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Many clauses may be unenforceable under the new rules.

People and Property: Bankruptcy Cancellation Clauses Under the Bankruptcy Reform Act

Emanuel B. Halper

WHEN WAS THE GREATEST REAL ESTATE AUCTION in the history of the world? If you want to know, you had better find someone older than I am. But I'll certainly tell my grandchildren about the day I walked into the W.T. Grant auction.

That auction didn't take place at Sotheby's or Parke-Bernet. The place was Judge Galgay's courtroom at the Federal Courthouse in Foley Square in New York City.

The W.T. Grant Company (may it rest in peace) had come on hard times. Once one of America's ablest and most aggressive merchants, Grant's had

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filed for an arrangement under Chapter XI of the old Bankruptcy Act in a desperate move to keep afloat. Chapter XI proceedings under the old Act made it possible to rehabilitate a sick but potentially viable company by allowing it to disgorge some of its losing operations.[1] The W.T. Grant proceedings ended up as liquidation proceedings because the court determined that no part of the operation was really salvageable.

A POPULAR AUCTION

To raise cash and satisfy creditors' claims, Grant's leasehold interests in a good many stores were being auctioned off. The winner of the auction for each leasehold was entitled to purchase the tenant's interest under the lease. Since many of the leases had been executed in the 1950s and 1960s, rents were low enough to whet the appetite of many retailers and many speculators.

A huge crowd was expected to converge on the courthouse. I was certain that Grant's landlords would show up en masse. Landlords who owned good stores would be eager to cancel the leases in the hope of finding a new tenant who would pay more rent. Landlords with unsuccessful stores were hoping that some other tenant would pick up Grant's interest. Lawyers and newspaper reporters would come to do what you would expect them to do. Retailers, speculators, union leaders, and a sprinkling of W.T. Grant creditors were also expected. I looked forward to the court appearance just as I look forward to conventions. I brought along an ample supply of business cards.

When I attend a convention, I'm used to standing in line to register. I stood in line at the courthouse, but it wasn't for registration. I had to sign in and subject my personal belongings to a security check.

It took some time to find the right courtroom. The room originally designated was too small, and the proceeding had been rescheduled for the largest courtroom available. Even the largest was not large enough. Not nearly. Real estate people, merchants, lawyers, creditors, spectators, the press, and the perversely curious jammed the room.

I thought I'd come early enough to be sure of a seat. What seat? All the seats were taken by bankruptcy lawyers (who seem always to have a pet chair reserved). I headed for the jury box, but twelve newspaper reporters beat me. Then I tried to camp on a window seat. I was beaten to the windowsill by union leaders who were protesting the store closings.

Standing room began to look attractive. But where can a guy stand when every inch of space in the courtroom is occupied by the shoes of fellow creatures? I discovered a corner behind the back row of benches. I could even sit there if I were willing to sit on the floor.

I exchanged greetings with many old acquaintances. I saw some of the old workhorses with whom I've been negotiating chain-store leases for the last twenty years. I was introduced to many people whom I had known only as telephone voices. Few people ever look as you imagine them when you know them only from the telephone.

The first thing an experienced bidder does when he enters a new courtroom is to check out where the telephone booths and lavatories are. There were three telephone booths on the floor, but several cautious lawyers had already taken possession to make sure that they could keep in touch with and get instructions from their clients. I checked the staircase and found that there was access to the floor below where there were another three telephone booths but no people at all. There, too, was a men's room that I figured would be vacant when I needed it.

I returned to the courtroom just in time. The court reporter asked us all to rise. That was no problem because most of us were already standing.

In walked Judge John Galgay. He had a cheerful countenance. His straight whitish-gray hair and ruddy cheeks made me feel comfortable.

