When Landlord-Tenant Law Meets Bankruptcy

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1 Please see the author’s biography on page 17. The author wishes to thank Marvin Ruth and Daniel Kiefer for their assistance with these materials.
A. Landlord or Tenant Files for Bankruptcy

Many financially impaired individuals and businesses seek refuge through the bankruptcy process. Although the broad concepts contained in the expansive bankruptcy code (the “Code”) are generally understood, many practitioners remain unaware of specific benefits afforded debtors during this process. This is especially true in the area of landlord-tenant law, where upon the filing of a bankruptcy petition, the normal contract rights and obligations of landlords and tenants—as well as the remedies available to enforce such rights and obligations—change dramatically. In order to fully appreciate the effect a bankruptcy filing may have on a landlord or a tenant, several core concepts must first be understood.

1. The Bankruptcy Estate

Upon filing a bankruptcy petition, a body of assets known as the bankruptcy estate (the “Estate”) is created.\(^2\) The Estate is broadly defined and includes “all legal and equitable interests of the debtor in property as of the commencement of the case.”\(^3\) As further discussed below, landlords should be aware that property of the Estate may include funds used to pay rent, security deposits, and rights created by the lease itself. The Code seeks to protect Estate assets to further the general purpose of the bankruptcy process: Achieving a fair and equitable distribution of the debtor’s assets to all of the debtor’s creditors. Consequently, numerous sections of the Code work in conjunction to protect the Estate for this distribution.

\(^3\) 11 U.S.C. § 541(a)(1).
2. The Automatic Stay

As with the Estate, the automatic stay (the “Stay”) springs into effect the instant a new bankruptcy case commences.\(^4\) Specifically, the Stay protects the debtor by prohibiting “any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate.”\(^5\) Additionally, the Stay prevents a creditor, including a landlord, from taking any action to “collect, assess or recover a claim against the debtor that arose before the commencement of the case.”\(^6\) Practically speaking, the Stay prevents a landlord from commencing eviction actions, continuing an unfinished eviction action, or attempting to collect past due rent.

Although certain exceptions to the Stay exist and relief from the Stay may be sought (both possibilities are discussed in more detail below), most tenant-debtor bankruptcies require strict landlord adherence to Stay protections. In fact, these protections have been interpreted broadly,\(^7\) making even the most casual of collection attempts a potential violation. For example, the simple act of phoning the debtor to ask for a past-due rent payment or leaving a rent reminder note, may violate the Stay. As a result, a landlord should proceed with caution once a tenant files a bankruptcy petition.

3. Preferences

To further protect and enlarge the Estate, a trustee or debtor in possession\(^8\) may avoid certain preferential transfers made by the debtor to a creditor prior to the petition

\(^8\) A debtor in a Chapter 11 reorganization case is called a debtor in possession (“DIP’’). A DIP has the same authority and powers given a trustee under the Code. For purposes of simplicity, both a DIP and a trustee will be referred to as a “debtor.”
date.\textsuperscript{9} If successfully avoided, the assets or funds related to the transaction may then be recovered for the benefit of the Estate. Preferential avoidance actions serve to prevent debtors from hand selecting their “favorite” creditor and providing it full satisfaction of its debt, while other creditors go without.

To successfully avoid a transfer, the debtor must demonstrate (among other things) that the transfer was on account of an antecedent debt and occurred on or within 90 days before the commencement of the case.\textsuperscript{10} For landlords, this means that they risk losing rents collected within the 90-day period leading up to a tenant bankruptcy filing.

Fortunately, the Code provides an exception applicable to most landlords. If the payments were made in the ordinary course of business (i.e. at the same time each month for the last six months) a debtor may not avoid the transfer.\textsuperscript{11} However, if a tenant-debtor cures a major default (multiple months’ worth of rent) with a lump sum payment shortly before filing its petition, a strong argument may exist that the payment constitutes a preferential transfer.

