

## **It's the Leased You Can Do - An Overview of §502(b)(6) and Lease Claims**

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Section 502(b)(6)<sup>1</sup> provides a statutory cap for allowed claims resulting from the termination of a real property lease in which the debtor is the lessee<sup>2</sup> or tenant.<sup>3</sup> The purpose of the landlord's cap is "to compensate the landlord for his loss while not permitting a claim so large ... as to prevent other general unsecured creditors from recovering a dividend from the estate."<sup>4</sup> That seems admirable, however the calculation of the claim may revive nightmares of high school algebra class.

While "brevity is the soul of wit,"<sup>5</sup> it is also admirable in legal articles, so I will not address issues like: damages for post-petition rejection of an assumed lease, administrative expense claims for rent, stub rent, triple net leases and other exhilarating topics. I will focus on the fundamentals of applying §502(b)(6) and a hopefully easily understood sample calculation.

Before we start, we must define the phrase "claim ... for damages resulting from the termination of a lease." There is a split of authority on what this phrase means and what damages incurred by the landlord must be included in the capped calculation. Some courts interpret this term broadly holding a debtor's rejection of a lease under §365(a) results in a breach of all covenants in the lease, therefore, all damage claims by the landlord including, for example, covenants requiring the debtor to maintain and repair the premises are subject to the cap of § 502(b)(6).<sup>6</sup> The narrower interpretation applies § 502(b)(6) "to solely those damages arising as a consequence of the lease being terminated" but does not apply to non-rejection tort damages such as waste, destruction, or removal of leasehold property.<sup>7</sup>

The initial calculation in the preamble to §502(b)(6) is the amount of "the claim of a lessor for damages resulting from the termination of a lease of real property ...." This requires calculating the uncapped damages recoverable under applicable non-bankruptcy law resulting from termination of the lease by the debtor. The amount of the claim under §502(b)(6) must then be calculated based on: the *earlier* of the dates set forth in §502(b)(6)(A)(i) and (ii). A comparison is then made to the *greater* of the amount of the rent for 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.<sup>8</sup> The court then compares those capped amounts in §502(b)(6)(A) and (B) to one another and compares the greater of these two figures to the total non-capped damages under applicable non-bankruptcy law. If non-capped damages are *less* than the greater of the amounts in §502(b)(6)(A) and (B), then the landlord is entitled to the non-capped damages. If total non-capped damages are *greater* than the greater of the amounts set by §502(b)(6)(A) and (B) (which is usually the case), then the landlord's cap applies, and the landlord is only entitled to the greater of the capped amounts in §502(b)(6)(A) and (B).<sup>9</sup>

To start the calculations, the date of the termination of the lease must be determined. The rejection of an unassumed lease constitutes a breach immediately before the date of the bankruptcy petition, even if the rejection occurs after the date of the bankruptcy petition, therefore, the landlord has a pre-petition claim for damages resulting from the breach of the lease.<sup>10</sup> The date from which the calculation begins is the date of the filing of the bankruptcy petition, unless there is an earlier surrender or repossession of the property.<sup>11</sup> Most courts look to state law to determine whether the leased property has been surrendered or repossessed.<sup>12</sup>

The term "15 percent, not to exceed three years, of the remaining term of such lease ..." has been debated by courts. Some courts hold the 15% refers to the time left on the lease.<sup>13</sup> Other courts hold the 15% refers to the amount left owing under the lease.<sup>14</sup> If the rent changes over time, some courts following the time method hold "it is necessary to calculate the rent that would

accrue in the absence of lease termination to the first 15% of the remaining term, here 14.21 months. Any escalators that would take effect during those 14.21 months are to be honored.”<sup>15</sup> In other words, if the lease obligation increases only after 15% of the remaining lease term has passed, the calculation is based on the lower amount.

