

WELCOME



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HOW DOES BANKRUPTCY AFFECT THE LANDLORD TENANT RELATIONSHIP?

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WHAT IS BANKRUPTCY?



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Process

- Debtor files for bankruptcy.
- Creates automatic stay.
- Meeting of creditors
- Bankruptcy Trustee
- Discharge



Chapters

- Chapter 7 – Liquidation
 - Generally, wipes slate clean
- Chapter 11 – Reorganization
 - Typical for corporations to continue
- Chapter 13 – Adjustment of Debts
 - Occurs when debtor has income and wants to keep valuable assets
 - Payment plan



Automatic Stay

- An automatic stay prohibits a person from filing a lawsuit or continuing a lawsuit against a debtor who files for bankruptcy.



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What if someone violates automatic stay?

- A willful violation of the automatic stay gives rise to damages to any person injured:
 - Actual damages
 - Costs and attorneys' fees
 - Punitive damages



Willful Intent

- Willful intent means the person knew about the automatic stay and acted intentionally in violation of the stay.



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What happens to leases?

- An unexpired lease is part of the tenant's bankruptcy estate.



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Effect of a Discharge

- Voids judgments
- Imposes an injunction against commencing or continuing an action or collection
- Does not apply to postpetition debts



Assuming or Rejecting a Lease



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Two Options when Tenant files BKY

- Trustee may:
 - ▣ Assume the lease
 - ▣ Reject the lease



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Assuming or Rejecting Lease

- Trustee must assume or reject the entire lease.



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What is a lease?

- Bankruptcy defines a lease as a rental agreement for the use of real property.
- Applies only to unexpired prepetition leases.
- Applies even if tenant is not in possession, i.e. subleases



Options to Purchase

- An option to purchase is not assumable.



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Rejecting a Lease

- Upon rejection of a lease, the tenant's interest is extinguished.
- Treated as if tenant breached the lease prior to bankruptcy.
- Landlord is entitled to immediate possession.
- Subleasee's possessory rights also extinguished unless there is a nondisturbance agreement.



Assuming a Lease

- Lease continues or it may be assigned to a third party.



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Assumptions

- A trustee may assume the Lease if
 - ▣ The tenant promptly cures or provides adequate assurance of promptly curing the default
 - ▣ Compensates or provides adequate assurance for actual monetary losses
 - ▣ Provides adequate assurance of future performance



Time Period

- Trustee for a nonresidential tenant has 120 days to assume or reject a lease or the lease is rejected
- 60 day time limit for residential lease under Chapter 7



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Anti-Assignment Clauses

- Bankruptcy does not recognize anti-assignment clauses.
- Does not apply to shopping center leases because tenant has obligation to assure that assignee will honor any use restrictions.



Acceleration Clauses

- California law allows a landlord to receive some or all the consideration of an assignment.
- Bankruptcy court does not enforce acceleration clauses.



Unexpired Leases

- Expired leases may not be assumed.
- A lease is expired if Landlord served:
 - ▣ A notice for a non-curable breach; or
 - ▣ A 30/60 Day Notice and the 30 or 60 days have passed prior to filing bankruptcy.



What to do?

- If lease has expired and landlord believes tenant will file bankruptcy, landlord should service notice to evict tenant.



Landlord's Responsibilities

- Once tenant files bankruptcy, landlord is not obligated to pay for utilities or other services for tenant unless and until the lease is assumed.
- Does not apply to residential leases.



Tenant's Obligations

- Although prepetition rent may be relieved, a tenant is still obligated to pay rent while the trustee decides to assume or reject lease.



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WHAT IF THE TENANT FILES FOR BANKRUPTCY?



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No Automatic Termination

- A tenant's bankruptcy does not by itself terminate a lease.
- Any provision that states a tenant's bankruptcy automatically terminates a lease is unenforceable.



Automatic Stay

- A tenant's bankruptcy triggers an automatic stay of:
 - ▣ The enforcement against the debtor or property of the estate of a judgment obtained before the commencement of a bankruptcy
 - ▣ Any act to obtain possession of the property



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What does the automatic stay mean?