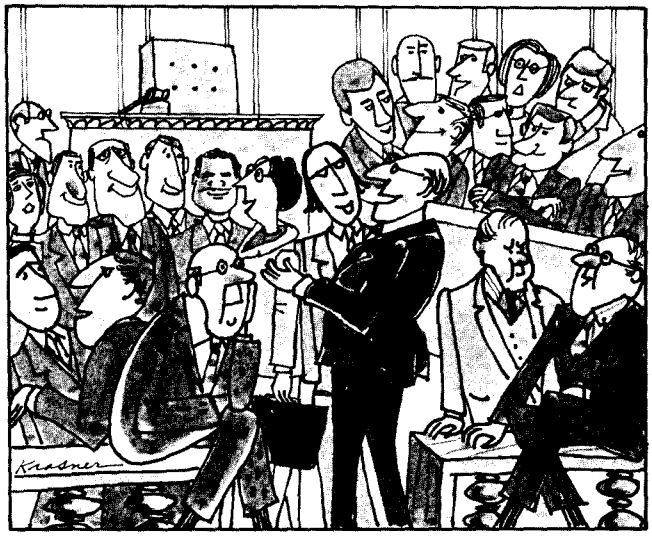
He sat high on the bench. His head was considerably above ours. I wondered whether that was arranged out of concern for his survival in a courtroom in which so little oxygen had to do for so many. Up there, he got the first crack at any fresh air entering the room.

W.T. Grant's attorneys handed the judge a list of stores to be auctioned off. The documents described the location of each store, its size, the most important provisions of each lease, and the book value of the store's trade fixtures. If Grant had already received offers to purchase the leasehold, the amounts of the offers were noted.

Before the judge could start the bidding, aggressive lawyers representing the landlords jumped to their feet. They protested the bidding procedure and the format of the papers that Grant's lawyers used to start the proceeding. They claimed that their clients' leases contained clauses that permitted

[1] As of October 1, 1979, the provisions of the Bankruptcy Reform Act are effective. Chapter 11 of the new Act performs functions similar to Chapters X, XI, and XII of the old Act.

the landlord to cancel the lease if the tenant filed a petition in bankruptcy or for an arrangement under Chapter XI. They claimed that the leases gave the landlords a right to cancel if Grant attempted to assign its leasehold interest. Some landlords' attorneys invoked the Fourteenth Amendment to the U.S. Constitution; others invoked *Collier on Bankruptcy;* and still others invoked the *Bible.*



Judge Galgay was determined to conduct the bidding procedures before he passed on the landlords' objections. After permitting each landlord's attorney to make his oration, Judge Galgay gently but firmly reserved decision on the attorney's request and insisted on proceeding to the bidding.

SOME EXCERPTS FROM THE TRANSCRIPT

Here are some examples I've excerpted for you from the transcript of the proceedings. The excerpts are almost exactly as the court reporter typed them. Delations are noted by dots (. . .). Spelling errors have been corrected. Additions are indicated by brackets [ ].

JUDGE GALGAY: I apologize for the fact that we don't have seats to accommodate all of those interested parties, but this is the largest courtroom we could get on [the] short notice that we had.

Let's try to be as orderly as we can. I will try to give everyone an opportunity to be heard in whatever matter they are involved in. . . .

JUDGE GALGAY: Would you proceed.

THEODORE GEWERTZ (A Grant Attorney): The leases up for assignment are listed on Exhibit A to the Application, which was brought on by Order to Show Cause here dated March 23, 1976.

In each instance the landlord, any leasehold mortgagee and all interested bidders were notified and received copies of the Order to Show Cause and Applications.

One thing we would like to request, by reason of the number of people here, we would request that Counsel table not be approached after the bidding so that we can expedite this and not be delayed by having to make side negotiations while the hearing is going on this afternoon.

JUDGE GALWAY: All right, let's proceed.

. . . .

THEODORE GEWERTZ: Yes, Your Honor. Let's move to the next one. The next matter is store 1143, Folcraft, Pennsylvania. Their — The high bidder here is again Berlyn-Spillane Corporation for $3,000. That does not include any trade fixtures.

JUDGE GALGAY: All right.

THEODORE GEWERTZ: If the arrearages amount to $2,655.15 —

JUDGE GALGAY: Give that to me again.

THEODORE GEWERTZ: $2,655.15. I understand that the bidder is withdrawing the bid. So we have no bid.

So I would ask — unless there are other bidders in the room, I would ask for permission to withdraw the Application with respect to this store, 1143.

JUDGE GALGAY: Is anyone else interested in bidding on store 1143, Folcraft, Pennsylvania?

