Between The Lines

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Brokers Beware! Pre-Bankruptcy Listing Agreements, Employment, and Rejection

Robert D. Lantz

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A listing broker enters into a right-to-sell listing contract with a seller of real estate. This listing contract provides that the broker who finds a buyer who is "ready, willing and able to complete the sale" as specified in the listing contract will entitle the broker to its commission. The seller then files bankruptcy and now, as a Chapter 11 debtor-in-possession, informs the broker that it intends to reject the listing contract and it will do the sale as part of a Chapter 11 Plan so as to save money on the commission. Or, alternatively, the seller files for Chapter 7 relief and the Chapter 7 trustee informs the broker that, while the trustee appreciates bringing the purchaser to the table, the trustee intends to reject the listing contract.

The prepetition listing contract is increasingly creating frustration with brokers as debtors-in-possession and Chapter 7 trustees use certain provisions of the Bankruptcy Code to obtain a windfall by not being burdened by a listing contract, which contract may provide for as much as 6% in commissions and other obligations. Brokers need to be aware of the threats, obligations, and, yes, the possible opportunities presented by bankruptcy when listing a property for a seller.

Pursuant to 11 U.S.C. § 365(a), "subject to the court's approval, [a trustee or debtor-in-possession] may assume or reject any executory contract or unexpired lease of the debtor." Curiously, "[no one has ever come up with a precise, definitive definition of what an executory contract is, nor is it entirely clear why the [Bankruptcy] Code singles out executory contracts and leases from other forms of legal obligations between debtors and creditors." Bernstein, Michael L., and Kuney, George W., BANKRUPTCY IN PRACTICE, 281 (5th Ed. 2015). However, generally speaking, an executory contract is any contract that has not been fully executed or performed by either side of the contract. Listing

R. Clay Bartlett has been Promoted to an Equity Member of CP2!

Mr. Bartlett's practice is focused primarily on business and real estate including assisting and advising clients on matters ranging from business entity selection, purchase and sale transactions, to land planning, zoning and development. Mr. Bartlett also maintains an entertainment law practice, assisting music venues and festivals procuring and contracting with talent.

2017 BEST LAW FIRMS

U.S. News & World Report along with *Best Lawyers®* recently recognized Coan, Payton & Payne, LLC as one of the "Best Law Firms in Colorado" for 2017 in the areas of Corporate Law, Construction Law and Real Estate Law.

The 2017 "Best Law Firms" rankings can be seen in their entirety by visiting: bestlawfirms.usnews.com

CP2 Welcomes New Attorney

Chelsea R. Clark

Chelsea R. Clark

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Chelsea R. Clark's legal practice focuses on commercial real estate and business law including purchase and sale transactions, land use and development planning matters, as well as general business and corporate transactions. Chelsea previously worked as the Development Manager for a well-known industrial project in Northern Colorado as well as a real estate paralegal for a law firm in Aspen, CO.

Chelsea Clark received her Juris Doctor degree in 2016 from the University of Denver Sturm College of Law and graduated with honors in 2006 from Colorado State University with a bachelor's degree in Business and a History Minor.

Ms. Chelsea Clark works out of the firm's Fort Collins office serving clients across Fort Collins and the Northern Colorado area.

contracts are generally construed as executory contracts under the Bankruptcy Code.

11 U.S.C. § 365 only applies to an executory contract in existence at the time the bankruptcy case is filed. An executory contract must be assumed or rejected in its entirety. Generally, section 365(d)(3) requires a trustee or debtor-in-possession to "timely perform all the obligations under the contract if it is assumed." "[T]he effect of rejection [of an executory contract] is to relieve a debtor from future performance under the contract; rejection does not undo past performance under the contract. Consequently, to the extent that both or either of the parties have performed under the executory contract, the debtor's rejection has no effect on such performance." *Taylor-Wharton Intern. v. Blasingame (In re Taylor-Wharton Intern.)*, 2010 WL 4862723, at *3 (Bankr. D. Del. Nov. 23, 2010).

