

# RUBIN LLC

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## The Commercial Landlord's Checklist for Tenant Bankruptcies, In Plain English

A commercial landlord may be tempted to do nothing if its commercial tenant files for bankruptcy protection. Indeed, the landlord may be lulled into complacency if the tenant continues or resumes paying its post-filing obligations on time. More recently, we have seen proactive debtor tenants reject their leases and vacate their space swiftly upon the filing of a bankruptcy in order to avoid having to pay post-petition rent for locations they wish to abandon. In those situations, too, a landlord may think that it can simply ignore what transpires in the tenant's bankruptcy case. In fact, there are several steps that a commercial landlord should take, and alternatives that it should consider, should one of its commercial tenants file a chapter 11 bankruptcy case. Here is a handy reference guide highlighting considerations for the commercial landlord facing a business tenant bankruptcy.

**1. Stop litigation due to the automatic stay.** The tenant's filing for bankruptcy triggers an automatic stay that, among other things, bars a landlord from commencing or continuing eviction or collection actions against the tenant or foreclosing on a tenant's furniture fixtures and equipment, and which prevents the landlord from issuing a notice of default or termination under the lease. Once a tenant files for bankruptcy, landlords may not invoke any so-called "ipso facto" provision in a lease that provides for its termination if a tenant becomes a debtor under the Bankruptcy Code or has become insolvent. Accordingly, if a tenant files a bankruptcy case, the landlord must immediately have the counsel it retained to enforce its rights against the tenant halt its efforts and provide notice of the automatic stay to any court in which a motion by landlord against the tenant is pending. A landlord who takes action in violation of the automatic stay may become liable for monetary sanctions, including the imposition of attorney's fees. To avoid missteps, communications with a tenant in a bankruptcy case should initially be made through counsel.

**2. Gather the lease, including all amendments, and documents supporting the tenant's payment obligations.** The landlord must ascertain how much the tenant owed as of the bankruptcy filing date, identify the elements of that claim, and be able to substantiate the amounts of each component of the landlord's claim. It is also important to identify the amount of time remaining on the term of the lease, including any extensions. The landlord should therefore ensure that it has a complete copy of the lease and all amendments, and a ledger showing all amounts paid and owed through the date of commencement of the case as well as the amounts that the tenant is supposed to pay under the lease on a going forward basis. Copies of tax invoices, utility bills, and monthly maintenance bills, for example, are needed to support the landlord's claim, and to understand what claims the landlord may have that will arise post-petition or if the tenant chooses to reject the lease (more on that later). If the tenant continues to use the space post-petition, the landlord's claims for the post-petition period generally constitute administrative claims that are afforded a higher priority of payment. The landlord should therefore expect those claims to face more careful scrutiny.

**3. Confirm the existence of any credit enhancements, their nature and amount.** Landlords should review and confirm any credit enhancements (and the nature and amount) given by or for a tenant debtor. Credit enhancements such as security deposits, letters of credit, and third-party guarantees may provide additional sources of recovery for landlord claims. If the tenant provided a cash security deposit that has not been exhausted prepetition, the landlord may want to apply (setoff) the security deposit against outstanding arrearages. But a security deposit is technically property of the tenant's bankruptcy estate, so the landlord may not apply the security deposit it is holding without first obtaining relief from the automatic stay by order of the bankruptcy court. In our experience, debtors generally do not voluntarily stipulate to grant the landlord stay relief; rather, the landlord will likely have to file a motion for such relief. When to file such a motion is a strategic decision that will depend on the facts and circumstances of the particular case.

If the tenant provided a letter of credit that was not completely drawn down prepetition, the landlord may be able to draw down on the letter of credit. The proceeds of a letter of credit are not property of the tenant debtor and not subject to the automatic stay. Accordingly, a landlord usually will be able to draw down on the letter of credit after the tenant files its bankruptcy case. But there may be wrinkles. Landlords may only draw down on a letter of credit in strict conformity with the terms set forth in the parties' agreement. The landlord should consult with bankruptcy counsel before actually drawing down on the letter of credit.

Finally, if the landlord is holding a guaranty from a guarantor who is not also a debtor in bankruptcy, the landlord may pursue the guarantor. Generally, a non-debtor guarantor does not receive the benefit of a debtor's automatic stay. In unusual circumstances, a tenant debtor may ask the bankruptcy court to extend the automatic stay to protect any non-debtor guarantors. The landlord may thus be forced to litigate whether the tenant is entitled to such an injunction. If there is no injunction, the landlord will want to consider whether the tenant's obligations to the landlord were modified without the guarantor's consent, as that might provide an avenue for the guarantor to wriggle of the hook of the guaranty.

