UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF NEW YORK

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In re

PROGRESSIVE RESTAURANT
SYSTEMS, INC. Case No. 95-14370 K

Debtor

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Numerous courts have addressed the "prompt cure" requirement of 11 U.S.C. § 365(b)(1)(A) and have addressed the significant challenge presented by the absence of a definition of that term, when they have attempted to balance the right of a lessor to evict a defaulting tenant, against the privilege accorded a defaulting tenant to attempt to rehabilitate under the Bankruptcy Code.[1] Some courts have adopted rules of thumb as to what constitutes "prompt cure" without providing meaningful guidance to others as to how the rule of thumb was settled upon.[2]

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[1]Many of the cases are discussed in *In re The Gold Standard at Penn, Inc.*, 75 B.R. 669, 673-74 (Bankr. E.D. Pa. 1987), and in *In re Embers 86th Street, Inc.*, 184 B.R. 892, 900-01 (Bankr. S.D.N.Y. 1995).

[2]There is no need to specify those holdings, but an exception is the case of *GMAC v. Lawrence*, 11 B.R. 44 (Bankr. N.D. Ga. 1981), decided in a district in which the "reasonable cure" addressed in 11 U.S.C. § 1322 (b)(5) had been long established to require cure within one year, and consequently, since "prompt" must be faster than "reasonable," it was held that § 365(b)(1)(A) would require a faster cure than that. In the present district, the § 1322(b)(5) cure of mortgage arrears is permitted to take as long as

Here, the Chapter 11 Debtor-in-Possession is a "Wendy's" franchisee that wishes to assume the real property leases by which it operates thirteen restaurants. Several of the leases were substantially in arrears at the time of the filing of the petition. The Debtor proposes to cure arrears by making monthly installment payments for sixty months. Several lessors have objected, and others may yet object.[3] They argue that five years is not "prompt." Under the circumstances of this case, this Court agrees. To this Court, a "prompt cure" of real property lease arrears is a cure that will be complete before the leasehold is likely to change significantly in value, and the Court believes that the pertinent market is changing faster than on a five-year basis.

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five years if the collateral is the debtor's homestead, and no judge here has ruled that a Chapter 13 debtor would have to cure within five years even if Chapter 13 plans were statutorily permitted to last more than five years. Hence, the five-year cure proposed in the case at bar cannot be addressed by reference to the local § 1322 standard.

[3]The assumption of the leases comes before the Court not by motion under Bankruptcy Rule 6006, but as a provision of a filed, but yet unconfirmed, Plan of Reorganization. The lessors that have objected have done so in the form of objections to the Disclosure Statement, claiming that the Court may not approve the Disclosure Statement either because the Plan is not confirmable on its face (the argument being that the proposed cure is not "prompt" as a matter of law), or because the Disclosure Statement fails to discuss this issue as a potentially catastrophic impediment to confirmation. Other lessors could object at a later stage in the proceeding, such as the confirmation hearing.

QUESTION 1: DOES THE STATUTE REQUIRE AN EVIDENTIARY HEARING?

The statutory language, though difficult, is not impenetrable. A debtor-in-possession may assume a lease if it "cures, or provides adequate assurance that [it] will promptly cure, such default." 11 U.S.C. § 365(b)(1)(A). Unless the debtor-in-possession "cures," which is to say unless it pays the arrearages immediately, it must do two things: (1) specify a means of "prompt" cure; and (2) demonstrate that the means of "prompt" cure is adequately assured.[4]

The Debtor-in-Possession here has argued that it is entitled to a full evidentiary hearing exploring the circumstances that it believes warrant a five-year cure, and that the logical arena in which these matters should be addressed is a hearing on confirmation. Although the Court would agree that requirement number (2) above (a demonstration that the means of "prompt" cure is adequately assured) may well require an evidentiary hearing if that issue is reached, the Court believes that the promptness requirement is tested by the circumstances of the lessor-tenant relationship, and that the need for a hearing in that regard depends upon whether those considerations are

[4]It also must provide adequate assurance of future performance of regular lease payments, over and above any cure issues. 11 U.S.C. § 365(b)(1)(C).

sufficiently settled in the record before the Court. Here, the record seems to be complete, as discussed later. (A confirmation hearing would focus on the Debtor's financial prospects, which are as irrelevant to the question of what constitutes a prompt cure, as they would be dispositive of the issue of "adequate assurance.")