Any security deposit, even in the form of a letter of credit, should be applied to reduce the capped amount.<sup>16</sup>

Any credit from the landlord’s mitigation of damages by reletting the premises or other means is applied to the non-cap termination damages to be calculated for comparison purposes with the cap calculations of §502(b)(6)(A) and (B) and does not reduce the capped amounts in §502(b)(6)(A) and (B) which are already limited by statute.<sup>17</sup>

Attorney’s fees resulting from termination of the lease may be included in the non-cap termination damages to be calculated for comparison purposes with the cap calculations of §502(b)(6)(A) and (B). Attorney’s fees resulting from termination of the lease are included in the amounts to be capped by §502(b)(6)(A) and (B) and are not added to the capped amounts *after* calculation to increase the landlord’s claim. Attorney’s fees resulting from events not related to termination of the lease are not limited by §502(b)(6), as those damages are not within the scope of §502(b)(6).<sup>18</sup>

With respect to future rent or some types of deferred rent, § 502(b)(6)(B) permits a landlord to claim, without limitation, the entire amount of rent *already due and owing* under the lease as of the *earlier* of: the bankruptcy petition date, or the date the landlord repossessed, or the tenant surrendered, the property. A claim for *future rent* under the lease is capped by §502(b)(6)(A) and may not be included beyond the statutory limit.<sup>19</sup>

Surely that is enough groundwork, now for our hypothetical lease and calculation of damages. Our example is: a 120 month lease with rent of \$3,000 per month - total rent of \$360,000, and a security deposit of \$6,000. The Debtor paid for 12 months but is past due for the 13<sup>th</sup> month and files bankruptcy prior to the rent payment due for the 14<sup>th</sup> month on April 1, 2018. The Debtor immediately moves to reject the lease. Below are the calculations under §502(b)(6) for this simple example.

1. All damages incurred by landlord resulting from termination of lease, <i>excluding</i> damages <i>not</i> related to termination of the lease. 108 mos. x \$3,0000	\$324,000.00
2. Date of petition	Mar 1, 2018
3. Date landlord repossessed property or tenant surrendered property ( <i>i.e. pre-petition repossession or surrender date</i> )	Mar 31, 2018
4. Earlier of dates in 2 & 3 or petition date <i>unless</i> there was a pre-petition repossession or surrender date	Mar 1, 2018
5. Amount equal to one year of rent (without acceleration) from date listed in 4.	\$36,000.00
6. Amount equal to 15% of rent not to exceed three years (without acceleration) from date listed in 4. Time method: 108 mos. x .15 = 16.20 x \$3,000 = \$48,600. Amount method 108 mos. x \$3,000 = \$324,000 x .15 = \$48,600	\$48,600.00
7. Greater of 5 or 6	\$48,600.00
8. Amount of unpaid rent (without acceleration) from date listed in 4. Excludes <i>future</i> rent.	\$3,000.00
9. Deductions such as security deposit, etc.	\$6,000.00
Total of claim under §502(b)(6) which is <i>lesser</i> of 1 <i>or</i> total of 7+8-9	\$45,600.00

Well, there you are - not as painful as high school algebra and hopefully more helpful. If only real life leases and the calculations were this easy, but at least this may help some of us

understand the basics.

1. (b) Except as provided in subsections (e)(2), (f), (g), (h) and (i) of this section, if such objection to a claim is made, the court, after notice and a hearing, shall determine the amount of such claim in lawful currency of the United States as of the date of the filing of the petition, and shall allow such claim in such amount, except to the extent that—

(6) if such claim is the claim of a lessor for damages resulting from the termination of a lease of real property, such claim exceeds—

(A) 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, following the earlier of—

(I) the date of the filing of the petition; and

(ii) the date on which such lessor repossessed, or the lessee surrendered, the leased property; plus

(B) any unpaid rent due under such lease, without acceleration, on the earlier of such dates....

