

CHALK ONE UP FOR THE LANDLORDS: USE CLAUSES MUST BE HONORED IN TENANTS' BANKRUPTCIES

After twenty years of fighting tenant-favorable bankruptcy decisions on lease assignments, landlords have won a major victory. The case of *In re Trak Auto Corporation v. West Town Center, LLC*, 2004 WL 856859 (4th Cir.), decided April 22, 2004, could be a turning point in upholding a landlord's rights to enforce lease restrictions on use, alterations and other operating issues.

The issue revolved around a limitation in the Trak lease that permitted only the retail sale of automobile parts and accessories and such other items as are customarily sold by Trak at its other auto stores. Trak also agreed to use the leased property only as a Trak Auto Store.

When Trak Auto went into bankruptcy and tried to assign the lease, it did not receive any interest from auto parts retailers (perhaps because there were then seven auto parts stores within three miles of the center). Instead, it found an apparel merchandiser who offered \$80,000 to buy the lease, and use the store to sell brand-name family apparel at discount prices. Over objection from the landlord, the bankruptcy court approved that assignment which, of course, would make the bankruptcy estate \$80,000 richer, and leave the landlord with a discount clothing store it did not want. On appeal, the bankruptcy court's decision was affirmed by the federal court, and the landlord appealed to the United States Court of Appeals, which reversed the lower courts and agreed with the landlord.

In reaching its decision, the court weighed the potential advantage to the bankruptcy estate of permitting unfettered assignability of leases against the advantages of honoring Congressional intent and deferring to shopping-center owners' judgments

about what is good for their shopping centers. In criticizing the bankruptcy court's decision, the circuit court held: "This analysis overlooks the fact that West Town, the shopping center landlord, made the judgment that an auto parts retailer is important to a successful mix of stores in the center. And, in its lease with Trak Auto, West Town successfully negotiated to have the leased space dedicated to the sale of auto parts. West Town insists that this use restriction be honored by any assignee of Trak Auto, and that is West Town's right under Section 365(b)(3)(C), regardless of market conditions. Section 365(b)(3)(C) simply does not allow the bankruptcy court or us to modify West Town's 'original bargain with the debtor.'"

The Trak Auto case is likely to become a leading case and will frequently be cited by landlords in future battles between bankrupt tenants and shopping center owners in an effort to enforce use restrictions, as well as other common restrictions and obligations which appear in retail leases, such as provisions forbidding alterations or closing of a store without the landlord's consent, and provisions requiring tenants to share profits they may receive on assignment of subleasing. However, tenants will undoubtedly respond that none of those clauses are specifically protected in 365(b) as "a radius, location, use or exclusivity provision."

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