**4. Watch out for bar dates and other deadlines.** This may sound simple, but it is a common pitfall for landlords. A landlord cannot rely on its tenant debtor to list its prepetition claims accurately in the schedules of assets and liabilities filed with the bankruptcy court. Moreover, the tenant might designate the landlord's claims as disputed, contingent, or unliquidated. The landlord (with the assistance of counsel) should file a proof of claim in the bankruptcy case for prepetition amounts owed before the deadline fixed by the bankruptcy court for filing prepetition claims. Courts are divided on whether the tenant's obligation to pay "stub rent"—which is rent for the portion of the calendar month in which the case was filed following the case filing date—should be treated as a prepetition or post-petition claim. Moreover, the consequences for failing to file a claim before the deadline imposed by a bar date order are dire. If a landlord receives timely notice of a bar date for filing prepetition claims, and fails to timely file a proof of claim, the landlord will usually (but not always) be barred from asserting a prepetition claim against the debtor.

There are other bar dates that the landlord must watch out for, such as (i) the last date to object to the amount that the debtor tenant proposes to pay the landlord to cure prepetition and post-petition monetary defaults in connection with a proposed assumption or assignment of a lease, and (ii) the last date to object to a proposed assumption or assignment if the debtor or its assignee have not provided adequate assurance of its ability to perform the tenant's obligations under the lease. Proposed cure amounts may be buried in schedules or supplemental exhibits filed with the bankruptcy court in connection with a motion or a plan of reorganization. If the bankruptcy court permits the tenant to reject (i.e., breach) the lease, the court will set a deadline for the landlord to file a claim for damages it suffered as a result of the rejection. Landlord's bankruptcy counsel should be on the lookout for such notices.

**5. Understand the tenant debtor's requirement to comply with post-petition obligations.** Generally speaking, a tenant in bankruptcy has a statutory obligation to pay post-petition rent due under a commercial lease until the lease is assumed or rejected. Accordingly, landlords should immediately notify counsel if post-petition obligations are not being performed. But a debtor may obtain from the court, "for cause," an extension of time to perform lease obligations arising within the first 60 days after the filing of its case. Such extensions were granted for example, after the onset of the COVID-19 pandemic. Additionally, under the Consolidated Appropriations Act of 2021, until at least December 27, 2022, in certain smaller chapter 11 bankruptcy cases known as "subchapter V cases," the tenant debtor may obtain from the court a second 60-day extension of time to start paying rent after filing its case. Landlords should know that they may be forced to file a motion to compel a debtor tenant to pay post-petition rent if payment is not timely made without justification.

**6. Be aware that damages as a result of the rejection of lease by a tenant debtor are capped.** The Bankruptcy Code allows a tenant to reject (i.e., breach), via court order, a lease whose obligations the tenant wishes to escape. It is relatively easy for a tenant debtor to obtain such court authorization. If a tenant rejects a lease, the landlord is entitled to assert a claim for lease rejection damages, which the Bankruptcy Code treats as a prepetition unsecured claim. To prevent landlord claims from swamping the claim of other unsecured creditors, the law caps the amount of a landlord's rejection damages claim at the greater of (i) one year's rent under the lease, or (ii) 15%, not to exceed three years, of the remaining term of the lease. Bankruptcy courts disagree over how to calculate this cap for lease rejection damages. The issue may be complicated if the amount of rent escalates over the remaining lease term. Because preparing a claim for lease rejection damages is not a straightforward exercise, counsel should be consulted to assist in preparing any proof of claim that includes lease rejection damages.

**7. Know what rights landlords have (and don't have) with respect to a tenant debtor's assumption of commercial leases.** Under current law (as of December 2021), a tenant debtor may have up to 300 days to decide whether to assume or reject its leases. If a tenant debtor decides to assume its commercial lease, the landlord should be aware that, in order to assume the lease, the debtor must (i) cure all defaults (other than certain non-monetary defaults), (ii) compensate the landlord for actual damages resulting from a breach of the lease; and (iii) provide adequate assurance that it will be able to perform the lease in the future. Moreover, if the lease is on property that constitutes a "shopping center," adequate assurance of future performance must include assurance that (a) the debtor (or assignee) will have a similar financial condition and operating performance as the debtor tenant at the time the debtor became the lessee under the lease, (b) any percentage rent due under the lease will not decline substantially, (c) the assumption will be subject to radius, location, use or exclusivity provisions contained in the lease being assigned, and (d) the assumption or assignment of the lease will not disrupt tenant mix or balance in the shopping center. On the other hand, a landlord will usually not have the ability to block an assignment of the lease even if the lease contains provisions prohibiting assignment by the tenant.

**8. Prepare for the possibility of disruptive going-out-of-business sales.** While commercial leases may contain provisions prohibiting GOB sales, bankruptcy courts will routinely authorize GOB sales for tenant debtors in retail cases. Landlords should be prepared for the possibility of these often chaotic events that may be disruptive to other tenants. Landlords should also consult with counsel to pursue strategies to institute safeguards and minimize disruptions to other tenants, such as by limiting the time period for GOB sales to be conducted, monitoring signage and advertising, ensuring compliance with local ordinances governing noise levels and building capacities, and negotiating cleanup requirements.

## **Conclusion**

A commercial tenant's filing for bankruptcy protection raises a host of issues for a landlord to consider. The foregoing is by no means an exhaustive description of all of them. This reference guide is designed to help the landlord recognize issues that it is likely to have to navigate, and to provide guidance of considerations that should be taken into account.

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