

**ASSUMPTION IN PART? THE IMPACT OF MASTER LEASES
ON THE ASSUMPTION AND REJECTION OF LEASES**

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A trustee or debtor in bankruptcy is empowered under Bankruptcy Code § 365(a) to reject or assume, with court approval, any executory contract or unexpired lease. Bankruptcy Code §§ 365(b)-(f) set forth restrictions on and conditions to the debtor's exercise of the general power to assume or reject. The Bankruptcy Code allows the debtor "to pick and choose among the debtor's executory contracts and unexpired leases, and to assume those which benefit the estate and reject those which do not". In re Plitt Amusement Co. of Washington, Inc., 233 B.R. 837, 840 (Bankr. C.D. Cal. 1999). The debtor cannot, however, retain only the beneficial aspects of a lease or contract while rejecting its burdens. Id. Instead, it is well-accepted that a debtor must decide to either assume or reject the executory contract or unexpired lease in its entirety; contracts and leases may not be assumed in part and rejected in part. See, e.g., NLRB v. Bildisco and Bildisco, 465 U.S. 513 (1984); In re Cafeteria Operators, L.P., 299 B.R. 384, 388-389 (Bankr. N.D. Tex. 2003); In re Convenience USA, Inc., 2002 Bankr. LEXIS 348 (Bankr. M.D.N.C. Feb. 12, 2002); In re Lockspur Inc., 82 B.R. 37 (Bankr. E.D. La. 1988).

Although courts acknowledge the "black letter law that the Bankruptcy Code requires assumption of an entire agreement," In re Storage Technology Corp., 53 B.R. 471 (Bankr. D. Colo. 1985), a number of debtors have attempted to carve up "master leases" covering multiple properties into a series of divisible leases. The debtors' goal is to treat each property separately, allowing the assumption of some lease obligations while rejecting others.

The debtor in Convenience USA, Inc. attempted to divide such a master lease into separate leases. The facts of that case are illustrative of the issues landlords and tenants face. In re Convenience USA, Inc., 2002 Bankr. LEXIS 348 (Bankr. M.D.N.C. Feb. 12, 2002). There, the debtor had acquired 28 convenience stores in a single transaction. As part of that transaction, the debtor entered into a master lease with U.S. Properties Operating L.P. (“USPO”) covering 27 locations. Two years later, the debtor filed for bankruptcy protection and sought to reject the master lease as to only six of the locations. USPO objected, arguing that the debtor must assume or reject the master lease as a whole. Id.

The bankruptcy court recognized that contracts and leases must generally be assumed or rejected in their entirety. The court noted, however, that “where a contract, though contained in a single document, is divisible into several different agreements, some of the divisible agreements may be assumed or rejected under § 365 without assuming or rejecting the entire contract.” Id., 2002 Bankr. LEXIS 348 at *2. In short, if a lease or contract can be divided into separate parts, each of which can be enforced separately such that failure to perform one promise does not necessarily put the promisor in breach of the entire contract, the lease or contract can be treated as multiple agreements. In re Cafeteria Operators, L.P., 299 B.R. 384, 389 (Bankr. N.D. Tex. 2003), citing Black’s Law Dictionary 324 (7th ed. 1999); see also In re Wolfen Oil, LLC, 318 B.R. 392, 397-398 (Bankr. N.D. Tex. 2004).

Whether a contract or lease is divisible is generally a question of state law. In re Cafeteria Operators, L.P., 299 B.R. at 389. Courts generally look to determine the intent of the parties and whether the contract can be or has been treated as divisible by the parties. Id. In finding that the master lease in Convenience USA was divisible under Texas law, the court looked at several factors to determine the parties’ true intent with respect to that lease. The fact

that the landlord had the unfettered right to sell any of the leased properties, with the effect that the lease would remain in effect at a reduced total rent, favored a finding of divisibility. The landlord also had the right, upon a default, to terminate the debtor's possession of one or more of the leased properties rather than all of the properties. The fact that rent was allocated among the 27 properties also favored divisibility, as did the fact that the lease would continue (with a reduction in the total rent) despite the complete destruction or condemnation of one or more of the leased properties. The court concluded:

With respect to the two contingencies, the parties had two choices. The parties could have elected to provide in the lease that if one of the leased properties were sold, condemned, or destroyed, the entire lease would terminate. Presumably, the parties would have made this election if the economic realities had dictated such a resolution upon the loss of one or more of its properties. The parties did not elect such a provision. Instead, the parties elected to have a contract under which the lease of some of the properties may be terminated without effecting the continuing lease of the remaining properties. Choosing such terms reflects an intent to have a divisible contract.

In re Convenience USA, Inc., 2002 Bankr. LEXIS 348 at *9.

The bankruptcy court held that the master lease was divisible into 27 leases, each of which could be separately assumed or rejected by the debtor. The court also rejected the landlord's contention that, even if the lease were divided, a cross-default provision would prohibit assumption of one lease without curing the defaults under all leases. It held that giving effect to "the cross-default provisions in this case would prevent the [debtor] from utilizing the provisions of § 365 to reject some of those leases while reserving the decision whether to reject or assume and assign the remaining leases at a later time...Such a result is contrary to § 365(f) and is not permissible under bankruptcy law." In re Convenience USA, Inc., 2002 Bankr. LEXIS 348 at *9; see also In re Plitt Amusement Co. of Washington, Inc., 233 B.R. at 847 (well

settled in bankruptcy that cross-default provisions do not integrate otherwise separate transactions or leases).

The Convenience USA decision is consistent with other decisions around the country. In addition to the factors discussed above, courts have found support for finding that a lease is divisible where the monthly payment is made by separate checks for each location, or a lump payment is made but the parties have allocated the payment among the separate properties by prior agreement. In re Cafeteria Operators, L.P., 299 B.R. at 390. Courts also point to severability clauses providing that if any provision of the master lease is rendered invalid, the remaining provisions remain in effect. See, e.g., In re Plitt Amusement Co. of Washington, Inc., 233 B.R. at 845. Finally, courts examine the actions of the parties under the lease. Where the parties have treated the lease as severable by, for example, allowing the sale of individual locations, the court is more likely to find the lease to be divisible. In re Cafeteria Operators, L.P., 299 B.R. at 392.

The issue of severability is likely to come up again and again, as debtors enter into master leases for real estate and personal property. It is probable that attorneys will attempt to draft master leases to avoid findings of divisibility by bankruptcy courts so that such contracts and leases must be assumed or rejected *in toto*. Will national landlords be successful in drafting and defending master leases covering dozens of locations across the country? At least one decision indicates that will be a difficult task.

In Plitt Amusement, Judge Bufford noted that attorneys representing the landlord in a master lease covering hundreds of separate locations could, by “artful drafting,” try to require assumption or rejection of the entire master lease, thus frustrating “the ability of the debtor to rehabilitate the business by assuming the profitable portions of the business.” Judge Bufford

concluded that “such artful drafting of the sales documents cannot be permitted to circumvent section 365.” In re Plitt Amusement Co. of Washington, Inc., 233 B.R. at 847-848.

Bankruptcy lawyers and their brethren practicing corporate and real estate law should study the decisions on severability and tailor any master leases to address them. There will, however, be limits to counsel’s ability to protect such facilities from a finding of divisibility through artful drafting.