



Important Q&A for Commercial Landlords Whose Tenants Seek Bankruptcy - Part Two

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Foster Swift Finance, Real Estate & Bankruptcy News

February 5, 2024

Introduction

This article is Part Two of a series offered to commercial tenants and landlords, advising them about issues and questions they will have to address if the other party to their commercial lease seeks bankruptcy.

While **Part One**, outlined issues that commercial tenants typically face when their landlord files for bankruptcy and offered legal tips to tenants for how to address them, this article explores the other side of the coin and offers tips to landlords on how to address issues and questions they will have when a tenant declares bankruptcy.

Can a Commercial Landlord Enforce Lease Terms Allowing Termination of the Lease if the Tenant Files for Bankruptcy?

A commercial tenant's bankruptcy does not trigger a right of the landlord to terminate the lease. In addition, even if the lease does include a right of termination when a tenant seeks bankruptcy, the "automatic stay" discussed below will block a landlord from enforcing such a term.

Can a Landlord Pursue Pre-Bankruptcy Claims Against its Tenant?

As in all bankruptcies, a tenant filing for bankruptcy receives an "automatic stay" of any claims, lawsuits, or collection proceedings pending at the time of the filing. The stay does not terminate the landlord's claims against its bankrupt tenant, but it does limit claimants to pursuing their claims in the bankruptcy case only.

If your tenant files a Chapter 11 (reorganization) case, you should immediately review the schedules of debt that your tenant submits with its bankruptcy petition, to determine if your claims are listed, and if so, whether the claims are listed as undisputed, non-contingent or unliquidated. If your claims are not listed, or if you believe the tenant's

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listing of your claims is incorrect, you should promptly prepare and file your own proof of claims and make certain your claims are supported by documents or calculations that establish their legitimacy. You should also pay close attention to the deadline ("bar date") for filing claims, because missing the deadline may result in your claim not being considered by the Court.

If your tenant files a Chapter 7 (liquidation) case, you will also need to act quickly to file your claims. In Chapter 7 cases, the period to file a claim is limited, typically to 70 days after filing of the petition if the case was filed voluntarily by the tenant, or 90 days after filing if the case was involuntary, so a timely filing of claims is critical to the landlord's ability to collect whatever may be available from the bankrupt tenant.

Is the Tenant Required to Continue Performing Under the Lease?

Once a tenant files for bankruptcy it has an automatic right to assume or reject contracts, including your lease. The landlord in this situation should prepare for either option.

- **Tenant Assumes the Lease.** If your tenant assumes the lease, it is generally good news since the assumption obligates the tenant to pay all pre-petition and post-petition rents. With an assumption, the tenant is also required to provide adequate assurance of its ability to perform its obligations of the lease. An assurance is also required if your tenant assumes the lease so as to assign it to a third party. In that case, an assignee of the lease must also provide adequate assurance that it will comply with the terms of the assigned lease and that it has the capability to perform such obligations.

However, landlords should keep in mind that before an assumption, tenants will often attempt to renegotiate terms of a lease, so the landlord should be prepared for such negotiations. As part of these negotiations, the landlord should assess its options if negotiations are not successful, including its ability to collect on claims it has against the tenant and whether it can attract another tenant if necessary.

- **Tenant Rejects the Lease.** If a tenant rejects the lease, the landlord is entitled to recover possession of the leased premises, and it may have a claim for damages against its tenant for rejecting the lease. Such claims can include damages for the rent that would have been payable before the bankruptcy, although these claims are limited to the lesser of: (i) 1 year of rent, or (ii) 15% of the rent for the remainder of the term or for three years, whichever period is shorter. Additional amounts that may be part of a damages claim include real estate taxes, maintenance charges, utilities, or legal fees payable by the tenant under the lease.

Landlords should also look carefully at any guarantees issued on behalf of the tenant at the start of the lease. If a landlord required the tenant to provide a guarantee from a third party for tenant's obligations under the lease, the landlord may have claims against the guarantor that are not limited by the tenant's automatic stay.

Can Landlords Take Possession of Tenant Security Deposits?

Landlords should pay careful attention to how they use tenant security deposits. Although the landlord may hold the deposit in escrow, the deposit is an asset of the tenant's bankruptcy estate and cannot be used to cover debts except as approved by the bankruptcy court. Claims against the security deposit should be made as part of the landlord's claims in the bankruptcy case.



What is the Tenant's Obligation to Continue to Pay Rent and Fees?

If your tenant exercises its right in bankruptcy to assume the lease, the tenant (or the party to which tenant assigns the lease), must pay all rent and fees that are due under the lease, whether they are due for pre- or post-petition periods. In the event of lease renegotiation before assumption, the tenant's obligation to pay rent and fees remains the same for the renegotiated terms.

If your tenant exercises its right to reject the lease, the landlord should include a claim for unpaid rent in its creditor claim. Although most such claims are unsecured (and typically are paid only small amounts on the dollar), landlords with tenants that paid a security deposit will have a priority versus other claims, at least to the extent of funds in the security deposit.

If your tenant continues to occupy your premises after filing for bankruptcy, it still owes rent for the period of occupancy. To collect such rent, the landlord must include the claim in its creditor claim, but the landlord's claims for such post-petition rent will be considered an "administrative claim", giving them a higher priority than unsecured claims.

Finally, landlords should carefully monitor their tenant's bankruptcy case to assure that they have advance notice of the bankruptcy court's processes for hearing claims and be ready to assert their rights in the bankruptcy case.

For additional assistance in managing issues that arise when commercial tenants file for bankruptcy, please contact Scott Hogan or another member of Foster Swift's Finance & Bankruptcy practice team.