



Bankruptcy Q&A: What Commercial Landlords Need To Know

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One of your tenants files bankruptcy – now what? Bankruptcy proceedings are complicated, and consulting bankruptcy counsel early in the process will help commercial landlords avoid: (1) taking actions against the tenant or the premises that will violate applicable laws; and (2) missing important deadlines and opportunities to increase their recoveries. Below we offer a glimpse into some frequently asked questions, and encourage you to contact us for further discussions if you think any of this applies to one of your tenants.

1. What are a tenant's rights after filing bankruptcy with respect to a commercial lease of real property?

A tenant that files bankruptcy – i.e., a “debtor” – can (a) assume a lease and reorganize, (b) assume a lease and assign it to a buyer, or (c) reject a lease that it no longer deems valuable. Generally, in order to assume a lease, a tenant in bankruptcy will need to pay all amounts due to the landlord under the lease, and demonstrate its ability to perform under the lease going forward. If the lease will be assigned to a buyer, the tenant still needs to cure all defaults, but the buyer will need to establish its ability to perform under the lease. If the lease is for space located in a shopping center, the tenant (or proposed assignee/buyer) must satisfy additional requirements, including that the assumption (or assignment) will not disrupt the shopping center's tenant mix. When a tenant elects to reject a lease, it is essentially breaching the lease and triggering certain damages due to the landlord (these are explained in more detail below).

2. How long after filing bankruptcy does the tenant have to decide what to do with a commercial lease of real property?

Generally, a debtor has 120 days from the filing of its bankruptcy to decide whether to assume, assume and assign, or reject the lease. That time may be extended for an additional 90 days for a total of up to 210 days with bankruptcy court approval. Any further extensions require the commercial landlord's consent.

3. Can a commercial landlord collect rent from a tenant in bankruptcy?

Once a tenant files for bankruptcy protection a commercial landlord cannot collect unpaid rent that was due before the case was filed (if the tenant later decides to assume the lease, these amounts will be paid). But, generally, a commercial landlord is entitled to collect rent that is due after the bankruptcy filing. In some cases filed post-COVID-19, bankruptcy courts have granted a temporary deferral of a tenant's obligation to pay post-filing rent. This type of request is made by a tenant early in the process, and landlords should consult bankruptcy counsel early to preserve their rights.



4. When is it too late for a tenant to assume a lease during its bankruptcy case?

It is too late for a tenant to assume a lease during a bankruptcy case: (a) beyond the applicable time periods set forth above (generally 120 – 210 days after filing); (b) if that lease expired prior to the bankruptcy case being filed; or (c) if the lease was terminated under state law prior to the bankruptcy filing. In other words, a tenant cannot try to assume a lease that no longer exists.

5. If a landlord's lease is rejected during the bankruptcy case, is the landlord entitled to damages?

When a tenant rejects a lease, it is essentially breaching the lease and triggering damages due to the landlord. Upon rejection, a landlord may assert a claim for "rejection damages," which are capped at the greater of one year's rent or 15% of the rent for the remaining lease term, not to exceed three years' rent, plus unpaid pre-bankruptcy rent and additional rent. That cap does not apply to guarantors that did not also file for bankruptcy and guaranteed a tenant's obligations under the lease.

6. Can a landlord enforce an anti-assignment clause in the lease during the bankruptcy case to prevent its lease from being assumed?

Anti-assignment clauses or clauses that require a landlord's consent to assign are generally unenforceable in bankruptcy as a matter of public policy.

7. Can a landlord enforce a lease provision that provides for automatic termination of the lease upon a bankruptcy filing by a tenant?

These clauses are generally unenforceable under the Bankruptcy Code.

8. Can a landlord attempt to collect unpaid rent from a tenant, or continue or commence eviction proceedings against a tenant during a bankruptcy case?

The filing of a bankruptcy petition immediately gives rise to an "automatic stay," which generally prohibits any act to collect unpaid debt or to continue/commence any proceeding against the tenant (now a debtor). A landlord should obtain legal advice to discuss other methods of protecting its interests. For example, the automatic stay generally does not apply to third parties that did not also file bankruptcy, such as guarantors, or letters of credit (see below).

9. When can a landlord apply a security deposit to satisfy unpaid rent?

The answer depends on whether the deposit is in the form of cash or a letter of credit. In general, a landlord may not draw on a cash security deposit during the course of a bankruptcy case, but may draw on a letter of credit to satisfy amounts due. With court permission, a cash security deposit can usually be applied to offset unpaid rent that accrued before the bankruptcy filing.



10. Does a tenant have to perform its obligations under a commercial lease during the course of its bankruptcy case?

Yes. The Bankruptcy Code provides that the tenant must perform all post-bankruptcy obligations under a commercial lease until it assumes, rejects, or assumes and assigns the lease. Since COVID-19 has been impacting the economy, some tenants have been asking, and some bankruptcy courts have been granting extensions and deferrals of these obligations.

11. If the lease is rejected during the bankruptcy case, what is the procedure for receiving a distribution in the bankruptcy case?

If a lease is rejected, that means it will not be assumed, and there is no requirement to “cure” or pay the pre-bankruptcy filing amounts due. In that case, the landlord can file a proof of claim, along with supporting exhibits, with the bankruptcy court. Landlord’s should be careful to file these timely or they risk waiving their claims in the case. Bankruptcy counsel should be consulted to assist with preparing and filing a claim to ensure it is properly prepared and timely filed.

For additional information, please contact

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