The Code also provides that the debtor may not avoid the transfer if the landlord provided the debtor with “new value.”\textsuperscript{12} In the leasing context, a landlord can be found to have provided new value after each lease payment was made by permitting the debtor to remain in possession of the leased property.\textsuperscript{13}

\textsuperscript{9} 11 U.S.C. § 547(b).
\textsuperscript{10} 11 U.S.C. § 547(b)(1)-(4). Please note that additional factors must be demonstrated, including that the debtor was insolvent at the time of the transfer (which is assumed if within 90 days of the filing), the transfer was made for the benefit of the creditor, and the transfer allowed the creditor to receive more than it would have under normal bankruptcy conditions.
\textsuperscript{11} 11 U.S.C. § 547(c)(2).
\textsuperscript{12} 11 U.S.C. § 547(c)(1), (4).
\textsuperscript{13} See Southern Technical College, Inc. v. Hood, 89 F.3d 1381, 1384-85 (8th Cir. 1996) (“Each month, a lessee receives new value from its lessor when it continues to use and occupy the rented premises”); In re General Time Corp., 328 B.R. 243, 247 (Bankr. N.D. Ga. 2005) (“payment of current rent is premised upon current consideration and is therefore an exchange of “new value” between the parties”); Brown v. Morton
Finally, there is no cause of action for preferential payments on an assumed lease (see below for discussion on assumption or rejection of leases).

4. Contractual Language

Commonly, rental agreements contain clauses that terminate or modify the lease in the event that the lessee becomes insolvent or files a bankruptcy petition. Although landlords usually insist on such language, the Code deems these provisions unenforceable, with specific, limited exceptions. Additionally, leases often contain provisions limiting or prohibiting assignment of the lease. Again, the Code trumps these provisions by granting a debtor the authority to assign a lease “notwithstanding a provision in . . . [the lease], or in applicable law, that prohibits, restricts, or conditions the assignment of . . . [the lease].” Consequently, landlords need to consider other options to protect themselves from tenant insolvency (i.e. requiring a larger security deposit, more thorough screening process, credit checks, etc.).

B. Rejecting, Assuming, Assigning and Relief from Stay

Subject to court approval, a debtor may reject, assume, or assume and assign an unexpired lease of the debtor. A court will generally approve the rejection of a lease “except upon a finding of bad faith or gross negligence of the [debtor’s] business

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(\textit{In re Workboats}, 201 B.R. 563 (Bankr. W.D. Wash. 1996) (holding that debtor's continued occupancy of building despite delinquency of rent payments constituted “new value” extended by the landlord).  
14 \textit{See In re IT Group, Inc.}, 331 B.R. 597, 601 (Bankr. D. Del. 2005) (assumption of a contract bars a preference claim by a debtor for payments made during the preference period) (citing \textit{Kimmelman v. Port Authority of New York and New Jersey (In re Kiwi International Air Lines, Inc.)}, 344 F.3d 311, 317-319 (3\textsuperscript{rd} Cir. 2003)).  
17 11 U.S.C. § 365(f)(1). Please note that the specific procedure involved in rejecting, assuming, or assuming and assigning a lease will be discussed in more detail below.  
Importantly, the authority to assume or reject an unexpired lease applies equally to tenant-debtors, as well as landlord-debtors. As each of these elections (rejection, assumption, and assignment) present different issues and concerns, they are discussed separately below.

1. **Rejecting a Lease**

   The Code requires certain time limits for the rejection of a lease of real property. The amount of time afforded to the debtor to make a decision depends on the type of case filed. In a Chapter 7 case involving residential real property, the debtor must reject the lease within 60 days of filing or rejection occurs automatically.\(^{20}\) Under all other Chapters, there are no fixed time restrictions for the debtor to reject a lease on residential real property.\(^{21}\) However, the decision to reject or assume must come before the confirmation of the plan.\(^{22}\) If a debtor ignores these timelines or delays making a choice, a landlord may seek an order from the court compelling rejection or assumption.\(^{23}\)

   There are additional protections for commercial landlords. Instead of an initial 60-day rejection period with unlimited extensions for cause, a commercial tenant debtor has only a 120-day initial rejection period with the possibility of obtaining one 90-day extension.\(^{24}\) As a result, the absolute maximum a commercial property lessee may delay its choice to assume or reject an unexpired lease is 210 days. After the 210-day period,

\(^{19}\) Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc. 756 F.2d 1043, 1047 (4th Cir. 1985); Orion Pictures Corp. v. Showtime Networks, Inc. (In re Orion Pictures Corp.), 4 F.3d 1095 (2d Cir. 1993).


\(^{22}\) Id.

