcy Code.