

**United States Bankruptcy Court
Northern District of Illinois
Eastern Division**

Transmittal Sheet for Opinions for Posting

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Bankruptcy Caption: *In re* Peking Duck USA, Inc.

Bankruptcy No.: 23 BK 05135

Adversary Caption: N/A

Date of Issuance: January 4, 2024

Judge: Jacqueline P. Cox

Appearance of Counsel:

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**UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION**

In re:)	Bankr. No. 23-05135
)	
Peking Duck USA, Inc.,)	Chapter 11
)	
Debtor.)	Judge Jacqueline Cox
_____)		

Amended Opinion on Motion to Assume Lease or Executory Contract (Dkt. 70)

Before the court for ruling is the motion of the Debtor, Peking Duck USA, Inc. (the “Debtor”), under section 365 of the Bankruptcy Code to assume its lease with its landlord, RN 124/125 Company, LLC (the “Landlord”). Motion to Assume Lease or Executory Contract (“Motion to Assume”) (Dkt. 70). For the reasons noted herein, the motion will be denied.

I. Jurisdiction

The court has subject matter jurisdiction under 28 U.S.C. § 1334(b) and the district court’s Internal Operating Procedure 15(a). This court has authority to hear and determine all cases under title 11 and all core proceedings arising under or in cases filed under title 11. 28 U.S.C. § 157(b). “Motions concerning the assumption or rejection of executory contracts are core proceedings under 28 U.S.C. § 157(b)(2)(A) (matters concerning the administration of the estate), and (b)(2)(O) (proceedings adjusting the debtor-creditor relationship).” *In re UAL Corp.*, 293 B.R. 183, 184 (Bankr. N.D. Ill. 2003) (citations omitted).

II. Background

The Debtor operates a restaurant on the premises in issue. Without the lease the Debtor’s prospects of reorganizing by continuing to operate are questionable.

The Debtor operates the Lao Sze Chuan restaurant in Chicago's Magnificent Mile District. After experiencing difficulties during the COVID-19 pandemic, it sought chapter 11 bankruptcy relief on April 19, 2023. It has continued to operate the restaurant as a debtor in possession under 11 U.S.C. §§ 1107 and 1108.

The Debtor and its Landlord are parties to a lease first executed in 2012 for premises at 520 N. Michigan Avenue, Chicago, Illinois. *See* Stipulations by Parties Related to Hearing on Debtor's Motion to Assume Executory Lease ("Stipulations"), ¶ 1.

During the COVID-19 pandemic, the parties entered into various forbearance agreements that deferred, reduced and abated payments due under the lease. Per the lease modifications, if the Debtor was unable to commence making regular monthly rent payments in July 2021, the abated rent would be forgiven. The Debtor failed to pay the regular rent due in July 2021 and was in default under the lease. Despite being unable to make the regular monthly payments beginning in July 2021, the Debtor continued to pay and the Landlord continued to accept partial rent payments from the Debtor through April 2023 when the Debtor filed its bankruptcy petition. Stipulations, ¶¶ 2 - 5.

The regular monthly payments are approximately \$74,552.62. The Landlord alleges that the Debtor owes arrears of pre-petition rent in the amount of \$1,372,615, which is subject to an objection to claim filed by the Debtor. Motion to Assume, ¶ 5; Objection to Claim (Dkts. 45-46).

At no point in any month following July 2021 until the bankruptcy petition was filed did the Debtor pay the full amount of rent due under the lease. Stipulations, ¶ 6.

On September 8, 2022, the Landlord sent a notice of default, which the Debtor received on or about September 8, 2022. On September 30, 2022, the Landlord sent a second notice of default, which the Debtor received on or about September 30, 2022. On October 10, 2022, the Landlord

served a 5-Day notice, which the Debtor received on October 25, 2022. Stipulations, ¶¶ 7-9.

The Debtor answered the eviction complaint filed by the Landlord in the Circuit Court of Cook County, Illinois on January 27, 2023, and raised affirmative defenses, disputing the amount claimed by Landlord as arrears and asserted that the Landlord had waived strict compliance with the lease by continuing to accept partial payments of rent from the Debtor. The Landlord disputes the affirmative defenses. Stipulations, ¶ 10.

Post-petition the Debtor has remained current on rent due under the lease through December 1, 2023 (as outlined in Debtor's Exhibit 4). The Debtor has not been current on rent payments from July 2021 through the filing of the bankruptcy petition. From the date of default in July 2021 the arrears due to Landlord from the Debtor until the bankruptcy was filed continued to increase. Stipulations, ¶¶ 12-14.

On August 22, 2023, the bankruptcy court entered an Order approving a \$1.4 million loan facility as post-petition debtor in possession financing. Stipulations, ¶ 15; Order Granting Motion for Post-Petition Financing (Dkt. 63).

III. Debtor's Authority to Assume the Lease

Generally, a debtor in bankruptcy may assume an executory contract or unexpired lease it held pre-petition. *See* 11 U.S.C. § 365(a). If there has been a default under the terms of the lease, the debtor must cure the default when it assumes the lease or provide adequate assurance that the default will be cured promptly. *See* 11 U.S.C. § 365(b)(1)(A). The Debtor's financing facility appears to satisfy this requirement.