2. Since lessor vs. lessee confuses me, I will refer to the lessor as landlord and the lessee as tenant.

3. *In re Vause*, 886 F.2d 794, 801 (6th Cir. 1989); *In re Healthy Hut Inc.*, 506 B.R. 526, 533 (Bankr. D. Haw. 2014); *In re MDC Sys., Inc.*, 488 B.R. 74, 82 (Bankr. E.D. Pa. 2013); *In re USinternetworking, Inc.*, 291 B.R. 378, 380 (Bankr. D.Md. 2003).

4. H.R.Rep. No. 95-595, at 353-54 (1977).

5. William Shakespeare: Hamlet: Act 2, Scene 2.

6. *In re Foamex Int'l, Inc.*, 368 B.R. 383 (Bankr. D.Del. 2007); *In re Mr. Gatti's, Inc.*, 162 B.R. 1004 (Bankr. W.D.Tex.1994).

7. *In re Brown*, 398 B.R. 215, 218 (Bankr. N.D.Ohio 2008) (citations omitted). See also, *In re El Toro Materials Co., Inc.*, 504 F.3d 978, 980 - 981 (9th Cir. 2007), cert. denied, *El Toro Materials Co., Inc. v. Saddleback Valley Cmty. Church*, 552 U.S. 1311, 128 S.Ct. 1875, 170 L.Ed.2d 746 (2008); *In re Lindsey*, 1997 WL 705435, at \*6 (4th Cir. Nov. 7, 1997)(*per curiam*); *In re Energy Conversion Devices, Inc.*, 483 B.R. 119 (Bankr. E.D. Mich. 2012); *In re Atlantic Container Corp.*, 133 B.R. 980 (Bankr. N.D.Ill.1991); *In re Bob's Sea Ray Boats, Inc.*, 143 B.R. 229, 231 (Bankr.D.N.D.1992); *In re Best Products Co., Inc.*, 229 B.R. 673 (Bankr. E.D.Va.1998).

8. *In re Shane Co.*, 464 B.R. 32, 40 (Bankr. D. Colo. 2012); *In re Iron-Oak Supply Corp.*, 169 B.R. 414, 419 n. 8 (Bankr. E.D. Cal.1994); 2 *Norton Bankr. L. & Prac.* 3d § 46:49 (Section 502(b)(6)(A) is illustrated by considering situation where “a \$5,000 per month lease is rejected five years prior to the end of the lease term. One-year’s rent would be \$60,000 (12 months times \$5,000) .... Fifteen percent of the remaining term would be \$45,000 (five years times \$60,000 per year times 15%), a sum which does not exceed three-years’ rent (\$180,000). Thus, the landlord’s claim would be the greater of the two, or \$60,000. If the remaining term of the lease was 10 years, the landlord’s claim would be 15% of \$600,000 (10 years times \$60,000 per year), or \$90,000.”).

9. I know it is still confusing, but the chart and calculations below will make it clearer, so read on.

10. §365(g)(1); §502(g)(1).

11. § 502(b)(6)(A)(i), (ii). See *In re Int'l BioChemical Indus., Inc.*, 521 B.R. 395, 404 (Bankr. N.D. Ga. 2014); *In re MDC Sys., Inc.*, 488 B.R. at 83; *In re Connectix Corp.*, 372 B.R. 488, 494 (Bankr. N.D. Cal. 2007).

12. *1500 Mineral Spring Assocs., LP v. Gencarelli*, 353 B.R. 771, 786 (D.R.I. 2006); *In re Lomax*, 194 B.R. 862, 866 (Bankr. 9th Cir. 1996); *In re Titus & McConomy, LLP*, 375 B.R. 165, 171 (Bankr. W.D.Pa. 2007); *In re Peters*, 2004 WL 1291125, at \*3 (Bankr. E.D.Pa. May 7, 2004); *In re Schembrie*, 2007 WL 2848566, at \*5 (Bankr. W.D.Wash. June 29, 2007); *In re Smith*, 249 B.R. 328, 335 (Bankr. S.D.Ga. 2000); *In re Fifth Ave. Jewelers, Inc.*, 203 B.R. 372, 377 (Bankr. W.D. Pa. 1996).
  
