



AMERICAN  
BANKRUPTCY  
INSTITUTE

# Distressed Real Estate Symposium

## Hot Topics in Real Estate Cases

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## Hot Topics in Real Estate Bankruptcy Cases

2024 ABI Distressed Real Estate Symposium



## Learning Objectives

- Issues for landlords with respect to post-petition lease restructuring and the disposition of personal property by debtor tenants
- Special issues implicated in bankruptcies of hospitality-focused real properties
- Challenges in restructuring partially-developed properties
- Current issues with respect to postpetition financing and cash collateral
- Appropriate cram-down interest rate for different plans of reorganization in real estate cases



## Issues for Landlords



## Payment of Post-Petition Rent

(We know you want to talk about WeWork)

**SCENARIO:** May a debtor-tenant (or trustee) that failed to pay post-petition rent require a landlord to resort to a security deposit or letter of credit to satisfy post-petition lease obligation, notwithstanding Bankruptcy Code section 365(d)(3)?

*11 U.S.C. § 365(d)(3): “The trustee shall timely perform all the obligations of the debtor, except those specified in section 365(b)(2), arising from and after the order for relief under any unexpired lease of nonresidential real property, until such lease is assumed or rejected...”*

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## Payment of Post-Petition Rent

*Debtor's Position*

- **Marshalling**

- Sections 544 and 1107(a) of the Bankruptcy Code entitle the debtors to apply the doctrine of marshalling. The “Secured Landlords” should be compelled to marshal their assets, first recovering from the security already provided by the debtors before depleting the cash shared by all creditors and required to operate the business.
- Letters of credit delivered to landlord are part of a letter of credit facility directly backed by the debtors’ collateral. The letter of credit functions as an intermediary mechanism allowing the landlords to receive payments secured by cash posted directly by the debtors or by the debtors’ collateral.
- Given the clear reversionary right the debtors have to the cash collateralizing the security and to the excess draws, the “Secured Landlords” are secured creditors, secured by assets of the estates. “To deny this reality is to treat form over substance.” Accordingly, the availability of this security makes the Secured Landlords secured creditors such that marshaling can be compelled.

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## Payment of Post-Petition Rent

### *Debtors' Position (cont'd)*

- **Setoff:** Unlike a creditor's setoff rights, which are restricted by section 553, "there is no such restrictive language in section 558 and, consequently, Courts have concluded that a debtor may set off pre-petition claims against post-petition obligations it owes." *In re Women First Healthcare, Inc.*, 345 B.R. 131, 134 (Bankr. D. Del. 2006).
- **Recoupment:** Section 558 of the Bankruptcy Code preserves a debtor's common law right to assert a defense of recoupment to any debt asserted against it. *In re Prince Sports, Inc.*, 2013 WL 6906717 (Bankr. D. Del. 2013) (allowing debtor, under theory of recoupment, to apply prepetition credit to reduce postpetition administrative rent claim under section 365(d)(3)).
- **No Clear Remedy:** Section 365(d)(3) does not require any particular remedy for noncompliance, and the weight of authority indicates a bankruptcy court has broad discretion to fashion (or decline to provide) a remedy for landlords, if appropriate. *See, e.g., In re Southwest Aircraft Services*, 831 F.2d 848 (9th Cir. 1987); *In re Mr. Gatti's, Inc.*, 164 B.R. 946 (Bankr. W.D. Tex. 1994).

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## Payment of Post-Petition Rent

### *Landlords' Position*

- Letters of credit, and the proceeds thereof, are not property of the bankruptcy estate under the independence principle. Debtors cannot use non-debtor property as basis for setoff or recoupment.
- The debtors' leases almost universally provide that rent and additional rent are payable "without any set off, counterclaim, abatement or deduction." Isn't this part of the "timely performance" requirement of Bankruptcy Code section 365(d)(3)?
- "Allowing the trustee to use the [leased] premises to benefit the estate and then pay for that use, not with the cash contemplated by § 365(d)(3) but with the security deposit designed to protect the landlord against defaults, both strips the landlord of the protections of § 365(d)(3) and unfairly benefits the estate at the expense of the landlord." *In re The Leather Factory, Inc.*, 475 B.R. 710, 718-719 (Bankr. C.D. Cal. 2012).
- In rejecting the trustee's claim of setoff, *Leather Factory* held that "pre-petition security deposits and post-petition administrative claims lack mutuality of obligation and cannot be set off." *Id.* at 719.