\(^{23}\) Id.

rejection occurs automatically unless the lessor provides prior written consent for an extension. 25

Usually, a tenant will default on its obligations to a landlord prior to filing a bankruptcy petition. When this happens, the landlord has a claim as a general unsecured creditor for the unpaid pre-petition rent. 26

Additionally, the rejection of a lease is treated as a breach of the lease as of the petition date, entitling the landlord to damages for future rent and other lease obligations arising as a result of the rejection. 27 However, the claim for future damages is limited. 28 This limitation is generally known as the “Landlord’s Cap” because it caps the amount the landlord may claim as a result of the debtor’s rejection of the lease, and serves to compensate the landlord while preventing his damage claim from becoming so large that it prevents other unsecured creditors from recovering from the debtor’s estate.

Application of the Landlord’s Cap, however, is not particularly straightforward. First, the landlord must determine the gross amount owed under the lease. After that has been determined, the cap must be applied. The claim is then limited to the lesser of (a) 15 percent of the remaining gross rent and (b) three years’ rent, unless the 15% amount is less than one year’s rent, in which case the claim is limited to one year’s rent. A split of authority has arisen, however, as to whether one takes 15% of rent remaining under the lease, or 15% of the time remaining on the lease. The majority of courts favor the “rent

28 Id.
remaining” approach, however, Ninth Circuit courts have utilized the “time remaining” approach.\(^{29}\)

Tort claims for damage to the property, which may be compensable under the lease, are not generally subject to this cap in the Ninth Circuit, although claims for routine maintenance may potentially still be subject to the cap.\(^{30}\) This Section also presumes that the landlord has damages resulting from the rejection of the lease. If the landlord re-lets the premises at a higher rent, there may not be an allowable Section 502(a) claim.

Thus, when a defaulting lessee files bankruptcy and rejects a landlord’s lease, the landlord may assert a general unsecured claim for the outstanding pre-petition rent owed (which are not capped), as well as the damages described above (which are capped pursuant to 11 U.S.C. § 502(b)(6)). Additionally, in cases involving nonresidential real property, a tenant-debtor has the duty—beginning post petition—to satisfy all of the lease terms,\(^{31}\) including the payment of rent.\(^{32}\) If the debtor fails to pay post-petition rent, a landlord may pursue an administrative claim if it can be demonstrated that the Estate benefited from the use of the leased property.\(^{33}\) Generally, a debtor who continues to occupy the leased space, benefits from that use for purposes of 11 U.S.C. § 503(b). The landlord, however, only gets an administrative claim for the value of the benefit provided, which may or may not equate to the amount of rent due under the lease. In the Ninth

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\(^{29}\) See In re Connectix Corp., 372 B.R. 488, 491-93 (Bankr.N.D.Cal. 2007) (discussing the split and adopting the “time remaining” approach).

\(^{30}\) See Saddleback Valley Community Church v. El Toro Materials Co. (In re El Toro Materials Co., Inc.), 504 F.3d 978 (9th Cir. 2007) (recovery against debtor for waste, nuisance, and trespass arising from failure to remove mining debris was not limited by statutory cap), which only partially overturned a prior Ninth Circuit BAP decision, Kuske v. McSheridan (In re McSheridan), 184 B.R. 91 (9th Cir. BAP 1995).

\(^{31}\) Except the obligations listed in 11 U.S.C. § 365(b)(2).


Circuit, the claim is generally the amount provided in the lease, regardless of actual value to bankruptcy estate.\textsuperscript{34} Administrative claims have higher “priority” then general unsecured claims and must be paid in full as part of the plan of reorganization.

Like a tenant-debtor, a landlord-debtor may also reject or assume a lease.\textsuperscript{35} Once a landlord-debtor rejects a lease, its duties and obligations under the lease are discharged.\textsuperscript{36} However, unlike the landlord of a rejected lease, the tenant of a rejected lease maintains substantial rights under the Code. The tenant of a landlord rejected lease may treat the lease as terminated and abandon the premises or it may continue in occupancy and retain all its rights under the lease not associated with the landlords performance.\textsuperscript{37} Although the tenant must continue paying rent, “the value of any damage caused by the non-performance after the date of such rejection, of any obligation of the [landlord] under the lease”\textsuperscript{38} may be offset against rent payments. In some cases, a tenant may end up paying very little rent or nothing at all. In addition, a tenant maintains the right to extend or renew the lease in accordance with applicable provisions contained in the original agreement (assuming such provisions remain enforceable under non-bankruptcy law).\textsuperscript{39}