LEONARD S. HARRIS (Attorney for McCrory Corporation): McCrory Corporation. McCrory bids $5,000 for both the lease and the fixtures.

THEODORE GEWERTZ: I need a figure on the fixtures.

LAWRENCE CHERKIS (Another Grant Attorney): Your Honor, the book value for the fixtures is $63,500.

JUDGE GALGAY: Would you repeat that?

LAWRENCE CHERKIS: $63,500 book value of the trade fixtures of Folcraft, Pennsylvania.

THEODORE GEWERTZ: Then the bid is not adequate because I figure twenty percent of the $63,000 is $12,700.

JUDGE GALGAY: Mr. Harris, would you like to revise your bid?

LEONARD S. HARRIS: Yes, if I may have a moment to see my principal, I will be right back.

We will now increase the bid to $15,000, including lease and fixtures.

THEODORE GEWERTZ: Your Honor, that is not sufficient since it does not cover the twenty percent plus the $2,655.15 by virtue of my addition. I hope I am right.

JUDGE GALGAY: Well, Mr. Harris, do you want to reconsider your bid?

LEONARD S. HARRIS: If I may have another moment, please.

A VOICE: What is the amount necessary to cover?

JUDGE GALGAY: I don't do the addition.

THEODORE GEWERTZ: Something around $15,500 at the minute.

LEONARD S. HARRIS: Make it $15,500.

JUDGE GALGAY: Why don't you make it $16,500 and it will relieve all doubts.

THEODORE GEWERTZ: The administrative work involved certainly doesn't leave much margin.

LEONARD S. HARRIS: If I assume Your Honor to say my fee will come out of this, I will be very happy to agree.

JUDGE GALGAY: Did I hear a bid of $16,500?

LEONARD S. HARRIS: Yes, Your Honor.

JUDGE GALGAY: Are there any other bids?

(No response.)

JUDGE GALGAY: Hearing none, I assume that this is the highest bid.

You will submit an Order to that effect, Mr. Gewertz.

THEODORE GEWERTZ: Yes, Your Honor.

JUDGE GALGAY: This is on behalf of McCrory Corporation. . . .

THEODORE GEWERTZ: The next one is store 1093, Clark, New Jersey. The high bidder here thus far is S.S. Kresge Company, who has bid $41,500 for the lease and $46,000 for the trade fixtures, which is twenty percent of the book value of the trade fixtures.

There are other bidders, at least three other bidders, Zartleg Corporation, Paul R. Williams, Jr. as agent and the Stop 'N Shop Companies, Inc.

The arrearages on this store amount to some $22,330.38.

JUDGE GALGAY: The highest bidder according to your document is S.S. Kresge at $41,500 for the lease and $46,000 for the trade fixtures.

THEODORE GEWERTZ: Yes, Your Honor.

JUDGE GALGAY: Is Marcia Siegelman, the landlord, represented in Court?

JOHN NEWMAN: John Newman, attorney and attorney in fact for Marcia Siegelman. My office is at number 1 Washington Street, Morristown, New Jersey.

Before the bidding progresses, I would like to make a statement for the landlord.

JUDGE GALGAY: Go ahead.

JOHN NEWMAN: And on behalf of the landlord who is the owner of premises. I would like to make this Court aware and also the prospective bidders that the W.T. Grant Company is in material default of covenants and agreements under its lease agreement.

An Answer has been filed with this Court and a statement of default. The breach of covenants on repairs and maintenance we estimate approaches $100,000.

It has not been corrected despite notice by the landlord and despite the fact, after months of notice by the municipal government of ordinance violations and breaches of codes.

In fact, we brought here today the building inspector of the Township of Clark in case there is any doubt as to Grant's violation of municipal codes in this regard.

It is the landlord's position that the W.T. Grant Company under its lease was to remain liable. That was stated in our Answer. In the event of an assignment, the landlord is not prepared to issue an estoppel certificate at this time, but only the statement of default, which was heretofore filed with this Court.

The Grant Company, as Your Honor knows, abandoned the premises and the remainder of our contentions are set forth in the Answer and Statement of Default.

I have additional copies here for any bidders here who might be interested.

JUDGE GALGAY: Thank you.