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## Payment of Post-Petition Rent

### *Landlords' Position (cont'd)*

- In *In re Go Fig, Inc.*, 2009 WL 537090 (Bankr. E.D. Mo. 2009), the bankruptcy court held that a Chapter 7 trustee could not use recoupment to apply the security deposit against the landlord's § 365(d)(3) administrative claim.
- The court distinguished the pre-petition debtor and post-petition debtor as different legal entities, such that the administrative claim and the security deposit arose out of different transactions. The court also cited policy considerations: applying the deposit against administrative claims would effectively strip the landlord of the higher priority treatment that enables debtors to obtain post-petition services.
- See also *In re PYXSYS Corp.*, 288 B.R. 309 (Bankr. D. Mass. 2003); *Pereira v. Rich Taubman Assocs. (In re KP Fashion Co.)*, 2011 WL 3806116 (S.D.N.Y. 2011) (rejecting trustee's attempt to recharacterize draw on standby letter of credit to landlord's administrative claim, rather than to pre-petition damages).

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## Payment of Post-Petition Rent (Subchapter V)

**SCENARIO:** Subchapter V debtor-tenant fails to pay post-petition pre-rejection rent, notwithstanding Bankruptcy Code section 365(d)(3). Landlord moves to compel payment before effective date of lease rejection and return of possession, but hearing occurs after effective date of rejection. Debtor-tenant argues against immediate payment, contending unpaid rent may be paid through Subchapter V plan under Bankruptcy Code section 1191(e).

*11 U.S.C. § 1191(e): "Notwithstanding section 1129(a)(9)(A) of this title, a plan that provides for the payment through the plan of a claim of a kind specified in paragraph (2) or (3) of section 507(a) of this title may be confirmed under subsection (b) of this section."*

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## Payment of Post-Petition Rent (Subchapter V)

### Immediate Payment Not Required

**In re Steepologie, LLC**, 2024 WL 117525 (Bankr. W.D. Tex. 2024)

- Landlord's claim should be allowed as an administrative expense claim arising under § 503(b) of the Bankruptcy Code, to be paid alongside other administrative claims.
- Motion for immediate payment denied.

### Administrative Rent May Not Be Paid Over Term of a Plan

**In re Seven Stars on Hudson Corp.**, 618 B.R. 333 (Bankr. S.D. Fla. 2020)

- § 1191(e) specifically refers to claims "of a kind" specified in § 507(a)(2), which then refers to administrative expenses allowed under Section 503(b). But a debtor's obligation to pay post-petition rent is governed solely by § 365, not by § 503(b). "As such, even though new Section 1191(e) permits certain administrative expense claims to be paid over the term of the plan, this provision undoubtedly does not apply to administrative rent."

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## Abandonment of Personal Property

**SCENARIO:** In connection with rejection of a nonresidential real property lease, may a debtor-tenant abandon the estate's interest in personal property remaining in the premises to the landlord, allowing the landlord to dispose or transfer the personal property in its discretion "free and clear" of the claims of third parties?