\textbf{2. Assuming a Lease}

In order to assume an unexpired lease, a debtor must cure all defaults or provide adequate assurance that the defaults will be “promptly cured.”\textsuperscript{40} Since the Code fails to define “promptly cured,” evaluating promptness falls to the courts. In evaluating

\textsuperscript{34} See, In re Cukierman, 265 F.3d 846 (9th Cir. 2001)
\textsuperscript{35} 11 U.S.C. § 365(h).
\textsuperscript{40} 11 U.S.C. § 365(b)(1)(A).
“promptness,” courts look to the facts and circumstances of each case.\textsuperscript{41} Specifically, courts consider factors including, “the debtor’s past financial performance, any inequitable conduct engaged in by the non-debtor party, and the remaining term of a lease or relationship between the parties.”\textsuperscript{42} Although the Code requires the cure of most monetary defaults, a default resulting from the breach of an insolvency or bankruptcy clause need not be cured before assumption.\textsuperscript{43}. In order to cure the default, all unpaid amounts due under the lease must be paid, which may include obligations for taxes, insurance, CAM, utilities, repairs, clean-up costs, late charges, interest and other monetary obligations due under the lease.\textsuperscript{44} The cure amount may also include the landlord’s attorneys’ fees, if such fees are provided for under the lease.\textsuperscript{45}

Finally, in order to assume a lease, the debtor must also provide adequate assurance of future performance under the lease.\textsuperscript{46} In other words, the debtor must demonstrate that it will be able to continue making payments due under the lease going forward. If the debtor demonstrates the above criteria to the court’s satisfaction, the debtor may assume an unexpired lease. Once assumed, the lease returns to its pre-petition form with full legal force and effect. However, if the debtor assumes an unexpired lease, it must do so as an “all or nothing” transaction. The debtor cannot

\textsuperscript{41} \textit{In re Uniq Shoes Corp.}, 316 B.R. 748, 751 (Bankr. S.D. Fla. 2004).
\textsuperscript{42} \textit{Id.} at 751-52.
\textsuperscript{43} 11 U.S.C. § 365(b)(2)(A)-(D). As discussed \textit{supra}, these clauses are not enforced, thus requiring no cure.
\textsuperscript{46} 11 U.S.C. § 365(b)(1)(C).
remove or add contract provisions piece-meal (unless pre-approved by the non-debtor party).

Note, that if a contract is assumed, any liability incurred thereafter is an expense of administration.\textsuperscript{47} This is important because unlike pre-petition unsecured claims (e.g. damages for breach), post-petition administrative expenses of the estate must be paid in full in order for the debtor to confirm a Chapter 11 plan.

\section*{3. Assigning a Lease}

Once assumed, an unexpired lease may be assigned to a third party\textsuperscript{48} without the consent of the Landlord.\textsuperscript{49} Nevertheless, the third party assignee must provide adequate assurance of future performance under the lease, whether or not there has been a default.\textsuperscript{50} As discussed above, courts disregard anti-assignment clauses that prohibit or restrict assignment of the lease, in whole or in part.\textsuperscript{51}

Generally, assuming and assigning leases only occurs in specific circumstances where the Estate will gain a benefit. For instance, a debtor may seek to increase Estate assets by selling leases that contain rental rate provisions under current market-value. In addition, assumption and assignment may occur as part of the sale of a business as a going concern (whether as part of the plan for reorganization or a liquidation) with the buyer assuming the contracts and leases necessary for continued operation of the business. Most often it occurs in Chapter 11 cases in connection with a 363 sale of all of the debtor’s assets.

