

CREDITOR'S RIGHTS TOOLKIT

What Issues Exist for a Landlord When a Commercial Tenant Files for Bankruptcy?

When a commercial tenant files for bankruptcy, it can present a complex array of challenges for a landlord. Understanding the implications of a tenant's bankruptcy filing is crucial for a landlord to protect its interests and navigate the legal landscape effectively.

Key Issues

- **PAYMENT OF POST-PETITION RENT**

Section 365(d)(3) requires a debtor to timely perform all obligations under an unexpired lease of nonresidential real property until the lease is assumed or rejected. Subject to the treatment of stub rent (discussed below), amounts accruing post-petition, including rent obligations, are deemed administrative expenses entitled to priority and timely payment in full.

- **PAYMENT OF STUB RENT**

There is a split among courts on whether rent obligations that arise before the bankruptcy filing but cover some post-petition period (*i.e.*, rent due on the first of the month when the bankruptcy is filed later in the month) qualify as administrative expenses. Some courts adopt a "billing date" approach, holding that rent obligations are determined by the date they become due under the lease. Under this approach, if the rent obligation arises pre-petition (*e.g.*, on the first of the month), it is treated as a pre-petition general unsecured claim, even if the debtor occupies the premises post-petition during the applicable month. Other courts prorate rent obligations into pre-petition and post-petition components, referred to as the "accrual date" approach, allowing an administrative expense claim for the portion attributable to the post-petition period for such month and treating the portion attributable to the prepetition period as a general unsecured claim.

- **CURE AMOUNT AND ADEQUATE ASSURANCE**

If the debtor chooses to assume the unexpired lease or assign it to a third party, the debtor will be required to cure all past due rent and any other monetary defaults, as well as provide adequate assurance of its (or its proposed assignee's) ability to perform under the lease going forward. Such adequate assurance can take the form of providing financial statements to establish the ability to pay or providing a nondebtor guarantee, among other things. It is important to timely review any notice of proposed cure amount and adequate assurance and

to object if the amount reflected does not capture all past-due amounts and amounts that will become due and owing prior to assumption, or if the landlord has concerns about the proposed assignee's ability to meet its future obligations under the lease. The Bankruptcy Code provides special protections to landlords of shopping center leases, which will be addressed in a future installment of the Creditor's Rights Toolkit.

- **LEASE REJECTION DAMAGES**

If the debtor chooses to reject the lease, the landlord has a right to recover possession of the leased premises and can claim damages incurred on account of the rejection. However, such rejection damages are treated as a pre-petition claim and are limited to the lesser of (i) one year of rent or (ii) 15% of the rent for the shorter of the remainder of the term and three years.¹ This cap does not limit claims against any nondebtor guarantor (unless the guaranty agreement so provides), and only applies to a landlord's claim for rejection damages. The landlord can still seek allowance of claims for amounts outstanding as of the petition date, and for any unpaid lease obligations that accrued post-petition, pre-rejection.

- **TREATMENT OF SECURITY DEPOSIT**

A security deposit held by the landlord is considered an asset of the bankruptcy estate, and therefore the landlord must continue to maintain it in accordance with state law. The ability of the landlord to apply the security deposit to amounts owed without court approval will depend on whether the offset is considered a setoff or a recoupment.² The landlord can, and should, include the security deposit in its proof of claim, as the landlord is secured up to the amount of the security deposit.

- **TREATMENT OF LETTER OF CREDIT**

A letter of credit held by the landlord as security for the tenant's performance of its lease obligations is a direct obligation of the issuing bank to the beneficiary (here, the landlord), and so is not subject to the same limitations as a security deposit. The landlord typically can draw on a letter of credit without prior bankruptcy court approval, provided that the letter of credit's draw conditions are met.

Takeaway

By staying informed and taking strategic actions, a landlord can better navigate the complexities of a tenant's bankruptcy. Engaging experienced bankruptcy counsel is essential in this process, as counsel can provide valuable guidance and strategic advice tailored to the specific circumstances of the landlord's situation.

¹ 11 U.S.C. § 502(b)(6).

² See [Can I Net Amounts Owed to the Debtor Against Amounts Owed to Me?](#)