*11 U.S.C. § 554(a): "After notice and a hearing, the trustee may abandon any property of the estate that is burdensome to the estate or that is of inconsequential value and benefit to the estate."*

*11 U.S.C. § 363(b)(1): "The trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate...."*

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## Abandonment of Personal Property

- “Free and clear” abandonment was first permitted in Delaware
- Used nationwide since the 1990’s – with pushback in C.D. Cal.
  - *In re Sheikh Shoes, LLC* (Bankr. C.D. Cal. Case No. 2:17-bk-24626-VZ) – Judge Zurzolo points to Bankruptcy Code section 363 and characterization as “transfer”
  - *In re CBCRC Liquidating Corp. (Corner Bakery)* (Bankr. D. Del. Case No. 23-10245 (KO)) – Judge Owens declines “free and clear” abandonment based on, among other things, lack of notice to persons or entities who might have interest in personal property – relief granted as to pre- and post-petition secured lenders (expressly consented in courtroom)
- Debtor can only abandon “*property of the estate*” under Bankruptcy Code section 554
- Consider difficulty of state law remedies outside of bankruptcy court
  - Landlords lack information regarding potential lien claimants
  - Impact of bankruptcy court-approved delays in filing schedules that would disclose that information
  - Necessity for UCC search
- **What is the solution?**

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## Abandonment of Personal Property

### A Possible Solution?

- The Debtors shall generally *describe the Abandoned Property* in the Rejection Notice and *serve such notice on any and all third parties that may have an interest in the Abandoned Property*
- Absent a timely objection [10 days to object], any and all of the Debtors’ personal property and furniture, fixtures and equipment (FF&E) located on the leased premises on the Rejection Date of the applicable lease shall be deemed abandoned pursuant to section 554, as is, effective as of the Rejection Date.
- Landlords may, in their sole discretion and without further notice or order of this Court, utilize and/or dispose of such property *without further notice or liability to the Debtors or any consenting third parties* and, to the extent applicable, the automatic stay is modified to allow such disposition.

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## Abandonment of Personal Property cont'd

### A Possible Solution?

- The Debtors shall not abandon (i) any of their business, financial, or other records; (ii) any personal property that is leased to the Debtors or which is otherwise not owned by the Debtors, and shall use their reasonable best efforts to return such property to the owner of the property; provided, however, that the Debtors may abandon personal property owned by a landlord to the landlord at the applicable premises; and (iii) personal property against which the Debtors know a third party has asserted a lien other than the Prepetition Secured Parties and DIP Lenders, without providing notice to such party.
  - *In re Number Holdings, Inc. (99 Cents Only Stores)* (Bankr. D. Del. Case No. 24-10719 (JKS)) *Interim Order (I) Authorizing and Approving Procedures For Rejection and Assumption and Assignment of Executory Contracts and Unexpired Leases, (II) Authorizing Abandonment of Certain Personal Property, and (III) Granting Related Relief* [Docket No. 152], entered April 12, 2024.

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## Issues Related to Bankruptcies of Hospitality Properties and Properties in Development

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## Case Study: Crowne Plaza Times Square



- Mixed-use commercial property with ground-floor retail, several floors rented to commercial tenants, a parking garage, and a Crowne Plaza Hotel
- Hotel was non-operational
- Chapter 11 cases commenced on 12/28/22
  - *In re Times Square JV LLC*, Bankr. S.D.N.Y. case no. 22-11715 (JPM)
- Effective Date of plan occurred on 3/31/23

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## Case Study: Crowne Plaza Times Square

- Issues relevant to hospitality and CRE special situations:
  - Senior lenders' limited exercise of remedies to displace a zombie sponsor
  - Working with/around ownership group with multiple roles
  - Asset management issues for mixed-use property
    - Restarting operations at a distressed property
    - Optimizing the mix of retail/commercial/hospitality space in an evolving travel/central business district utilization environment
    - Maximizing parking/signage revenue
  - Rebranding through rejection of license (flag) agreement
  - Union/pension issues
  - Marketing/market testing in bankruptcy
  - Consolidation of property (land lease)/Joint Operating Agreement
  - Optimal debt capacity/capital structure

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## Case Study: Crowne Plaza Times Square

### Governance Issues

- Lenders' limited exercise of remedies
- Navigating a passive ownership group's multiple roles
- Asset and hotel management during a period of uncertainty

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## Case Study: Crowne Plaza Times Square

### Legal Issues

- License agreement rejection and rebranding
- Union and pension issues
- Marketing a single property in a shaky M&A and financing environment
- Addressing disparate lease and land ownership arrangements

