

TIPS FOR DEALING WITH A TENANT IN BANKRUPTCY

Johnathan C. Bolton
Goodsill Anderson Quinn & Stifel
Honolulu, Hawaii

WARNING: The information contained in this handout is general in nature and does not constitute legal advice. Please consult with an attorney experienced in bankruptcy law concerning any specific legal questions you may have about this material.

1. Once a bankruptcy case is filed, the automatic stay goes into effect, which prohibits all actions to collect monies from the tenant relating to the pre-bankruptcy period or to evict the tenant based on non-payment of rent.
2. The landlord cannot compel payment of pre-petition arrears once the case is filed.
3. Do not violate the automatic stay by moving forward with an eviction action. You must seek relief from the automatic stay from the Bankruptcy Court.
4. For the most part, underlying state law is still important even though the tenant has filed bankruptcy.
5. A provision in a lease stating that the filing of a bankruptcy case is an “event of default” entitling the lessor to terminate the lease is *unenforceable* in bankruptcy.
6. Once a bankruptcy case is filed, a landlord *cannot* effectuate a setoff from a pre-petition security deposit. Bankruptcy Court approval of a setoff is required.
7. Bankruptcy debtors are required to stay current on payments of post-petition rent. The failure to pay post-petition lease rent gives rise to an administrative claim. A lessor can also file a motion to compel payment of post-petition rent.
8. Do not apply post-petition payments to pre-petition rent. Post-petition payments should be applied to post-petition rent.
9. Landlords should file a proof of claim in the bankruptcy case before the scheduled bar date asserting the pre-petition amounts due under the lease, plus they should assert a *contingent* claim for damages if the lease is later rejected.
10. Landlords should monitor the bankruptcy case carefully in order to determine how unexpired leases will be treated in the case.
11. The Bankruptcy Code allows the tenant, as a debtor-in-possession, a right to assume or reject unexpired leases of nonresidential real property.

12. The tenant must either *assume* or *reject* (or ask for more time to assume or reject) a lease of nonresidential real property within sixty (60) days following a chapter 7 bankruptcy filing (or within 120 days in a chapter 11 filing, plus a single 90-day extension) or the lease is *deemed* rejected.
13. In order for a tenant to *assume* an unexpired lease, the tenant must cure all past due defaults, pay all pecuniary losses, and provide “adequate assurance” of future performance under the lease.
14. Be careful to read carefully any Plan of Reorganization or Sale Motion proposed in a bankruptcy case. It may propose treatment of a lease that is *worse* than is required under section 365 of the Bankruptcy Code. If you don’t object to provisions in the Plan or Sale Motion, you may get stuck with them!
15. A tenant can also *assume and assign* their unexpired leases to third parties, notwithstanding provisions in the leases prohibiting or restricting assignment (although the same requirements of cure and adequate assurance of future performance apply). Absent landlord consent, the proposed assignee must comply with the terms of the lease.
16. If the lease is assumed and assigned, the lessor can sometimes require a security deposit from the new assignee, especially if the assignee is an unproven company.
17. There are special rules for assumption and assignment for “adequate assurance of future performance” relating to shopping center leases. The assignee must comply with the use provisions of the lease. The Bankruptcy Code explains that the tenant cannot disrupt the “tenant mix” and “balance” by, for example, attempting to assign the lease to a competitor of the anchor tenant. The Bankruptcy Court will not force a lessor to accept a lessee that violates an exclusivity clause in a lease of another tenant.
18. If a lease is rejected by the tenant, the rejection is treated as a breach of the lease immediately before the petition date and the damages that can be claimed are treated as a pre-petition unsecured claim.
19. There is at least one decision in Hawaii that equates rejection of a lease with termination of a lease. Mortgagees who have liens on leasehold interests must protect their collateral in the event of a bankruptcy and subsequent rejection of the leasehold.
20. Damages based on rejection of a lease are capped by the provisions of the Bankruptcy Code. In most circumstances, the cap will be approximately one (1) year of rent going forward.

21. Any post-petition amounts owing to a lessor can be claimed as an administrative claim. Lessors must move quickly if post-petition rent is not being paid because the estate may be administratively insolvent.
22. Consider negotiating a “drop dead” clause in a plan if a debtor wishes to assume the lease within a plan.
23. There are special rules relating to residential rental property and the debtor’s ability to cure the monetary default giving rise to the judgment for possession.
24. A lease that was terminated pursuant to state law before the bankruptcy was filed is not a part of the bankruptcy estate. Timely termination of a lease with a problem tenant can be a landlord’s best defense in avoiding the consequences of a bankruptcy filing later. Best practice is to seek relief from stay or file a motion seeking a determination that the automatic stay does not apply.
25. Make sure that you effectuate the termination of the lease under state law correctly!