JOHN NEWMAN: I would like to add this, Your Honor.

I would like to join with other attorneys and put ourselves on record that we don't feel that this proceeding is authorized by Section 70B of the Bankruptcy Act. I know Your Honor will take that under advisement but I do want to be on record as far as that contention is concerned. Subject to the foregoing reasons and defaults as set forth here, the landlord is prepared to participate in the competitive bidding because the landlord wants to retake this store. Subject to that reservation, the landlord would be prepared to go forward with the competitive bidding process for itself.

JUDGE GALGAY: All right. Well, the total bid of S.S. Kresge is $87,500.

CHESTER ROBINSON (Attorney for K-Mart Corporation): That is correct, Your Honor.

JOHN NEWMAN: I assume the fixtures bid and the lease bid will be combined.

CHESTER ROBINSON: Aggregate bid.

JUDGE GALGAY: Yes.

. . . .

THEODORE GEWERTZ: I would say that this particular store was one of the most successful of all the Grant stores. . . . I don't find any breach of a repair clause to be an insuperable hinderance to the assignment of this lease.

I suggest that we go ahead with the bidding. . . .

JUDGE GALGAY: Let's use units of $5,000 to begin with.

CHESTER ROBINSON: $100,000.

EMANUEL B. HALPER (Representing Zartleg Corporation): As I see the bid of S.S. Kresge Company, it has separated its bid between the leasehold and the trade fixtures.

I would like to know if it is changing its bid now?

JUDGE GALGAY: No, my understanding is the total bid would cover both.

CHESTER ROBINSON: You heard the Court and you heard me, it's an aggregate bid combined, lease assignment plus fixtures, aggregate, $100,000.

JOHN NEWMAN: $105,000.

EMANUEL B. HALPER: $110,000.

CHESTER ROBINSON: $115,000.

JOHN NEWMAN: $120,000.

EMANUEL B. HALPER: $125,000.

. . . .

(The three bidders continued to alternate in $5,000 increments.)

CHESTER ROBINSON: $305,000.

JUDGE GALGAY: Let's slow up and go to $20,000. The last bid I have is $305,000 by Kresge.

CHESTER ROBINSON: Right, right.

EMANUEL B. HALPER: Your Honor, what was the last bid?

JUDGE GALGAY: $305,000 by Kresge.

EMANUEL B. HALPER: Your Honor, I bid $305,000 for the leasehold alone and $5,000 for the trade fixtures that relate to the restaurant operation alone.

CHESTER ROBINSON: If Your Honor pleases, I don't think you could split the trade fixtures bid.

JUDGE GALGAY: No, I am not going to change the rules in the middle of the game. This is for the entire assignment of the lease and all trade fixtures.

EMANUEL B. HALPER: All right, $305,000.

JUDGE GALGAY: I already had that bid.

EMANUEL B. HALPER: Then I bid $315,000.

JUDGE GALGAY: I have already increased the units by $20,000.

EMANUEL B. HALPER: Then I shall bid $325,000.

JOHN NEWMAN: $345,000.

CHESTER ROBINSON: $365,000.

. . . .

(The three bidders alternate with $20,000 increments.)

CHESTER ROBINSON: I am going to $785,000.

EMANUEL B. HALPER: We have no bid.

JOHN NEWMAN: Did I hear Kresge going to $785,000?

JUDGE GALGAY: You did.

JOHN NEWMAN: I am just a little confused because the attorney for Kresge came to me just a few moments ago and said he was withdrawing his bid. Is that changed?

CHESTER ROBINSON: That was changed and I didn't have a chance to speak with you since.

JOHN NEWMAN: I would appreciate the courtesy.

CHESTER ROBINSON: I would have given it to you but you were busy.

JUDGE GALGAY: This is a crowded room.

JOHN NEWMAN: Is it true if a deposit is put on the lease and there is a legal challenge, that the successful bidder would lose that deposit?

JUDGE GALGAY: That's not my understanding. That is not what we have been doing.

All the requirement of the bid is to indicate the good faith of the bidder in pursuing his rights. . . .

. . . .

JUDGE GALGAY: Well, let's move along as promptly as we can.