QUESTION 2: WHAT CONSIDERATIONS ARE SUBSUMED IN THE NOTION OF "PROMPTNESS"?

After examining the numerous cases addressing the "prompt cure" issue, one may compile a significant list of considerations surrounding any given lessor-tenant relationship, which considerations must, in this Court's view, be considered in determining whether a proposed cure is "prompt." The list includes:

(1) the magnitude of the arrearages to be cured;

(2) total duration of the lease and the length of time remaining in the lease;

(3) any "inequitable conduct" of the lessor. *See*, *e.g.*, *In re Coors of North Mississippi*, 27 B.R. 918 (Bankr. N.D. Miss. 1983)(discussing franchisor's "unclean hands in exacting involuntary preferential payments on pre-petition debt from the debtor);

(4) whether the lease is for commercial property or is the debtor's residence;

(5) whether the lease is a "special kind" of lease favoring the rights of one

party as opposed to the other. *See*, *e.g.*, *In re Whitsett*, 163 B.R. 752 (Bankr. E.D. Pa. 1994)(involving a lease of federally-subsidized housing in which lease the court found special protections for the lessee). Consider also other "special types" of leases such as those involving industrial development authorities and other transactions in which leases are used in lieu of land ownership to achieve particular tax purposes, to achieve compliance with (or to avoid) environmental concerns, to meet estate planning purposes, etc.); and

(6) past consideration paid, or benefits conferred, by the lessee (e.g., did the debtor make a substantial payment at lease inception in order to achieve lower monthly lease costs; has the debtor made substantial leasehold improvements that will be "forfeited" to the lessor if the lessor succeeds in its objection to the proposed cure).

There are surely other pertinent considerations not enumerated. There are yet others that may or may not be appropriate to consider. For example, if the real estate is in the midst of many other vacant similar parcels and there is, consequently, serious doubt about the lessor's ability to re-let the premises, would it be appropriate to question the *bona fides* of a lessor's opposition to a somewhat more extended cure period, such opposition arguably being against the lessor's own economic self-interest? Would it be appropriate to consider the diligence (or lack thereof) of the lessor in pursuing the arrears before the Chapter 11 filing?

In the case at bar, there is no assertion that any of the above considerations apply other than the initial term of the lease, the remaining term of the lease, and the size of the arrears. These are well settled in the record before the Court. (The Debtor has suggested, in other contexts, a "special type" of lease with Wendy's International, but the Court is not certain whether that is relevant here and, if so, in whose favor that operates.)

In light of the above, the present Court believes that "promptness" must bear some relation to the initial intentions of the parties when they entered into the tenant-lessor relationship, and that the parties' respective predictions for "change" are the principal considerations.[5] Not only would a "prompt" cure not extend beyond the point at

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[5]Consider, for example, the focus some earlier courts place on the initial term of the lease in relation to the remaining term. In attempting to define what "promptness" requires, Bankruptcy Judge Burton Perlman suggested that when the proposed cure period is virtually co-extensive with the claimed remaining life of the lease, it cannot be said "that the period of payment is sufficiently less than the complete period of the relationship between the parties [as to constitute] 'prompt' cure." *In re R/P Intl. Technologies, Inc.*, 57 B.R. 869, 873 (Bankr. S.D. Ohio 1985). Judge Perlman suggests that promptness has something to do with getting the defaults cured before the contemplated end of the lessor-tenant relationship. He relied in part for his reasoning on the case of *Motor Truck and Trailer Co. v. Berkshire Chemical Haulers (In re Berkshire Chemical Haulers),* 20 B.R. 454 (Bankr. Mass. 1982), which is often quoted for its statement that,

