



“Show Me The Money!” The Retail Contractor’s Mall Deposit In Bankruptcy

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In order to build for retailers in a mall environment, contractors are routinely required to place \$5,000, \$10,000, or more on deposit with the mall owner to secure against property damage, rule violations, or the failure to construct the project as designed and approved. These deposits are generally required by the underlying construction contract between the contractor and retailer and are included as part of an addendum described as “mall requirements.” Oftentimes, a large portion of these security deposits are forfeited upon final completion of the work pursuant to the express terms of the agreement.

With the chapter 11 bankruptcy filing of General Growth Properties, Inc.—one of the largest mall owners in the United States—last week in Manhattan, we are reminded that current economic conditions, including crushing debt obligations and sharply reduced retail sales, may continue to result in increased bankruptcy filings of mall developers and others. As a result, retail contractors must be more diligent in tracking and seeking the return of their mall security deposits. Generally speaking, the mall owner’s bankruptcy filing will not accelerate the return of a security deposit. There are, however, numerous variables dictating the procedure and timing for the return of a mall deposit in bankruptcy. We will focus on the likely scenarios.

It is important to recognize that the retailer for whom the contractor is working has a lease agreement with the mall owner; which likely also required a security deposit. In bankruptcy, a mall owner has the right to assume or reject these leases. Profitable leases in malls that the debtor plans to hold and operate post bankruptcy will likely be assumed. With some exceptions, all other leases will be rejected altogether or rejected and renegotiated.

If the retailer’s lease is rejected, the construction contract will probably be terminated or suspended. The retail contractor’s remedies for early termination are governed by state law and the terms of the construction contract. In either case, retail contractors have various avenues available to them to seek the return of their mall deposits.

The language of the construction contract may provide the contractor with a right of action for the return of its deposit directly from the retailer. Normally, retailers insulate themselves from such liability requiring contractors to look directly to mall owners. If the mall owner in bankruptcy assumes the lease, any side agreement between the mall owner and contractor characterized as such will likely be assumed too, and the security deposit will be returned in the ordinary course. Complications arise when the lease between the mall owner and retailer is



rejected. Upon rejection, the mall owner is no longer obligated for pre-petition obligations (e.g. rent, utilities, taxes, insurance, etc.) and may be able to successfully renegotiate future lease terms with the retailer or sell the mall property to another entity who might have the same rights vis-à-vis the retailer.

Nevertheless, mall security deposits, that are otherwise subject to return under the construction contract, are not the property of the mall owner. The debtor in possession or bankruptcy trustee, whichever the case may be, "takes no greater rights [in the mall deposits] than the [mall owner] himself had."¹ The deposit money should not be considered property of the debtor's estate. In those situations where construction has been completed and the mall deposit is overdue or where the construction contract was terminated prematurely (as a result of a rejected lease between the retailer and mall owner), the retail contractor is entitled to the return of its mall deposit.

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¹ Old Republic National Title Ins. Co. v. Tyler, 155 F 3d 718, 721 (4th Cir. 1998).