Most listing agreements provide that a commission is earned on the occurrence of the broker finding a buyer who is "ready, willing and able" to complete the Sale or Lease as specified in the Seller Listing Contract. Outside of bankruptcy, if the broker has presented the debtor with a full price offer, commission has likely been earned. *See e.g. Squires, Inc. v. Hohnholz*, 527 P.2d 1173 (Colo. App. 1974); *See, Colorado City Dev. Co. v. Jones-Healy Realty, Inc.*, 576 P.2d 160 ("Where variations [in the offer to purchase] are minor, the seller is obligated to identify those on which it would rely if it chooses to reject the offer"). However, in the context of bankruptcy, real estate listing contracts are considered "executory contracts" and a trustee or a debtor-in-possession (a Chapter 11 debtor) may seek to assume or reject the listing agreement.

Most courts apply a "business judgment" test to the trustee's or debtor-in-possession's decision to assume or reject a contract or lease. Trustees will often use brokers who flat fee their commission or even attorneys or auctioneers to reduce the fees and costs attributable to a broker. Under the Code, since the courts have applied a "business judgment" test to the trustee or debtor-in-possession's decision to assume or reject contracts or leases, it is often difficult for a broker to refute that the debtor's best business judgment is to go with a broker whose commission is $3,000.00 versus a broker who has a 4-6% commission when the home is valued at $1.4 million.

Bankruptcy presents the threat to a broker that he or she may not be compensated for presenting a "ready, willing, and able" purchaser to the debtor-seller. However, a broker who is savvy can work with a debtor-in-possession or a trustee to bring value to the estate and still earn a commission. The breakdown occurs when the broker believes he or she is not impacted by the seller's bankruptcy. There are opportunities for brokers to continue in a relationship with the debtor-seller postpetition if there is cooperation, coordination, and execution of a strategy to bring a "ready, willing, and able" purchaser to the table.

Chair of the Business Law Section of the Colorado Bar Association

G. Brent Coan was elected to Chair the Business Law Section of the Colorado Bar Association.

"It is a true honor for Brent to have been selected by his peers, the best and brightest business attorneys in Colorado, to serve as the Chair of the Business Law Section of the Colorado Bar Association," said founding member, Michael C. Payne. "Our whole team is so proud of Brent and of the hard work and dedication he has displayed in being elected to this position."

Mr. Coan's law practice focuses on corporate & real estate related matters including: purchase & sale transactions; business organization & capitalization; corporate M&A transactions; land planning & development; oil & gas development & transactions.

Just be a "Good Guy" – An Alternative Approach to Guarantees in Commercial Leasing

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"Let's think about this for a sec, Ted. Why would someone put a guarantee on a box? Hmm, very interesting." TOMMY BOY (Paramount Pictures 1995). If you don't know where the rest of that quote is going, I presume you haven't seen the movie. Stop what you're doing (after reading this article), and go watch it, immediately! For the rest of you, especially the landlords reading this, I think you understand where Ted was coming from when he prompted Tommy to start his hilarious spiel. It is conventional wisdom that there needs to be a guarantee on a lease. That may be true in many cases, but, there may be certain situations where the standard guarantee (the general, absolute, irrevocable one) can actually do more harm than good.

Let's take Tommy's advice and think about this for a second. What might be the consequences of the standard guarantee? It may provide the guarantor, typically a party in control of a tenant, the motivation to invest fully in the success of the tenant's business, as their personal assets are on the hook. Obviously, this seems like a great thing. However, if things have gone terribly for the tenant's business and the guarantor has extended their assets to keep the business operating, the guarantor may, ultimately, be in the same dire financial condition as the tenant. It could be the case that by the time there is a default under the lease, the guarantee isn't worth very much as a secondary source of repayment.