However, the Landlord argues that the lease terminated/expired pre-petition pursuant to Illinois law, while the Bankruptcy Code allows assumption of unexpired leases only. The landlord

also argues that the Debtor has not shown that it can perform under the lease in the future, and thus that it has not provided adequate assurance that it can do so.

A. Did the Lease Expire Before the Debtor filed for Bankruptcy Relief?

On October 10, 2022, the Landlord provided the Debtor with a statutory five-day notice document as required by Illinois law. It informed that the Debtor's rent default (and other charges) was then \$1,081,936.64. Response to Motion to Assume (Dkt. 85), Exhibit 2. It provided that "[i]n the event you fail to pay such amount within the time specified, the Lease, along with Tenant's right to possession of the Premises shall thereupon be terminated, and Landlord may commence an action for eviction, full payment of all amounts due and possession of the Premises . . ." *Id.*

On page 2, the notice stated that "[o]nly FULL PAYMENT of the rent demanded in this notice will waive the Landlord's right to terminate the Lease under this Notice, unless the Landlord agrees to writing to continue the Lease in exchange for receiving partial payment."

Section 365(c)(3) of the Bankruptcy Code states that the debtor may not assume an executory contract or unexpired lease of the debtor if "such lease is of nonresidential real property and has been terminated under applicable nonbankruptcy law prior to the order of relief." The order of relief is the date on which bankruptcy relief is sought. The Five-Day notice was issued on October 10, 2022; it was delivered to the Debtor on October 25, 2022 according to the Stipulations, ¶ 9 ("On October 10, 2022, the Landlord served a five-day notice which the Debtor received on October 25, 2022."). The Landlord argues that the lease terminated on November 1, 2022 when the Debtor failed to cure the default by that date.

In *In re Robinson*, a chapter 13 debtor sought to assume a residential lease. The landlord sought relief from the automatic stay which was granted by the bankruptcy court. The district court

affirmed. *In re Robinson*, 169 B.R. 171 (ND. Ill 1994). The debtor appealed to the Seventh Circuit which held, in part, the lease could not be assumed because under Illinois law it had ended pre-petition. *Robinson v. Chi. Hous. Auth.*, 54 F.3d 316, 323 (7th Cir. 1995). That landlord secured a judgment of possession before the debtor filed for bankruptcy. This court has not been shown that the Debtor's Landlord has secured an order of possession. In any event, does Illinois law provide for termination of a nonresidential lease before a Landlord secures a judgment of possession or an order of possession? Yes. Illinois law provides that leases expire or terminate before a landlord secures an order of possession or a judgment of possession. The lease terminates at the end of the period in the relevant notice. Illinois law provides that:

Action for rent - Action for possession

§ 5/9-209. A landlord or his or her agent may, any time after rent is due, demand payment thereof and notify the tenant, in writing, that unless payment is made within a time mentioned in such notice, not less than 5 days after service thereof, the lease will be terminated. If the tenant does not within the time mentioned in such notice, pay the rent due, the landlord may consider the lease ended, and sue for the possession under the statute in relation to forcible entry and detainer, or maintain ejectment without further notice or demand . . .

Notice made pursuant to this Section shall, hereinafter stated, not be invalidated by payments of past due rent demanded in the notice, when the payments do not, at the end of the notice period, total the amount demanded in the notice. The landlord may, however, agree in writing to continue the lease in exchange for receiving partial payment. To prevent invalidation, the notice must prominently state:

“[o]nly FULL PAYMENT of the rent demanded in this notice will waive the landlord's right to terminate the lease under this notice, unless the landlord agrees in writing to continue the lease in exchange for receiving partial payment.”

735 ILCS 5/9-209.

In *In re Williams*, 144 F.3d 544 (7th Cir. 1998) the Seventh Circuit noted that whether a Chapter 13 debtor's lease was terminated prior to her filing for bankruptcy was not the sole issue

before it. Also before it was whether the bankruptcy court abused its discretion when it modified the automatic stay. “To do that we have to determine if the open question of whether Williams’ lease ended is ‘cause’ for the bankruptcy court to modify the automatic stay under 11 U.S.C. § 362(d) to permit the state court to answer that question.” *Id.* at 546-47 (internal citation omitted).

Debtor Williams argued that until a landlord obtains a judgment of possession the lease is not finally terminated. *Id.*

The *Williams* court noted that before a landlord gets a judgment of possession the tenant might have a “viable possibility” of reviving a lease by asserting and proving certain defenses. *Id.* at 548-49. It ruled that Williams’ lease ended prior to her filing for bankruptcy and that “the only question left is whether Illinois law would void that ending, which question can only be answered by looking at Williams’ defenses to the forcible entry action.” *Id.* at 549.

Likewise, Peking Duck’s lease ended on November 1, 2022 by its terms and pursuant to the Illinois statute noted above before it filed for bankruptcy protection on April 19, 2023.