\textsuperscript{47} See Nostas Assocs v. Costich (In re Klein Sleep Prods., Inc.), 78 F.3d 18, 30 (2d Cir. 1996).
\textsuperscript{49} Cf 11 U.S.C. § 365(b)(3), (f) discussed infra.
\textsuperscript{50} Id.
4. Relief from Stay

Regardless of the rules governing rejection, assumption, and assignment of leases, a landlord may always move for relief from the Stay by motion to the bankruptcy court.\textsuperscript{52} If the court grants the landlord relief from the stay, the landlord can enforce all of its state law rights and remedies, including eviction. The grounds for relief include, (1) “for cause, including lack of adequate protection”\textsuperscript{53} and (2) lack of debtor’s equity in a property “not necessary to an effective reorganization”.\textsuperscript{54}

Commonly, landlords argue that a debtor’s failure to make rent payments after filing bankruptcy constitutes cause. In conjunction with this argument, landlords may also contend that a tenant’s failure to pay rent during bankruptcy leaves their property inadequately protected. At a minimum, this two prong argument usually compels a tenant to make rent payments, even if the Stay remains intact.

Additionally, most lease agreements do not provide a tenant with any real equity in the leased property. As a result, in Chapter 7 cases—where no reorganization is contemplated—landlords will often prevail on motions to lift the Stay.\textsuperscript{55} Nevertheless, even if the debtor seeks reorganization under Chapter 11 or 13, if the property in question is used as the debtor’s residence, a strong argument exists that the property is “not necessary to an effective reorganization.”

\textsuperscript{52} 11 U.S.C. § 362(d).
\textsuperscript{53} 11 U.S.C. § 362(d)(1).
\textsuperscript{55} Id. As discussed supra, if a landlord can demonstrate that the debtor has no equity in the property and that the property is not necessary to an effective reorganization, then relief from the Stay will be granted.
The Code also provides a strict timeline that courts must follow when ruling on relief from Stay motions. The stay automatically lifts 30 days after the motion is filed, unless the court, after notice and a preliminary hearing, orders that the stay be continued pending a final hearing to take place 30 days after that preliminary hearing, unless the parties agree otherwise or the court finds “compelling circumstances” that justify keeping the stay in place longer.\footnote{11 U.S.C. § 362(e)(1).} In cases where the debtor is an individual, the stay automatically lifts 60 days after the motion is filed, unless a final decision is rendered by the court during the 60-day period, or the 60-day period is extended by agreement of the parties or upon a finding of “good cause” by the court.\footnote{11 U.S.C. § 362(e)(2).}

C. **Considerations for Commercial Leases**\footnote{Some concepts discussed in this section may be applicable to leases outside of the commercial real estate context. However, because these issues often arise in a commercial setting, they are discussed here.}

1. **Sections 362(b)(10) & 541(b)(2)**

Although the Stay generally protects debtors from attempts by a landlord to obtain possession of a leased property, Code section 362(b)(10) provides an exception where a landlord may take action against the debtor “under a lease of nonresidential real property that has terminated by the expiration of the stated term of the lease before the commencement of or during a case under [the Code] to obtain possession of such property.”\footnote{11 U.S.C. § 362(b)(10).} In other words, a commercial landlord may take possession of a commercial property leased by the debtor if the term of the lease naturally expired before the filing date or later expires during the case. A landlord is further protected by Code section 541(b)(2) which specifically excludes such leases from property of the Estate.\footnote{11 U.S.C. § 541(b) states in part “Property of the estate does not include— . . . (2) any interest of the debtor as a lessee under a lease of nonresidential real property that has terminated at the expiration of the stated term of such lease before the commencement of the case under this title, and ceases to include any...}
Together, these sections provide a commercial landlord with valuable eviction powers unavailable in other circumstances.

2. **Shopping Center Leases**

   The Code provides additional protections for landlords leasing commercial “shopping centers.” Although the Code does not define a shopping center, at least one court has concluded that a shopping center likely exists when “a combination of leases [are] held by a single landlord, leased to commercial retail distributors of goods, with the presence of a common parking area.”

   Since shopping centers require a unique blend of tenants intended to cover a broad range of the retail spectrum, these leases usually contain tenant mix provisions, as well as use and exclusivity restrictions. Unlike other lease clauses that the Code disregards, section 365(b)(3) specifically protects a landlord from an assumption or assignment that will “disrupt any tenant mix or balance in such shopping center.” Additionally, 365(b)(3) allows a landlord to enforce lease restrictions relating to use, exclusivity, and radius.

   Moreover, shopping center landlords receive a heightened standard for adequate assurance of future performance. For example, shopping center landlords can require that the financial condition and operating performance of the remaining tenant (whether a third party assignee or the debtor itself) meet the level of the debtor “as of the time the interest of the debtor as a lessee under a lease of nonresidential real property that has terminated at the expiration of the stated term of such lease during the case.”