Mr. Gewertz, you will submit an Order on S.S. Kresge on store number 1093 —

THEODORE GEWERTZ: I don't think the bidding is finished.

JUDGE GALGAY: I thought it had been.

ELIAS MANN (An attorney representing several bidders and landlords on other leaseholds): It hasn't concluded.

JUDGE GALGAY: I thought that was the last bid.

THEODORE GEWERTZ: It hasn't been knocked down yet, Your Honor.

EMANUEL B. HALPER: Your Honor, what was the last bid?

JUDGE GALGAY: $785,000 by S.S. Kresge.

EMANUEL B. HALPER: We bid $805,000.

CHESTER ROBINSON: $825,000.

JOHN NEWMAN: $845,000, the landlord.

CHESTER ROBINSON: At this point, Your Honor, may I ask for an adjournment on this matter until tomorrow morning?

EMANUEL B. HALPER: We object to that, Your Honor.

JUDGE GALGAY: No, it wouldn't be orderly to do that, Counselor. I have had that request in other matters.

I'm afraid we have to face up to —

CHESTER ROBINSON: Reality.

JUDGE GALGAY: The last bid I have is from Zartleg Corporation at $845,000.

JOHN NEWMAN: That's the landlord's bid.

CHESTER ROBINSON: The landlord's bid.

JUDGE GALGAY: Was that the landlord's bid?

JOHN NEWMAN: Yes, it is.

JUDGE GALGAY: All right, are there any other bids beyond the landlord's bid of $845,000?

(No response.)

JOHN NEWMAN: Your Honor, can I move that the bidding be closed?

JUDGE GALGAY: Well, I was just giving a respectful interlude to —

EMANUEL B. HALPER: Can the interlude be just a little longer interlude, a brief interlude?

JUDGE GALGAY: Is Kresge going to be bidding on other properties in the next two or three items?

CHESTER ROBINSON: Not the next two or three, but several on the sheet farther down.

JOHN NEWMAN: If Your Honor please, we would very much like to conclude the bidding as early as we could on this store.

I am sure that Kresge and perhaps others would want to see what their position is after the—at the end of the day and I think that's very unfair to the landlord.

JUDGE GALGAY: All right, but I don't want to chill any bidding. At the same time, I don't want to be unfair to you as a landlord or any other bidder.

I will take just a two minute recess. Off the record.

(Discussion off the record.)

JUDGE GALGAY: All right, the last bid I have is $845,000 by the landlord.

EMANUEL B. HALPER: We pass.

CHESTER ROBINSON: $865,000.

JUDGE GALGAY: Are there any other bids?

JOHN NEWMAN: We bid $845,000. Kresge's bid was $865,000?

JUDGE GALGAY: That's right.

EMANUEL B. HALPER: We pass.

JOHN NEWMAN: You are not bidding anymore?

EMANUEL B. HALPER: We just pass.

CHESTER ROBINSON: That's not fair. Let him stay in the pot or get out.

JUDGE GALGAY: I am not going to make any rules that are going to be that fine. Let the next highest bidder bid over $865,000.

JOHN NEWMAN: Your Honor, one of our objections is that Grant is going out of business, no longer has any liability.

Now we are faced with a bidder who is coming in to bid and a prospective tenant, the name of Zartleg or Zart Corporation —

EMANUEL B. HALPER: Zartleg.

JOHN NEWMAN: Who is this company, who is this phantom company that is coming in and pretends to be responsible on this whole bidding situation?

JUDGE GALGAY: I think he is entitled to an answer. Would you describe who Zartleg is and what the nature of their solvency is as well as the kind of business that they do?

EMANUEL B. HALPER: Your Honor, I have bid previously in — Zartleg has bid previously in this Court, Your Honor.

Every time Zartleg had to put up money, it came with certified checks in hand.

JUDGE GALGAY: I am aware of that, but the landlord doesn't know who you are. They are entitled to know.

They want to make sure you are not running massage parlors or something.

EMANUEL B. HALPER: Your Honor, I can give you assurance that we will not do that. I can assure you that we will do no such thing. . . .