> For instance, a debtor with 90 years remaining on a 99 year lease, who proposes to cure its arrearage by monthly payments over an 18 month period, might be found to have offered adequate assurance of a *prompt cure*. On the other hand, where . . . the debtor's offer to cure its lease default

which the parties bargained for their relationship to end (the end of the lease term), but it also should not insulate a debtor who is still in arrears from a lessor who needs to address changing market circumstances. Whether the parties elect to enter a short-term lease of commercial real estate or a long-term lease, the material terms of the lease reflect their respective predictions regarding the value of the leasehold interest. That value may be measured by many factors such as the useful life of the structures on the land, and tax implications for the lessor, as well as the business prospects for the tenant.[6] Congress could not have intended that a "prompt" cure take such a long time that the lessor might see the value of the leasehold significantly increase while it is stuck with a tenant that has not fully cured its defaults, yet cannot be evicted. For example, if there are "business cycles" influencing the value of the leasehold in a particular locale, a cure would not be "prompt" if it drags the lessor all the way through and past the next upward swing of the

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> over the next 18 months contemplates the final payment being made contemporaneously with the expiration of the lease term, [no court] would find that such a proposal qualifies as a '*prompt*' cure under § 365(b)(1).

Berkshire Chemical, 20 B.R. at 458.

[6]In a Chapter 11 proceeding, the same analysis occurs during the brief period the debtor has in which to decide whether to assume or reject a lease. The debtor gets a fresh look at the terms of the lease, after which it can either confirm its initial predictions, or reject the lease.

cycle.

QUESTION 3: IS A RULE OF CONVENIENCE APPROPRIATE?

There is a need for a rule of convenience, a presumptive answer to the question of how long a "prompt" cure may take. Such a rule would be applicable in all cases involving rent arrears owed on commercial real property leases, absent special circumstances requiring deeper exploration. Without such a rule, we could explore the details of every lease in every case in which there is an argument regarding "prompt cure," yet remain unable to determine what "prompt" means.

Such a rule of convenience should specify some period of time, based upon suitable evidence, that is presumptively the longest period within which a cure could be completed before encountering significant change in the rental market. At a given point in time in a given locale, that might be six months, twelve months, twenty-four months, or (if there is less volatility) even longer. But that period of cure should not leave the lessor in a worse position than it is in now, if the debtor should default on the cure payments. Regardless of whether the "change' is predicted to be for the better or for the worse, a lessor is always in a "worse" position when it is unable to respond to change of any sort.

(When making deals that can extend over many years, there are opportunities in a market that has declined, as well as in a market that has increased.)

The likelihood of a significant change in rental prices or in the highest and best uses of the land in question must be considered within a particular geographic area, or market. In this Court, the geographic market should be viewed as being regional; in fact, it might be co-extensive with the borders of the District, or at least co-extensive with the boundaries of the Buffalo Division of the Western District. The thirteen-store array at bar here happens to perfectly illustrate the regional nature of the relevant market, since those stores are located in four of the seven counties of this Division of the District, and some of the lessors are regional as well.

Although the projections for change will vary from time to time within the market, they will not usually change from case to case at a given moment in time, except when dealing with truly unique real estate. (The notion that every piece of real estate is unique has important uses, but not in the present context.) Commercial real estate in this region can be presumed to be fungible, subject to other evidence, and a suitable rule of convenience would so presume.[7]

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[7]One reason that fungibility can be presumed, so as to render some of these distinctions meaningless, is the trend toward changes of use. Some farmland becomes development, some retail malls become office parks, some parking lots become buildings (and vice-versa), and some free-standing restaurants become branch banks (and vice-

This Court unquestionably could thoroughly litigate the pertinent differences among shopping center leases, industrial property leases, residential leases, office building leases, and the like. It could do the same as to pertinent differences among store sites in rural versus urban sites, and sites on one side of Buffalo as opposed to another side of Buffalo. And surely the various motivations that lead to long-term as opposed to short-term leases, or net-net leases as opposed to turnkey leases, etc. can be fully explored in litigating whether a given cure is "prompt." But the very purpose of a rule of convenience is to avoid such litigation in the absence of some showing that the rule ought not to apply or that it needs to be tempered by consideration of special circumstances.