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62 *In re Ames Dep’t Stores, Inc.*, 348 B.R. 91 (Bankr. S.D.N.Y. 2006); *see also In re Joshua Slocum Ltd.*, 922 F.2d 1081 (3d Cir. 1990) (buildings constituted shopping center where they were contiguous, stores shared and provided support for maintenance of common areas, and common parking lot available); *but see Matter of Goldblatt Bros., Inc.*, 766 F.2d 1136 (7th Cir. 1985) (debtor not tenant in shopping center absent evidence that the eight stores were developed to be a shopping center and absent typical indicia of shopping centers such as master lease, fixed hours, and common areas or joint advertising).
debtor became the lessee under the lease.”65 Beyond this, the lessee must also demonstrate that the percentage of rent due under the lease “will not decline substantially” once assumed or assigned.66 Consequently, “shopping center” landlords have greater control and bargaining power in the bankruptcy process than other common commercial landlords.

3. **Sales Free and Clear of Encumbrances**

Although section 365(h) allows a tenant to remain in possession of a leased property post-rejection by the landlord, a tenant may still lose its possessory rights after a sale under section 363(f). Section 363(f) allows a debtor to sell Estate property free and clear of any encumbrances under certain circumstances.67 When a landlord sells a tenant occupied property pursuant to this power, these competing rights collide. Currently, courts are divided as to the effect of a 363(f) sale and its impact on a tenant’s right to remain in possession. Some courts have determined that 363(f) extinguishes all liens and encumbrances, including those rights provided by 365(h).68 Other courts have concluded that the rights provided tenants under 365(h) cannot be extinguished by a 363(f) sale.69 Currently, the issue remains unsettled in the Ninth Circuit. As a result, a tenant that

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67 11 U.S.C. § 363(f) states:
The trustee may sell property under subsection (b) or (c) of this section free and clear of any interest in such property of an entity other than the estate, only if—
   (1) applicable nonbankruptcy law permits sale of such property free and clear of such interest;
   (2) such entity consents;
   (3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property;
   (4) such interest is in bona fide dispute; or
   (5) such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.
68 See *Precision Industries, Inc. V. Qualitech Steel SBQ, LLC*, 327 F.3d 537 (7th Cir. 2003); *In re Hill*, 307 B.R. 821 (Bankr. W.D. Pa. 2004).
remains in possession post-rejection should carefully weigh the benefit of maintaining its leasehold versus the risk of a potential sale under section 363(f). Either way, it is clear that the rights provided to the tenant of a rejected lease under 365(h) may not be absolute.

4. Security Deposits

As discussed above, landlords receive a general unsecured claim for past due rent, as well as damages incurred as a result of rejection. However, in bankruptcy, having a claim is much different than being paid on a claim. To properly protect their interests, many commercial landlords require security deposits before leasing. Under bankruptcy law, a landlord acquires a secured claim to the extent of the tenant’s security deposit.\(^\text{70}\) In the Ninth Circuit and most other courts, however, in calculating a landlord’s allowable claim for lease rejection damages, the security deposit must be deducted from the landlord’s Section 502(b)(6) capped damages, and not from its gross damages, regardless of whether the deposit was a cash deposit or a letter of credit posited by a third-party bank.\(^\text{71}\)

Although security deposits provide obvious benefits to the landlord, several issues may affect or limit these benefits. First, upon filing a petition, the debtor receives protection from creditors through the Stay. The Stay specifically forbids a creditor, including a landlord, from exercising the right of set-off against the debtor without consent of the court.\(^\text{72}\) In other words, although a landlord remains a secured creditor to the extent of its security deposit, a landlord must seek relief from the Stay before applying security deposit funds to outstanding debts. Second, if the amount of the security deposit exceeds the current or potential claim amount held by the landlord, the

\(^{70}\) See e.g., *In re Shane Co.*, --- B.R. ----, 2012 WL 12700, *7* (Bankr.D.Colo. Jan. 4, 2012) ("Furthermore, this treatment of security deposits is consistent with the security deposit’s traditional function. A landlord is a secured creditor to the extent of any security deposit it holds. As a secured or partially secured creditor, the landlord must satisfy its claim against the lessee out of the security it holds before asserting a claim against the lessee's general assets") (quoting, *In re Atlantic Container Corp.*, 133 B.R. 980, 989-90 (Bankr.N.D.Ill. 1991)).