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## Case Study: Crowne Plaza Times Square

### Operating Issues

- Reopening a hotel property with a broken capital structure in an unstable macroeconomic environment
- Optimizing space utilization in changing market conditions
- Maximizing the value of underutilized property attributes
- Finding a sustainable capital structure after a “long boom” in commercial real estate

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## Issues Related to Properties in Development

- Involuntary v. voluntary cases
- No income being generated
  - Need for DIP financing
- Chapter 11 sale as goal
  - Stalking horse bidder
  - Credit bids
  - Auction with or without reserve
  - Adequacy of sale price
- Multiple secured creditors
  - Mechanics’ liens
- Security of property

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## Issues Related to Postpetition Financing and Cash Collateral

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## DIP Financing and Cash Collateral Overview

- DIP Financing
  - Benefits for DIP lender include:
    - Potential priming liens
    - Control over case (e.g., budgets, timelines, etc.)
  - Incentive for prepetition lender to fund DIP
  - Potential issues in granting liens on leases
- Cash collateral
  - Considerations for consensual v. contested use of cash collateral
  - Diversion of rents from good properties to service case and/or fund nonperforming properties

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## Postpetition Funding: Adequate Protection

- Preexisting lender entitled to adequate protection for:
  - Use of collateral
  - Priming of prepetition liens (if applicable)
- Forms of adequate protection include:
  - Grant of additional liens on unencumbered property and/or replacement liens
    - Impact of Section 552
  - Superpriority administrative claims
  - Cash payments
  - Other
    - Equity cushion
      - *R&J Contractor Servs., LLC v. Vancamp*, 652 B.R. 237, 244 (D. Md. 2023) (“case law has almost as uniformly held that an equity cushion under 11% is insufficient to constitute adequate protection”).
    - Reporting
    - Collateral access
      - Issues with landlords

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## Postpetition Funding: Adequate Protection (cont'd)

- Limited to diminution in value
- 506(c) and 552 waivers
- Interim Relief
  - Challenges of establishing adequate protection early in case
  - Surcharge
    - Approval of expenses for preservation of property with or without consent of secured creditors
    - Prospective v. retrospective determination of surchargeable costs
  - Loan documents
  - Interim order terms

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## Determination of the *Till* Cramdown Interest Rate

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## Derivation of the *Till* Cramdown Interest Rate

- Determining whether an efficient financing market exists
  - Several circuit courts have concluded that, in the chapter 11 context, the *Till* formula approach should be utilized only after a bankruptcy court has first evaluated what, if anything, would be an "efficient market" rate. See *Apollo Global Mgmt., LLC v. BOKF, NA (In re MPM Silicones, L.L.C.)*, 874 F.3d 787, 798-801 (2d Cir. 2017); *Wells Fargo Bank N.A. v. Tex. Grand Prairie Hotel Realty, L.L.C. (In re Tex. Grand Prairie Hotel Realty, L.L.C.)*, 710 F.3d 324, 331-37 (5th Cir. 2013); *Bank of Montreal v. Official Comm. of Unsecured Creditors (In re Am. HomePatient, Inc.)*, 420 F.3d 559, 568 (6th Cir. 2005)
  - By contrast, some circuit courts have focused on the formula approach without discussing an efficient market. See *FLCA v. Topp (In re Topp)*, 75 F.4th 959, 962 (8th Cir. 2023) (approving formula approach using 20-year treasury rate as starting point); *First S. Nat'l Bank v. Sunnyslope Hous. L.P. (In re Sunnyslope Hous. L.P.)*, 859 F.3d 637, 646 (9th Cir. 2017) ("creditor bears the burden of showing that the prime rate does not adequately account for the riskiness of the debtor")
- Selection of appropriate base rate
  - Fixed v. floating rate index
  - Plan term

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## Selection of Risk Adjustments