- ❑ Landlord cannot serve 3-Day Notice
- ❑ Landlord cannot file an unlawful detainer
- ❑ Landlord cannot continue to prosecute an unlawful detainer



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Subleases

- A landlord cannot take actions against a tenant sublessor that would affect a subtenant who filed bankruptcy.



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Notice

- A debtor must notify state court and all parties of a stay.
- Landlord may not be required to receive notice if there is no pending case.



What if Landlord has no Notice?

- No notice of tenant's bankruptcy = no liability for taking action against tenant.
- But, once notice is given, landlord is bound by the stay.



What if Notice is Never Given?

- Debts which are not listed in the debtor's bankruptcy petition are not discharged.
- Theoretically, landlords who never receive notice are outside the scope of the petition and discharge.
- Practically, landlords face two problems:
 - Late notice (notice given at some point)
 - “No-asset debtor” – Ninth Circuit says failure to list on petition still constitutes discharge if debtor is assetless
 - Lease will be “deemed rejected” if not assumed



Security Deposits

- A security deposit is frozen.
- Cannot be used to offset back-due rent.
- May even apply if security deposit was used 90 days prior to the bankruptcy.



Expired Commercial Leases

- An expired lease does not fall within the bankruptcy estate if:
 - ▣ The Lease has terminated prior to or during a bankruptcy.
 - ▣ There must be a fixed date expiration.



Relief From Automatic Stay

- A landlord may continue with efforts to collect rent, terminate the tenancy, or litigate an unlawful detainer if the landlord seeks relief from the automatic stay.
- Must go into Bankruptcy Court to obtain relief.



How to get relief?

- Landlord must show that landlord is not adequately protected or that the debtor tenant has no equity in the property.
- Landlord must show that the property is not necessary for an effective reorganization.



Claims Against Bankrupt Tenant

- Landlord may only claim greater of one year or 15% of the entire term (not to exceed 3 years) against tenant if lease terminated.
- May also apply to damages to the property and routine maintenance.



How to Avoid

- Landlords can ask for higher deposits to cover the risk.
- Security deposits offset claims.
- If security deposit is greater than claim, trustee may sue to recover portion of security deposit.



WHAT IF THE LANDLORD FILES BANKRUPTCY?



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No Automatic Stays

- A landlord who files for bankruptcy can still file lawsuits or be able to continue a lawsuit.
- A landlord who is evicting a tenant and then files bankruptcy can still continue with the unlawful detainer.
- It does not stay an appeal initiated and appealed by landlord.



Assume or Reject

- A landlord has the option to assume or reject existing leases



Rejecting a Lease

- If a lease is rejected by the landlord, a tenant may
 - ▣ Treat the lease as terminated
 - ▣ Retain its rights under the lease (however landlord's obligations are wiped out)
 - ▣ Allowed to offset rent



RESIDENTIAL LEASES



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New Law

- In 2005, bankruptcy law modified how residential leases are treated during a bankruptcy.



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Stay

- A tenant's bankruptcy does not stay eviction for a judgment before the filing of a bankruptcy.



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Example

- Landlord wins unlawful detainer on February 1, 2011.
- Tenant files bankruptcy February 3, 2011.
- Landlord can still execute the writ of possession to evict the tenant after February 3, 2011.



Exception

- Tenant certification re nonbankruptcy “cure” rights
- Tenant has the right to cure the entire monetary default
- Tenant has deposited any rent that will be due within 30 days of filing bankruptcy
- Landlord has right to object



Property Where Drugs are Being Sold

- A bankruptcy does not stay an eviction action seeking possession based upon endangerment of the property due to illegal use of controlled substances on the property.
- Landlord required to go to court to seek a lift on the stay.



Relief from Stay

- Court will grant relief from stay if the unlawful detainer is based upon a 30 or 60 Day Notice.



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Strategies



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Financial Problems Before Default

- Review whether credit enhancement (letter of credit) is enforceable.
- Ensure checks are being received and stay on top of collections.
- Refrain from causing an assignment or sublease.



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Pre-Bankruptcy Workouts

- Beware of workouts if tenant threatens to file bankruptcy.
- Court can see these agreements as fraud.
- See an attorney if a workout is desired.



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CONCLUSION



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