

**Commercial Landlord/Tenant Law
when Tenant Declares Bankruptcy
and
(non-commercial) Summary
Proceedings**

Bankruptcy Concerns

- **When a Commercial Tenant Files Bankruptcy**
- ☐ All collection actions must stop as soon as the tenant files for bankruptcy . 11 U.S.C. § 362
- ☐ Section 362(d)(1): Relief from automatic stay if cause exists
- ☐ The Automatic Stay does not prevent landlord from collecting back rent from guarantors of the lease, even when the tenant is in bankruptcy. 11 U.S.C. §362, §524(e)8

Ipsa Facto Clauses

Lease should be written to give landlord the right to terminate or declare a default due to the tenant's financial condition. This is known as an *ipso facto* clause.

- Typical *ipso facto* triggers include:
- Filing a voluntary bankruptcy;
- Having an involuntary bankruptcy filed against the tenant;
- Becoming insolvent;
- Admitting in writing that the tenant is insolvent;
- Making a general assignment for the benefit of creditors; or some other financial condition covenant.

Section 365(e)(1), governs *ipso facto*

This section provides that an unexpired lease of the debtor may ***not*** be

- terminated or modified . . . solely because of a
- provision in such contract or lease that is
- conditioned on—
- (A) The insolvency or financial condition of the debtor;
- (B) The commencement of the bankruptcy case; or
- (C) The appointment or taking possession by the
- Trustee, but If lease has not terminated when the bankruptcy is filed,
- then the tenant must assume or reject the lease within a
- specified time after filing for bankruptcy:
- For Chapter 7 cases: 60 days (11 U.S.C. § 365(d)(1))
- For Chapter 11 cases: Before the confirmation of the plan but the
- court, on the request of any party to such contract or lease, may
- order the trustee to determine within a specified period of time
- (11 U.S.C. § 365(d)(2))
- The tenant may make a motion asking for an extension of period in which
- to assume or reject the lease

Assumption or Rejection

Tenant's decision must be made within the first 120 days of filing or lease is deemed rejected

One 90-day extension is allowed "for cause. Additional extensions require the written consent of the landlord

- Possession must be turned over immediately
- upon rejection
- **Non-monetary Cure Provision**
- Non-monetary defaults under leases must
- be cured prospectively
- Payment for losses caused by the nonmonetary
- default must also be paid as part
- of the cure

Rejection Damages Cap

Damages are capped at "the rent reserved

- by such lease, without acceleration, for the
- greater of one year, or 15 percent, not to
- exceed three years, of the remaining term of
- such lease"
- Damages excluded from the cap: those not
- arising from rejection of the lease

In order to provide adequate assurance of performance for assumption of

- lease, debtor/proposed assignee must prove the financial condition of assignee is compared to that of tenant at date of lease execution and/or assurance that any percentage rent due will not decline substantially

Assumption/Assignment

- Subject to all provisions of the lease,
- including radius, location, use, or
- exclusivity provisions, and
- Will not breach any such provision
- contained in any other lease, financing
- agreement, or master agreement relating
- to such shopping center
- Assignment will not disrupt any tenant mix or
- balance

Post-Petition Performance

After tenant has declared bankruptcy, it must timely

- perform its post-petition obligations under the lease (e.g., pay rent) until it is assumed or rejected.
11 U.S.C. §365(d)(3)
- Includes payment of rent, late fees, interest, and
- attorneys' fees.

A bankruptcy court's ability to eliminate these duties is

- limited to offering a 60 day extension for payment after the order for relief is entered.

Security Deposits

Security deposit are considered property of the

- tenant/debtor's bankruptcy estate. Thus, the amount of the deposit is credited against the landlord's allowed cap claim.
- Security deposits allow landlords priority in a bankruptcy
- distribution as secured creditors but is limited to the
- amount of the security deposit.
- The exercise of setoff rights are stayed. 11 U.S.C. § 362

Guarantors still on the Hook

- The rejection damages cap does not affect a
- guarantor's obligation under a lease.
- However, a guarantor's claim for reimbursement
- for the debtor's estate is subject to the cap. 11
- U.S.C § 502(e)(1)(A)
- ☐ The automatic stay does not prevent an action
- against the guarantor.

Letters of Credit as Security

Because of the “independence principle,” letter of credit obligations are wholly independent of the contract between the debtor/tenant and the creditor/landlord and generally do not involve any distribution of estate property.