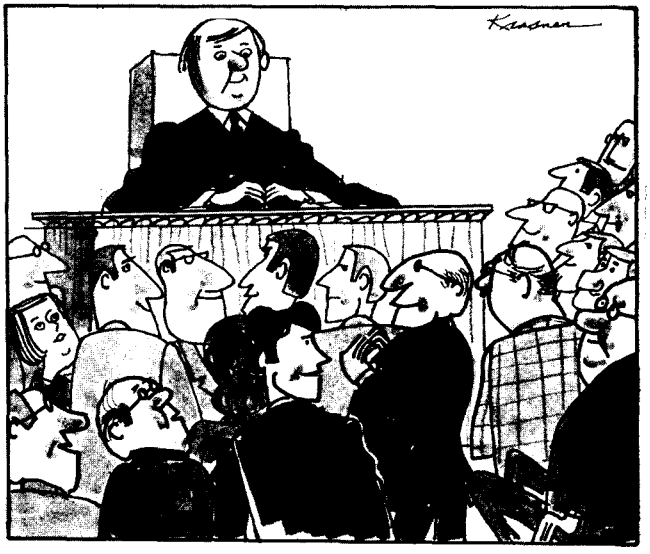
I guess you get the point. My clients' strategy was to avoid revealing their identity when bidding. Thus, I bid on behalf of corporations you never heard of. The landlords were challenging all the bidding procedures anyway. We figured that, after a client won the bidding for a leasehold, we could appease the landlord by having the winning bidder's parent corporation guaranty the tenant's obligations under the lease.

Understandably, the landlords objected to our stratagem. They objected because it prevented them from establishing a clear picture of the credit of the company that was doing the bidding. Some Grant landlords professed to be worried about the possibility that a massage parlor would open where a W.T. Grant variety store or department store closed. There was another possibility that they probably feared more. Perhaps a discount store would acquire the leasehold and provide competition for the other tenants.

So, I was accused of being a front for pornographers quite a few times. Sometimes, landlords pressed me aggressively. Nevertheless, most of the time, I was able to avoid revealing the client's identity.

BANKRUPTCY CANCELLATION CLAUSES UNDER THE OLD ACT

The Bankruptcy Reform Act makes sweeping changes in the resolution of bankruptcy issues. The disposition of leases of tenants who filed (or who were the subject of filings) under the bankruptcy laws before October 1, 1979 is governed by the old set of rules. The disposition of leases for tenants who file (or who are the subject of filings) under the bankruptcy laws after October 1 will be governed by the Bankruptcy Reform Act.



Under the old law, the bankrupt's trustee or the debtor in possession could reject its obligations under a lease. Tenants who filed for reorganization under Chapter X of the old law or for an arrangement under Chapter XI or XII also had the right to reject lease obligations.

Thus a landlord, confronted with a tenant's proceeding under the old Bankruptcy Act, had severely reduced expectations of receiving income from his property. A landlord who had executed a lease relying only upon the favorable credit of the tenant found himself involved with an insolvent under court protection. His chances of selling his property were limited, and his chances of refinancing were negligible.

Because of these dangers (and perhaps because it is possible to make windfall profits by canceling an old low-rent lease), landlords have insisted upon lease clauses that give them the right to cancel the lease in the event of the tenant's insolvency.

Popular bankruptcy cancellation clauses have fallen into three main categories. One type, the

"ipso facto clause," provides that the lease is terminated automatically if an event of insolvency occurs. Another type gives the landlord the option to cancel if the tenant becomes insolvent. A third type of clause gives the landlord the right to cancel if the tenant becomes insolvent but states that right can't be exercised if the tenant has complied with its other obligations under the lease.

The cancellation clauses define acts of insolvency as the following: filing an assignment for the benefit of creditors; being adjudicated a bankrupt; or filing or acquiescing to a petition in bankruptcy, reorganization, or arrangement. Some clauses also provide that the tenant is considered insolvent if a petition in bankruptcy is filed against the tenant and the petition is not dismissed within sixty or ninety days, or if a receiver or trustee of the tenant is appointed and is not discharged within sixty or ninety days.

Section 70(b) of the old Act provided that lease clauses that terminated the lease in the event of a tenant's bankruptcy were enforceable. Some courts construed Section 70(b) literally and enforced those clauses that provided for automatic cancellation in the event of a tenant's bankruptcy or insolvency.