13. *In re Heller Ehrman LLP*, 2011 WL 635224 (N.D. Cal. Feb. 11, 2011); *In re Blatstein*, 1997 WL 560119, at \*15 (E.D. Pa. Aug 26, 1997z); *In re Allegheny Int'l, Inc.*, 145 B.R. 823, 828 (W.D. Pa. 1992); *In re Connectix Corp.*, 372 B.R. at 494; *In re Elec. Acquisition, LLC*, 342 B.R. 831, 833 (Bankr. M.D. Fla. 2005); *In re Shane Co.*, 464 B.R. at 39; *In re Filene's Basement, LLC*, 2015 WL 1806347, \*4, Bankr. D.Del. 2015).
  
14. *In re New Valley Corp.*, 2000 WL 1251858, at \*12 (D.N.J. Aug. 31, 2000); *In re Andover Togs, Inc.*, 231 B.R. 521, 547 (Bankr. S.D.N.Y. 1999); *In re Rock & Republic Enterprises, Inc.*, 2011 WL 2471000, at \*20 (Bankr. S.D.N.Y. June 20, 2011); *In re Today's Woman of Florida, Inc.*, 195 B.R. 506, 507 (Bankr. M.D. Fla. 1996); *In re Gantos, Inc.*, 176 B.R. 793, 796 (Bankr. W.D. Mich. 1995); *In re Farley, Inc.*, 146 B.R. 739, 747 (Bankr. N.D. Ill. 1992).
  
15. *In re Iron-Oak Supply Corp.*, 169 B.R. 414, 420 (Bankr. E.D. Cal. 1994) . See, *In re Allegheny Int'l, Inc.*, 136 B.R. 396, 402 (Bankr. W.D. Pa. 1991), *aff'd and remanded*, 145 B.R. 823 (W.D. Pa. 1992.).
  
16. *In re AB Liquidating Corp.*, 416 F.3d 961, 963 (9th Cir. 2005); *In re PPI Enterprises (U.S.), Inc.*, 324 F.3d 197, 210 (3d Cir. 2003).
  
17. *In re PPI Enterprises (U.S.), Inc.*, 324 F.3d at 208 n. 17; *In re MDC Sys., Inc.*, 488 B.R. at 94; *In re Fifth Ave. Jewelers, Inc.*, 203 B.R. 372, 381 (Bankr. W.D. Pa. 1996); *In re Financial News Network, Inc.*, 149 B.R. 348, 353 (Bankr.S.D.N.Y.1993).
  
18. *In re Kupfer*, 852 F.3d 853, 859 (9th Cir. 2016); *In re El Toro Materials Co., Inc.*, 504 F.3d at 980–81; *In re Blatstein*, 1997 WL 560119, at \*16 ; *In re Wigley*, 533 B.R. 267, 272 (B.A.P. 8th Cir. 2015); *In re Healthy Hut Inc.*, 506 B.R. at 531; *In re MDC Sys., Inc.*, 488 B.R. at 94; *In re Rock & Republic Enterprises, Inc.*, 2011 WL 2471000, at \*25 (Bankr. S.D.N.Y. June 20, 2011); *In re Smith*, 249 B.R. 328, 340 (Bankr. S.D. Ga. 2000); *In re Smith*, 249 B.R. 328, 340 (Bankr. S.D. Ga. 2000); *In re Pac. Arts Pub., Inc.*, 198 B.R. 319, 324–25 (Bankr. C.D. Cal. 1996).
  
19. *In re Malease 14FK Corp.*, 351 B.R. 34, 42 (E.D.N.Y. 2006); *In re Brown*, 398 B.R. 215, 218 (Bankr. N.D. Ohio 2008); *In re Atl. Container Corp.*, 133 B.R. 980, 987 (Bankr. N.D. Ill. 1991).