- Circumstances of the estate
  - Asset relative to comp set
  - Debtor's financial condition
  - New value
  - Predictability of future cash flow
- Plan feasibility and default risk
  - Evaluation of cash flow risks
  - Debt Service Coverage Ratio ("DSCR")
  - How asset performed prior to pandemic
- Duration and interest rate risk
  - Fixed v. floating rate
  - Review of forward rate curve
- Nature of the security
  - Risk of future default

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## Derivation of the Risk Adjusted Rate – Formula Approach

	Creditor's Expert	Tenzer
<b>Base Rate</b>	Prime @ 8.5% <sup>1</sup>	10-Year T @ 4.60% <sup>2</sup>
<b>Risk Premiums</b>		
Circumstances of the Estate	0.75%	0.50%
Plan Feasibility and Default Risk	1.50%	0.50%
Interest Rate and Duration Risk	0.50%	0.25%
Nature of the Security	0.50%	0.25%
<b>Sub-Total Risk Premium</b>	<b>3.25%</b>	<b>1.50%</b>
<b>Total Risk Adjusted Rate</b>	<b>11.25%</b>	<b>6.10%</b>

Note 1: US Bank Prime Rate as of April 3, 2024

Note 2: US 10-Year Treasury Rate as of April 25, 2024

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## Panelists



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# Faculty

**Ivan M. Gold** is Of Counsel to Allen Matkins Leck Gamble Mallory & Natsis LLP in its San Francisco office, where he represents clients in all areas of real estate-related litigation in state and federal courts, as well as contested matters and adversary proceedings in bankruptcy court. He has experience in breach-of-lease and unlawful-detainer litigation, as well as pre-litigation counseling and negotiation involving a wide variety of commercial real estate, including neighborhood and regional shopping centers, office buildings, warehouse and industrial properties, data centers, restaurants and hotels. Mr. Gold represents shopping center developers and landlords of office and data center properties in major bankruptcy proceedings throughout the U.S. He also has utilized alternative dispute resolution in a wide variety of disputes, including arbitration, mediation and private judge proceedings. Prior to joining Allen Matkins, Mr. Gold was senior counsel at Brobeck, Phleger & Harrison LLP and a partner in the San Francisco law firm of Berg, Ziegler, Anderson & Parker. He has spoken at continuing education programs sponsored by ABI and the International Council of Shopping Centers, State Bar of California, Bar Association of San Francisco and California Continuing Education of the Bar on such topics as landlord/tenant disputes, the treatment of leases in bankruptcy proceedings, alternative dispute resolution and real estate-related litigation. Mr. Gold received his B.S. from American University and his J.D. from the University of California, Hastings College of the Law.

**Abigail O'Brient** is a partner with Covington & Burling LLP in Los Angeles. Her wide-ranging restructuring and creditors' rights litigation practice focuses on the representation of secured and unsecured creditors in insolvency cases and other proceedings nationwide. Ms. O'Brient routinely represents parties in litigation related to insolvency and distressed debt in state and federal court, as well as purchasers and sellers of distressed assets and fiduciaries in bankruptcy cases and other insolvency matters. Outside of the insolvency arena, she has significant judgment-enforcement and asset-recovery experience. Ms. O'Brient was a contributor to *ABI's Quick Evidence Handbook, Second Edition* (ABI 2018) and has been listed in *The Best Lawyers in America* for Bankruptcy and Creditor/Debtor Rights/Insolvency and Reorganization Law for 2023. She received her B.A. *magna cum laude* from Washington and Lee University and her J.D. from the University of California, Berkeley.

**Hon. Deborah J. Saltzman** is a U.S. Bankruptcy Judge for the Central District of California in Los Angeles and San Fernando Valley, appointed on March 18, 2010; she also hears cases in the Northern Division in Santa Barbara. As a member of the Ninth Circuit Bankruptcy Education Committee, she welcomes the opportunity to participate in bankruptcy education programs. She also currently serves on the Ninth Circuit Wellness Committee. Prior to her appointment to the bench, Judge Saltzman practiced bankruptcy law in Los Angeles, representing debtors, secured and unsecured creditors, asset-purchasers, creditors' committees and landlords in chapter 11 and out-of-court restructurings, as well as related financing transactions and litigation. She received her B.A. in 1991 from Amherst College Phi Beta Kappa and her J.D. in 1996 from the University of Virginia School of Law.