Other courts refused to enforce bankruptcy cancellation clauses. Some refused to enforce if the landlord accepted rent from the trustee or debtor, on the ground that the landlord had waived the right to terminate by accepting rent. Other courts refused to enforce bankruptcy cancellation clauses in arrangements or reorganization proceedings if cancellation of the leasehold would interfere with the successful rehabilitation of the tenant or if the public interest would be impaired.

DRASTIC CHANGES

Bankruptcy cancellation clauses will probably have little or no value under the Bankruptcy Reform Act. The Act makes almost all such clauses unenforceable. If a landlord does have a cancellation privilege enforceable under the Bankruptcy Reform Act, he will probably find that other provisions of the Act allow the landlord to cancel under those circumstances, even in the absence of a cancellation clause.

Here's why.

Paragraph (1) of Subsection 365(e) states, in effect, that the landlord can't terminate a lease solely because the lease contains a provision that provides for termination as a result of the insolvency or financial condition of the tenant, the "commencement of a case" under the Bankruptcy Reform Act, or the appointment of or taking possession by a trustee or custodian.

Paragraph (2) states that paragraph (1) doesn't apply in some situations. The principal situation in which paragraph (1) doesn't apply arises where "applicable law excuses" the landlord "from accepting performance to, the trustee or to an assignee of such . . . lease . . . ," and the landlord "does not consent to such assumption or assignment."

However, under these circumstances, trustees and debtors would not have the right to assume or assign the lease even if the lease doesn't contain a bankruptcy cancellation clause. It is my impression that the principal circumstance under which paragraph (2) of Subsection 365(e) would apply is if the tenant is expected under the lease to render personal services to the landlord. A trustee may not assume such a lease without the landlord's consent.

LEASE ASSUMPTION AND "ADEQUATE INSURANCE"

While the Bankruptcy Reform Act makes drastic changes in the rules governing the enforceability of lease cancellation clauses, we'll all have to wait a

while to learn just how drastic the changes are. Many of the new provisions are hard to understand, and it will be a long time before court decisions make them clear.

One thing that is clear is that, subject to some limitations, the trustee has the right to decide whether to assume or to reject an unexpired lease.

If a trustee can assume a lease, the trustee becomes the owner of the tenant's leasehold interest and can assign that interest. The right to assign is subject to additional limitations. If the trustee can't assume, I presume that the lease will be rejected automatically.

Subsections 365(c) and 365(d) of the Bankruptcy Reform Act, contain three limitations on the trustee's right to "assume" a lease. Limitations on the right of assignment are contained in Subsections 365(c) and 365(f).

Subsection 365(b) requires the trustee to take each of the following steps before it can assume the lease of the defaulting tenant:

- The trustee must either cure the default or provide "adequate assurance" that the default will be cured promptly;
- The trustee must compensate the landlord for any pecuniary loss that the landlord has suffered or provide "adequate assurance" that the landlord will be compensated.
- The trustee must provide "adequate assurance of future performance under the Lease."

For the purposes of construing Subsection 365 (b), the insolvency or financial condition of the tenant is not regarded as a default; nor is the appointment of a receiver, or the "commencement of a case" under the Reform Act regarded as a default. ("Commencement of a case" is a phrase of art under the new Act. It means beginning any proceeding under the Act.)

I'm sure that you are asking what does Subsection 365(b) mean by "adequate assurance." There's not much to go on, but Congress did set forth four rules for determining what "adequate assurances" are with respect to shopping center leases:

☐ The landlord is entitled to "adequate assurance of the source of rent and other consideration due under such lease." Although these words aren't crystal clear, my guess is that Congress is saying that the landlord is entitled to know that the trustee will be in a position to pay the rent and carry out its other responsibilities under the lease.