- Courts have uniformly held that neither a letter of credit nor its proceeds are property of the estate. *Int’l Fin. Corp. v. Kaiser Group Int’l, Inc. (In re Kaiser Group Int’l, Inc.)*, 399 F.3d 558 (3d Cir. 2005).
- Therefore the automatic stay does not prohibit a draw down on an uncollateralized letter of credit. See, e.g., *Willis v. Celotex Corp.*, 978 F.2d 146, 148 n.3 (4th Cir. 1991).
- However there is a split as to whether proceeds from a letter of credit implicate the rejection damages cap. see, e.g. *AMB Property, L.P. v. Official Creditors for the Estate of AB Liquidating Corp.*, 416 F.3d 961 (9th Cir. 2005) (proceeds of letter of credit were properly subtracted from the landlord's capped claim.) But see, *In re PPI Enterprises (U.S.), Inc.*, 324 F.3d 197 (3rd Cir. 2003) (proceeds from the letter of credit should reduce the landlord's cap claim).
- *In re Stonebridge Technologies Inc.*, 430 F.3d 260 (5th Cir. 2005) (security deposit in the form of a letter of credit held not subject to the cap if the landlord had not filed a proof of claim.)

Beware

- Avoid falling into the preferential transfer trap when
- negotiating a new lease arrangement. 11 U.S.C § 547
- Try to Pre-Petition Termination of the Lease
- Enforce Rights to Receive Current Rent & Obtain Security Deposit Setoff

When entering a new Lease consider how to handle

- Security Deposits, Guarantees, and Letters of Credit
- Obtain Current financial statement on tenant as an affirmative representation from tenant about the tenant's financial conditions can serve as presumptions in adversary proceedings against the landlord

Landlord/Tenant (non-commercial)

SUMMARY PROCEEDINGS

- In most instances when a landlord finds it necessary to sue a tenant to recover rent or possession of a premises, the proper vehicle is a summary proceeding for the recovery of real property. A summary proceeding for the recovery of real property (“summary proceeding”) is an expedited lawsuit for the recovery of rent and possession of a premises.

- Summary proceedings are expeditious because the parties' procedural rights and remedies are severely limited. Among other things, for example, the tenant's time to answer the lawsuit is accelerated and, absent leave of court, there is no discovery.

- Due to the accelerated nature of a summary proceeding and the limits on pre-trial discovery, a landlord prosecuting such a proceeding is held to a higher standard with respect to complying with the technical requirements under the normal Rules of Civil Procedure. In general, even though courts have adopted more liberal standards in recent years, technical defects that might have no effect on a plenary action will mandate dismissal of a summary proceeding

- There are two types of summary proceedings: nonpayment proceedings (“nonpayment”) and holdover proceedings (“holdover”). A nonpayment is a lawsuit for the recovery of rent due and, in the absence of full and timely recovery of rent due, possession of the premises. A holdover is a lawsuit for possession of the premises, regardless of the payment of rent, although past due rent or a fee for using and occupying the subject premises may also be recovered in a holdover.

- If the landlord has the option of bringing either a nonpayment or a holdover, the following are some major advantages and disadvantages of each. A nonpayment usually moves faster than a holdover. If the tenant pays the rent, or is able to demonstrate why it does not owe the rent, the tenant wins the proceeding. A holdover is usually a bit more challenging to prosecute than a nonpayment and takes longer. Payment of rent, or disproving that rent is owed, is not a defense to a holdover, however, and if the proceeding is properly prosecuted, it may terminate the tenancy. Deciding which summary proceeding to institute really depends on the landlord's goals and the lawyer's or managing agent's strategy. Maybe a landlord really wants a tenant out because the market is such that the landlord can rent the space for more.

- Suppose the lease has expired and now the tenant is a month-to-month tenant, so a thirty-day notice of termination is required as a predicate to initiating a holdover proceeding. The managing agent or lawyer, however, should ask the following questions: (1) How much rent does the tenant owe? (2) Can I prove it? and (3) If I can prove it, can the tenant pay it? If the tenant is in bad financial condition and will be unable to defend against a simple nonpayment, why bother bringing a holdover with its long predicate notice period? In that case it might be best to do a nonpayment with its relatively short predicate notice period.