



# RETAIL TENANT TROUBLES: PRE-BANKRUPTCY PLANNING

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In recent times, retail bankruptcies peaked in 2020 with an explosion of COVID-19-related filings and have since subsided, but the pendulum is widely expected to begin its swing back in 2023 given macroeconomic and industry developments. While commercial landlords are often concerned about the potential bankruptcy filings of

their retail tenants—especially if there are multiple locations in their portfolio—there are ways to keep an eye on worrisome tenants and possibly even mitigate exposure to them before a bankruptcy case is filed. These steps include gathering information, engaging with the tenant, and other, more specific, pre-bankruptcy measures.

## INFORMATION GATHERING

The best way to measure the health of a retail tenant is by assessing store-level metrics that a commercial landlord would have in its possession. Closely tracking a tenant's performance of monetary and nonmonetary lease obligations is often the most insightful measure in this category. Missing, late, or ir-



regular payments, maintenance left undone, and unresponsiveness when following up on those issues could be signals of financial trouble—especially if they are recurring.

Tenant sales reports—which are available to landlords where there is a sales-based component (i.e., percentage rent) under the lease or other reporting requirements—are also useful metrics to assess a tenant’s performance. This is especially helpful to review during a tenant’s busy season, perhaps the holidays, as a comparison to prior periods or a window into the current state of the business. Additional store-level concerns to monitor are inventory levels and labor shortages. If a store is running low on merchandise and does not appear to have adequate staffing for more than a brief period, the tenant may be cutting its costs as one last attempt to stay open or may already be preparing to close the store. Property management personnel can serve as the “boots on the ground” to evaluate these potential issues.

On a macro level, publicly available information may be able to shed some light on a tenant’s financial and operational health. For public companies, SEC filings contain certain information that must be disclosed, including a warning that it may file for bankruptcy or that it may not be able to continue as a going concern. For private companies, reliable trade publications and national news outlets often get ahead of a retailer’s bankruptcy filing with well-placed sources. It is also beneficial to track a tenant’s store closings locally, regionally, and nationally (as applicable) to determine whether any contraction is limited or more widespread. Finally, landlords should ask their advisors who practice bankruptcy and restructuring law whether they have heard anything about a particular tenant, whether from other landlord clients dealing with that tenant or additional industry sources.

## ASSESS GOALS

If your tenant may file for bankruptcy, there are immediate, critical considerations that need to be assessed to inform next steps. First, the landlord must determine its goals with respect to the leased premises (and, if applicable, the shopping center as a whole). The economics of the lease or leases at issue should be measured against the market and whether there is a substitute tenant that may be able to take the space in the event the landlord gains control of the space from the current tenant. While a tenant in bankruptcy has significant control over their interest in the lease, there are ways for a landlord to influence the tenant or the court to gain leverage.

## TENANT ENGAGEMENT

Engaging with a troubled retail tenant—especially one weighing a potential bankruptcy filing—is fact specific and can take many forms, but there are certain universal concepts to consider. If the landlord is holding a security deposit and can apply it under the lease, it should consider doing so immediately, as this becomes more difficult in a bankruptcy where court approval would be required. If there is a lease guarantor that does not file for bankruptcy, the landlord may look to the guarantor to satisfy any arrears even if the tenant does file.

A landlord might consider entering into a lease amendment with the tenant, especially if it is an anchor or other important shopping center tenant where the landlord may act more conservatively. This could prevent the space from going dark and co-tenancy provisions being triggered. A landlord that grants rent relief should try to obtain something in exchange, such as a release, security, or both (i.e., obtaining a guaranty from a solvent entity). Securing a letter of credit is best since the funds are not the property of the tenant and, therefore, drawing on the letter of credit does not require court approval.

A landlord should keep in mind that lease amendments that decrease or delay the tenant’s obligations are often not advisable because they limit the rent that comes due during the bankruptcy case (which is typically required to be paid). Furthermore, a distressed tenant may pocket the initial lease concessions and then look to “re-trade” the deal down the road by asking for further concessions or seeking to assign the lease to a third party. A landlord that wants to take an aggressive position and try to force the tenant to surrender the premises should consult counsel on how to do so in a way that excludes the lease from a later bankruptcy filing by the tenant.

## LEASE TERMINATION

If the landlord has attempted to terminate the lease prior to a bankruptcy by commencing an eviction action, for example, the landlord must gain a firm understanding of whether the lease was actually terminated under state law. If the lease was terminated, it should be “shielded” from the bankruptcy case, as the tenant would no longer have an interest in it. Under applicable bankruptcy law, a commercial lease that has terminated by expiration of the term is not the property of the tenant’s bankruptcy estate, and acts by the landlord to obtain possession of such premises are excluded from the automatic stay of creditor conduct. If the lease was terminated for

any other reason, it is best for the landlord to obtain Bankruptcy Court permission to obtain possession of the premises. Further, if the tenant has any property at the premises, a Bankruptcy Court order should be obtained prior to taking possession irrespective of the basis for termination of the lease. The penalties for violating the automatic stay in bankruptcy can be severe, and an order granting relief from the stay should be sought if there is any doubt as to the applicability of the stay.

## CONCLUSION

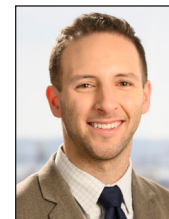
This is a broad overview of certain steps a commercial landlord can take prior to potential bankruptcy filings of their retail tenants. Pre-bankruptcy considerations are complex and dependent upon a number of factors, including the specific tenant and premises. It is, therefore, critical to retain counsel who is well versed in these matters.



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