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Practice Update

Landlord Tenant Issues in Bankruptcy Amid COVID-19

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In the midst of the COVID-19 pandemic, many commercial landlords may be wondering whether they'll receive their next rent payment as tenants struggle to make ends meet. Landlords and tenants alike should be prepared for a bankruptcy filing by the lease counterparty. This memorandum primarily focuses on the rights and remedies of landlords facing a tenant's bankruptcy filing. We are continuing to monitor proposed state and federal government moratoriums on the filing of eviction actions, and will provide further guidance should any be imposed.

Fortunately, landlords can be proactive in protecting their leases before a tenant files bankruptcy. We suggest (i) strict financial monitoring, and immediately enforcing defaults (subject to any government-imposed restrictions), (ii) taking a letter of credit, including the right to draw on it without demand, in lieu of a security deposit, and (iii) making loans to the tenant outside the lease, to create an additional claim against the tenant.

If a landlord receives notice that its tenant has filed a bankruptcy case, the landlord should be acutely aware of the automatic stay imposed by section 362 of the bankruptcy code. The automatic stay enjoins the non-debtor party from taking any action against a debtor or the debtor's property. In the leasing context, the stay prohibits many actions, including:

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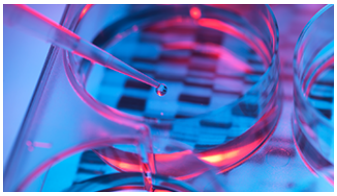

(i) self-help remedies such as changing the locks even if otherwise allowed in the applicable jurisdiction, (ii) filing or continuing to prosecute an eviction action, (iii) offsetting a security deposit against past due rent (although a letter of credit may be treated differently than a cash deposit), and (iv) sending a notice to terminate a lease or demand payment of past due rent. A landlord should consult bankruptcy counsel before taking any action with respect to the bankrupt tenant.

After the tenant files bankruptcy, the bankruptcy code (11 U.S.C. §§ 101-1101, et. seq.) requires a debtor to timely perform all obligations arising under the lease after the filing, including payment of rent. The debtor also has the right to assume or reject a lease. If a tenant seeks to assume a lease, it must cure all defaults under the lease, arising both pre- and post-filing, and must provide financial assurances it will perform under the lease going forward. If the tenant moves to reject a lease (which it has wide latitude to do), the landlord will have a claim for damages flowing from that rejection, subject to statutory caps.

Notably, a debtor may seek to assume a lease and assign it to a third party. Anti-assignment provisions are usually unenforceable in bankruptcy, however, the assignee or debtor will still be required to cure all defaults, and the assignee will have to provide financial assurances of its ability to perform going forward.

Although rarer, landlords who file bankruptcy are subject to many of the same requirements as tenants who file, and their tenants, likewise, become subject to the automatic stay. Landlord bankruptcies differ, however, in that a landlord who rejects a lease is automatically discharged of its obligations under the lease, but the tenant may remain in the leased premises provided it continues to pay rent. Tenants should similarly consult competent bankruptcy counsel in assessing their rights in a landlord's bankruptcy.