Unfortunately for this well-meaning debtor, because the lease was not unexpired, it can’t be assumed under section 365 of the Bankruptcy Code.

More compelling on the issue of when a lease expires pursuant to Illinois law is the 2012 Illinois Appellate Court ruling in *Village of Palatine v. Palatine Associates, LLC, et al.*, 2012 IL App (1st) 102707 (Ill. App. Ct. 2012). The Village of Palatine brought a condemnation proceeding to acquire real property being used as a shopping center. The shopping center owner received \$6,000,000 in just compensation from which claims of commercial tenants were to be apportioned. The landlord/owner sought a finding that a certain tenant had no interest in the award of just compensation because its leases had terminated prior to the entry of the award. The owner prevailed

in the trial court, which noted that “[lessor] terminated [lessee’s] lease by serving a five-day notice.” The trial court also said “[t]his Court makes no finding as to the right of possession other than the landlord terminated the Defendants’ ten[a]ncy on August 14, 2007, . . .” and then dismissed the cases. *Id.* at ¶ 31. The Appellate Court affirmed, ruling that the leases were terminated, not merely subject to termination, at the expiration of the five-day notice. *Id.* at ¶¶ 3, 92. “Accordingly, the five-day notices terminated All American’s leases in August 2007 at the end of the five-day period of time when All American did not pay all of its past-due rent, making All American not entitled to a portion of the just compensation award.” *Id.* at ¶ 58.

B. Does the Landlord’s acceptance of Partial Rent Reinstate the Lease?

The Appellate Court also considered whether acceptance by the landlord of lesser amounts prevented it from challenging the leases. The leases in issue stated that “[n]o payment by Tenant or receipt by Landlord of a lesser amount than rental or other charges herein stipulated shall be deemed to be other than on account of the earliest stipulated rent * * * and Landlord may accept such check or payment without prejudice to Landlord’s right to recover the balance of such rent or other charges or pursue any other remedy provided for in this Lease or available at law or in equity.” *Id.* at ¶ 75.

Illinois law provides that a landlord’s acceptance of partial rent after expiration of the period in the five-day notice does not reinstate the lease where the lease specifically allows the landlord to accept such without waiving its rights. The Debtor’s assertions herein to the contrary are rejected.

C. Adequate Protection Requirements of Section 365(b)

Generally, section 365(a) allows a trustee or debtor in possession to assume an executory contract or an unexpired lease. Section 365(b) states that if there has been a default, the debtor or trustee may not assume the executory contract or unexpired lease, unless at the time of assumption

the trustee or debtor cures or provides adequate assurance that the trustee or debtor will promptly cure the default.

The trustee has to:

- (1) cure the default or provide adequate assurance that the default will be promptly cured;
- (2) compensate or provide adequate assurance that the trustee will promptly compensate the other party for any pecuniary loss to the party resulting from the default; and
- (3) provide adequate assurance of future performance under the contract or lease.

3 COLLIER ON BANKRUPTCY ¶ 365.06 (Richard Levin & Henry J. Sommer eds., 16th ed.).

The Landlord argues that the Debtor has not satisfied its adequate assurance obligations. The court disagrees. The financing facility approved on August 22, 2023 provides sufficient assurance that the full default can be cured in a reasonable period of time. The Debtor's operations and the financing facility are sufficient assurance that it can meet its future obligations under the lease. The Debtor's problem is that its lease is not unexpired.

The issue of whether the Debtor can or has to pay the Landlord's attorneys fees will be determined by a state court. In any event, that issue has to be addressed in resolving the Debtor's objection to claim, which will be resolved by separate order.

The court will not address whether the Debtor's proposed plan improperly discharges court cases that the landlord has initiated against various guarantors. This ruling that the lease cannot be assumed makes that issue moot for bankruptcy purposes.

The Seventh Circuit made a keen observation in the *Williams* case:

Indeed, in a case like this all roads lead to the state court: if a tenant has no viable defenses, it makes sense to permit the landlord to get its judgment of possession; if the tenant has viable defenses, then it makes sense to permit her to assert them in state court.

Williams, 144 F.3d at 549.

Because the Debtor's lease was terminated pre-petition, the parties' differences will have to be resolved in state court.

IV. Conclusion

The Debtor's Motion to Assume Lease or Executory Contract is denied.¹

Date: January 4, 2024

ENTER: _____
Hon. Jacqueline P. Cox
U.S. Bankruptcy Judge

¹ A different Judge denied the Landlord's Motion for Relief from the Automatic Stay. *See* September 28, 2023 Order (Dkt. 68). The Debtor's Reply posits that that ruling was the law of the case, implying that the issue of the lease's termination had been resolved. Reply (Dkt. 86), pp. 2-3. At the beginning of the December 19, 2023 hearing the Debtor's attorney abandoned that argument. That Motion for Relief from the Automatic Stay was considered on the *Fernstrom* factors and did not include a conclusive ruling or finding regarding the termination of the lease in issue. *See In re Fernstrom Storage & Van Co.*, 938 F.2d 731 (7th Cir. 1991).