Now let's say that as a result of the hard times the tenant and guarantor have experienced, their backs are against the wall and both need to file bankruptcy. The landlord is now in a precarious situation. First, the landlord needs to regain possession of the property. As any landlord knows, the eviction process may not be quick and easy and the process can be further complicated and delayed by a bankruptcy filing. All the while, the landlord will be dealing with a property that is not income producing as it is still likely in the possession of the tenant. Of course, after a bankruptcy has been filed, there is very little incentive for tenant and/or guarantor to cooperate with the landlord which can make things even worse. Second, the landlord needs to figure out how to collect what are likely substantial outstanding amounts due under the lease from a bankrupt tenant and guarantor. Keep in mind that due to the protections of the bankruptcy system, the landlord either won't be able to collect anything from the bankrupt party or will only be able to collect pennies on the dollar.

Enter the "good guy" guarantee. With a good guy guarantee, the guarantor typically guarantees all obligations under a lease up to and until, with advance notice, possession of the leased premises are returned in the condition required by the lease and all amounts due and outstanding up to the date of delivery of possessions are paid. Of course, these terms can vary to address other economic issues, such as build-out costs that may have been paid by the landlord, vacancy losses, etc.

So, what would change in the above fact pattern if the guarantor provided a good guy guarantee? One possible outcome is that the tenant and guarantor would be incentivized to return possession of the leased premises without requiring

CP2 Welcomes New Staff!

Amanda Radtke : Paralegal

Ms. Radtke comes to us with a combined 16 years of experience in state court litigation and bankruptcy, including Chapter 7 debtor and Trustee representation. She has an AAS in Police Science and BA in Criminal Justice.

Becca Granowsky : Administrative Assistant

Ms. Granowsky is CP2's receptionist and administrative assistant in the firm's Fort Collins office. Her administrative responsibilities include assisting the firm's management with all admin functions of the Fort Collins office.

Jorie Pepper : Legal Assistant

Ms. Pepper comes to CP2 with Associate degrees in both Medical Assisting and Paralegal Studies. Jorie graduated from IBMC on the Dean's List with a 3.8 GPA in 2015. She started her legal career working in a collections law office.

Myranda Gonzalez : Administrative Assistant

Ms. Gonzalez works with the firm's accounting coordinator in the Greeley office along with her administrative responsibilities. She has a strong administrative assistant background, is fluent in Spanish, and brings over 3 years of accounting experience.

the landlord to proceed through eviction. Thus the landlord could have put the property back on the market much sooner. The landlord could stop the bleeding and the property would produce income, instead of losses, much sooner.

Though the landlord won't be able to proceed against the guarantor for future rentals under a good guy guarantee, the tenant would still be liable under the lease. Unfortunately, the tenant may still be at or near bankruptcy, but there is a possibility that the tenant won't quite exhaust all assets because of the good guy guarantees incentive to cute their losses a little sooner. So, there may be a better opportunity to collect from the tenant.

Some of you might be asking, what if the guarantor still had substantial means to support the tenant? Wouldn't the good guy guarantee allow the guarantor to get off the hook too early, without going all-in to support the tenant? This is a critical point that, ultimately, leads to the question of when the good guy guarantee is appropriate. If the guarantor does have substantial means, the good guy guarantee probably doesn't make sense as it could lead to the tenant calling it quits at the first sign of distress.

However, if the guarantor's means are essentially the business of the tenant, the guarantor is likely already fully invested in the success of the tenant and this is the ideal situation for the good guy guaranty. The guarantor will go all-in – which was one of the purposes of the standard guarantee in the first place – and the landlord is likely to get cooperation from the tenant and limit its losses in the event that the tenant's business fails.

While the outcomes discussed herein are not, wait for it . . . guaranteed, the moral of the story is that it makes sense to stop and think when it comes to guarantees. The scenario discussed herein and the good guy guarantee is just one example of how to adjust a guarantee such that it is more beneficial both to the landlord and the tenant. Other options exist to address other situations. When working through the lease arrangements, it is critical to stop and think about the situation at hand and the economic outcomes that may result from the form of the guarantee that is selected.

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