☐ The landlord should also receive adequate assurances that "any percentage rent due under such lease will not decline substantially." Here, Congress takes pity on a landlord who agrees to a rental that is a percentatge of gross sales of, say, a variety store or discount store chain. Under the old Bankruptcy Act, if the lease itself contained no restrictions, the trustee or debtor had great flexibility in deciding how to use the lease premises. For example, if the use clause of a department store lease allowed the tenant to use the demised premises for any legal purposes, the trustee could conceivably assign the lease to a low-volume operator, such as a furniture store. Never again would the landlord realize the amount of percentage rent to which it had become accustomed. Under the new law, it would appear that a trustee of a high-volume, low-markup food supermarket would not be able to assume a percentage lease and change the nature of the operation to a low-volume, high-markup, carriage-trade food store.

☐ The landlord must receive "adequate assurances" that assumption by the trustee and assignment of the leasehold interest will not "breach substantially any provision . . . in any other lease, finance agreement or master agreement relating to such shopping center." Subsection 365(b) mentions radius, location, use, and exclusive provisions as examples of clauses that should not be breached "substantially."

The last-mentioned provision may prove to be one of the most confusing and disruptive of all of the changes in the Reform Act. Suppose a department store tenant of a shopping center with a lease that contains no restrictions on the products that the tenant may sell "commences a case" under the new law. Suppose also that the lease for a small store in the same shopping center is subordinate in lien to the department store lease, and that the small store lease prohibits the sale of toys in the shopping center. Could the department store trustee be prohibited from selling toys?

Here is an example of another problem: Suppose a small store lease, also subordinate to the department store lease, prohibits the use of any other store in the shopping center as a department store. Could the department store trustee assume the department store lease with the intention to continue the department store operation?

Subsection 365(b) also includes a potential conflict between the Bankruptcy Reform Act and the antitrust laws. The Federal Trade Commission is attempting to regulate exclusive clauses and is be-

ginning to regulate radius clauses. But in Subsection 365(b), Congress may have extended the protection offered by both of these types of clauses. It may be that the legislators were confused when they included these assurances in Subsection 365(b). Perhaps they did not realize that a trustee would be bound by all of the provisions of a lease except those unenforceable by law. Thus, presumably a trustee would be bound by the use clause, radius clause, and other lease clauses even in the absence of a special assurance in the new law.

☐ Another form of "adequate assurance" that must be offered to shopping center landlords is "that assumption or assignment of such lease shall not disrupt any tenant mix or balance in such shopping center." Here, too, the Act appears to ignore the fact that the trustee would in any case be bound by use clauses in its leases. And here, too, there may be danger that courts will conclude that a trustee will be unable to use the demised premises for uses to which the tenant would have been entitled but for the appointment of the trustee.

MISCELLANEOUS PROBLEMS

The areas requiring new interpretation are numerous. Under Subsection 365(k), a lease assignment by a trustee relieves the trustee and the estate of the tenant "from any liability for any breach of such . . . lease occurring after such assignment."

The new Act limits the rights of a trustee to assume a lease and to assign the leasehold interest in three or four ways:

☐ Part (1) of Subsection 365(e) seems to be saying that a trustee of a tenant can't assume a lease for personal services without consent of the landlord. Under the law of contracts, a party who is required to render personal services under a contract cannot delegate its duties. The same rule shoud apply to leases in unusual circumstances. The trustee of a watch repairman who sublets space in a jewelry store on the strength of the excellence of the repairman's work should not be in a position to assign the sublease without the consent of the jewelry store operator. Is that what Congress intended? What else do these words mean?

☐ Subsection 365(d) limits the time periods in which a lease may be assumed or rejected.

☐ Section 365(f) gives a trustee the right to assign leasehold interests even if the lease contains a restriction against assignment. However, the trustee is allowed to assign a lease only if the trustee assumes the lease. Consequently, a trustee's right of assignment is subject to the limitations on the trustee's right to assume under Subsections 365(b), 365(c), and 365(d).

AGAIN IN THE COURTROOM

As the Bankruptcy Reform Act goes into effect, the real estate world is coping with another gigantic retail insolvency proceeding—the Food Fair, Inc. petition for an arrangement. Shortly, we'll all assemble again in Judge Galgay's courtroom. It will be as crowded as it was during the Grant proceedings. Many of the same characters will squeeze into the courtroom. Retailers will search for bargains; landlords will search for windfalls. The rest of us will search for a telephone booth, the men's room, the ladies' room, or just a place to sit down.