**Richard J. Shinder** is the founder and managing partner of Theatine Partners, an advisory and fiduciary services boutique based in Greenwich, Conn. He has more than 30 years of experience as an investment banker, restructuring advisor, distressed and special-situations investor and fiduciary

in connection with complex restructurings and recapitalizations, special-situations financings, M&A transactions, private credit and distressed investments. Prior to establishing Theatine Partners in May 2020, Mr. Shinder was group head of the Restructuring and Special Situations Group at Piper Jaffray & Co. Prior to Piper, he was a managing director in TPG Capital's credit-investing strategy, and prior to that, he was a partner in the Restructuring Group at boutique investment banking firm Perella Weinberg from 2009-14. Before Perella Weinberg, he was a senior member of the Special Situations Group (SSG) at Goldman Sachs, the firm's proprietary alternative investment business. Earlier in his career, Mr. Shinder worked in the merchant banking and investing businesses of Merrill Lynch & Co. and Avenue Capital, respectively, and was also a managing director in The Blackstone Group's (now PJT Partners) market-leading Restructuring and Reorganization Group. He started his career with Lehman Brothers in New York, where he worked in the Municipal Infrastructure and Leveraged Finance Groups and spent two years seconded to the Asia Investment Banking team based in Hong Kong. Mr. Shinder is a highly regarded restructuring expert and frequent lecturer, speaker and panelist on business and financial topics, and he has written and spoken extensively on economic, financial, geopolitical, cultural, and corporate governance-related issues; his opinion essays have been featured in the *Wall Street Journal* on multiple occasions, as well as in other publications. He also has served as both an independent director as well as an interested (designee) director for multiple companies, as well as on a number of nonprofit and philanthropic boards. Mr. Shinder is a member of the Economic Club of New York and the Turnaround Management Association, and sits on the leadership committee of Catholic Renewal, a philanthropic industry body affiliated with Catholic Charities. He received his undergraduate degree *summa cum laude* from Gonzaga University and his M.B.A. with distinction from the University of Pennsylvania Wharton School of Business.

**Gary M. Tenzer** is a co-founder, principal and managing director of George Smith Partners, Inc. in Los Angeles and has more than 40 years of experience in originating, structuring, underwriting and placing sophisticated real estate financing transactions, with properties reaching \$250 million in debt and equity financing. He has been involved in the placement of innovative financing for residential, multifamily, retail, office, commercial, industrial, mixed-use, congregate care, hospitality, land development, large-scale community development and special purpose properties. Mr. Tenzer was appointed as the interest rate expert in the chapter 11 bankruptcy of General Growth Properties, Inc. (GGP) in 2009, the second-largest mall owner in the country, and included 158 of its 200 U.S. malls. His reputation also attracted The Operating Engineers Pension Trust, a \$2 billion Taft Hartley Pension Fund, where he served as the Trust's real estate financing advisor. Mr. Tenzer previously served as a member of the board of directors of a NYSE-listed national developer of active-adult communities, as well as a director of a federally chartered commercial bank on both the bank's loan and credit policy committees. In 2012 and 2013, he served as co-chair of the Crocker Symposium on Real Estate and the Law, jointly sponsored by the LA County Bar and the UCLA Ziman Center for Real Estate, for which he is a member of the advisory board. Mr. Tenzer is a frequent guest lecturer on real estate and real estate finance at the UCLA Anderson School of Management, as well as both the graduate and undergraduate programs at the University of Southern California's Marshall School of Business, and he is a frequent panelist at real estate conferences. He also has been a frequent lecturer at UCLA and the University of Southern California in its undergraduate and graduate real estate finance classes, and has served as a mentor in USC's Master of Real Estate Development program. Mr. Tenzer received his A.B. in economics in 1976 from the University of California at Berkeley, and his M.B.A. in 1978 and M.S.B.A. in 1979 from the University of Southern California.