If, as the Court has now determined, "prompt cure" is linked to the length of time it takes for changes in the value of the leasehold to reach the point at which the damage may be viewed as "significant," the question becomes, "What is that length of time, in this region, at this point in time?"

The Court has no doubt that diligent counsel could convince it that competent experts as to non-residential real property leases might differ as to whether it takes six months, twelve months, or eighteen months for the change in leasehold values to

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versa).

become "significant." And after one moves past that starting point in a particular case and applies thereto some of the other considerations discussed above, one might conclude that twenty-four months or even more might be tolerably "prompt."

QUESTION 4: MAY A RULE OF CONVENIENCE BE DERIVED FROM THE FACTS OF THE PRESENT CASE?

The facts before the Court are too limited to serve as a basis from which to derive a rule of convenience. We know only the facts of the six leases in question. One objector to the proposed cure period is Bowmart Properties. The Debtor owes this lessor more than $40,000 on a lease that carries a minimum annual rental of $52,500. Thus, the pre-petition arrears are substantial. It is a twenty-year lease, with two five-year options, and was entered into eight years ago. The five-year cure period amounts to a sizeable portion of the initial lease term, and, consequently, an even larger portion of the remaining lease term.

Another objector is Charles L. Ludwig, an individual who also is a Chapter 11 debtor in this Court. Ludwig is owed at least $14,000 in pre-petition rents and over $20,000 in unpaid pre-petition property taxes for which the Debtor was liable. This too was a twenty-year lease, with two five-year renewal options, entered into eight years ago. The amount of rent provided for by the lease is not in the record before the Court.

According to his counsel, Ludwig has not paid the property taxes that the Debtor was supposed to pay, and will have to address those in his own Chapter 11 plan or suffer the loss of the property at tax foreclosure.

The third objector is Wendy's International, Inc., the franchisor, which owns four of the thirteen stores. The Debtor acknowledges more than $150,000 of lease arrearages to Wendy's.[8] These also were twenty-year leases, with two five-year renewal options, two of which leases were signed in 1988, one in 1994, and another in 1995.

According to Debtor's counsel, two other lessors with substantial arrearage claims have consented to a ten-year cure period. But the lessors here do not consent, arguing that five years is not "prompt" cure.

This is not a record from which a rule of convenience could be derived. However, regardless of which test for "judicial notice" is employed under Fed. R. Evid. 201 (generally known to the community, verifiable by reference to reliable authority, or indisputability), it seems to the Court that the commercial real estate rental market in

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[8] Wendy's alleges far more substantial defalcations in connection with the entire franchise relationship, and strongly objects to the Debtor's effort to sever-out the rental defaults from other defaults for § 365 purposes. Wendy's International claims that all of its agreements with the Debtor were one package and that if the Debtor does not assume the entire package, it should not be permitted to assume any aspect of it at all. That issue is being separately briefed.

Western New York can be expected to change significantly in a period of time considerably less than five years. As to retail stores, for example, the difference between a good Christmas season and a fair one may be dispositive of rental rates for the following spring. Industrial buildings might be less volatile. It would need to be proven to the Court were it argued that commercial real estate rental values here will remain essentially flat throughout the next five year period.

CONCLUSION

Bowmart, Ludwig and Wendy's International's objections to the Disclosure Statement will be sustained if the Debtor fails by August 16, 1996 to make an offer of proof in light of the above discussion, supporting its five-year cure. Failing same, the Plan is facially not confirmable, since those six leases may not be assumed on the proposed terms and the assumption of those leases is material to the proposed plan.

This ruling is without prejudice to amendments to the Plan and Disclosure Statement.

SO ORDERED.

Dated: Buffalo, New York
August , 1996

/s/Michael J. Kaplan

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U.S.B.J.