

SDNY Revisits Rent Cap Calculations: A Pendulum Shift to the Time Approach

By: Amy E. Vulpio

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Among the Bankruptcy Code's most powerful one-two punches, Section 365(a) allows a debtor to reject burdensome unexpired leases and Section 502(b)(6) caps the landlord's resulting claim for rejection damages at "the rent reserved ... for the greater of one year, or 15 percent, not to exceed three years" of the remaining lease term. In the Southern District of New York, this weapon just got a little stronger, as Bankruptcy Judge Michael E. Wiles departed from prior precedent to endorse the "time" approach for computing the Section 502(b)(6) rent cap. See *In re Cortlandt Liquidating LLC*, Case No. 20-12097 (Feb. 2, 2022).

In *Cortlandt Liquidating*, the Plan Administrator advocated for the "time" approach, which looks at the first 15 percent of the remaining lease term, thereby depriving landlords of the benefit of scheduled rent increases. In keeping with prior precedent in the district, the landlord argued for the "rent" approach, which tallies all rent due over the remaining lease term and multiplies the total by 15 percent, thereby allowing the landlord to capture at least a portion of the benefit of future rent increases.

The district last addressed the issue in a reported decision more than a decade ago, at which time the "rent" approach was the prevailing theory nationwide. Nonetheless, observing that "the weight of the relevant authorities in other districts has shifted very strongly in favor of the Time Approach" and that "[t]he entire phrase is worded in terms of periods of time," Judge Wiles found himself persuaded to follow the "time" approach over the "rent" approach.

Focusing on the plain language and a "natural reading" of the statute, Judge Wiles found that "15 percent" modifies the remaining lease term, not the rent reserved. While recognizing that landlords would inevitably find his interpretation inequitable, Judge Wiles rejected the notion that fairness was relevant to his decision between the competing approaches and held that the "time" approach was consistent with Congress' legislative purpose behind Section 502(b)(6), *i.e.*, to cap landlords' claims in proportion to other creditors' claims. Judge Wiles was further persuaded by the fact that, in 2015, leading bankruptcy law treatise *Collier's* jettisoned the "rent" approach in favor of the "time" approach and "better reasoned" decisions from Alaska to Delaware thereafter followed suit.

For commercial landlords doing business in the Southern District of New York, Judge Wiles' departure from the "rent" approach and embrace of the "time" approach represents a disappointing but unsurprising pendulum shift. With more rent cap claims on the horizon as the commercial real estate market navigates post-pandemic changes, *Cortlandt Liquidating* will provide important guidance for landlords' calculation of lease rejection claims and for debtors' and trustees' review and potential objection to them.

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