\(^{71}\) *AMB Property, L.P. v. Official Creditors for the Estate of AB Liquidating Corp. (In re AB Liquidating Corp.),* 416 F.3d 961 (9th Cir. 2005).

debtor may seek “turnover” of the additional assets for the benefit of the Estate.\textsuperscript{73} Fortunately, if required to return a security deposit, a landlord need only return the amount in excess of its allowable claims.

D. Residential Tenants and the Stay

There are several avenues of relief for residential real property landlords facing a tenant-debtor bankruptcy commonly known as the “eviction exceptions.”

1. Judgment of Possession

The “judgment exception” allows a landlord to continue eviction proceedings post-petition, so long as the landlord obtained a judgment for possession before the filing of the debtor’s bankruptcy.\textsuperscript{74} Unlike relief from the Stay that must be sought from the court, this exception makes the Stay inapplicable. Thus, a landlord may continue eviction proceedings as if the bankruptcy had not been filed.

However, despite this exception, the Code still provides the debtor a 30-day period during which the default may be cured.\textsuperscript{75} To take advantage of this 30-day period, the debtor must file a certification simultaneously with its petition (that must also be served on the landlord) verifying: (1) that non-bankruptcy law allows for a cure of the entire monetary default and (2) that the debtor has deposited with the clerk of the court any rent that would become due within the first 30 days after the filing date.\textsuperscript{76} During this 30-day period, if the debtor cures the entire default amount of the judgment for possession, the exception will not apply and the Stay will continue.\textsuperscript{77}

2. Endangering the Property/Controlled Substances

The “endangerment exception” allows a landlord to continue an eviction action commenced before the bankruptcy case if the eviction action is based on the tenant’s

\textsuperscript{73} 11 U.S.C. § 542(a).
\textsuperscript{74} 11 U.S.C. § 362(b)(22).
\textsuperscript{75} 11 U.S.C. § 362(l)(1)&(2).
endangerment of the property or use of controlled substances on the property.\(^{78}\) This exception also allows the landlord to commence a new eviction action if the debtor has endangered the property, illegally used controlled substances on the property, or permitted others to use controlled substances on the property within 30 days of the filing date.\(^ {79}\)

To take advantage of either of these options, a landlord must certify to the court under penalty of perjury that an applicable eviction action was previously commenced or that such endangerment did occur.\(^ {80}\) If the debtor does not object, the landlord may proceed with the eviction 15 days after filing the certification.\(^ {81}\) However, if the debtor objects, it may do so by questioning the truth or legal sufficiency of the landlord’s certification.\(^ {82}\) Within 10 days of filing an objection, the court must hold a hearing to determine whether or not the landlord may proceed with the eviction action.\(^ {83}\)

F. **Putting the Knowledge to Use**

The bankruptcy process moves quickly, forging ahead regardless of any one creditor’s participation (or non-participation). Although debtors receive many benefits and protections once they enter the bankruptcy process, these protections are not absolute. Nevertheless, most creditors do not avail themselves of the rights and protections provided by the Code simply because they fail to participate in the process. Alternatively, active participants usually receive the best treatment. With this motto in mind, landlord/tenant creditors should remember the following rules when faced with a bankruptcy filing:

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\(^{79}\) Id.
\(^{80}\) Id.
\(^{81}\) Id.
\(^{82}\) 11 U.S.C. § 362(m)(1).
1. **The rules have changed.** The Code disregards many non-bankruptcy rights and remedies, including certain provisions contained in the lease itself.

2. **Don’t violate the Stay.** The Stay prohibits almost all debt collection acts and eviction actions immediately upon the filing of a bankruptcy petition (with certain exceptions explained above).

3. **Know your rights.** Relief from the Stay may be sought in a variety of circumstances depending on the Chapter of bankruptcy filed and the type of property involved (residential vs. commercial).

4. **Preserve your claims.** Landlords of tenant-debtors are entitled to a general unsecured claim for outstanding pre-petition rent, damages if the lease is rejected, and potential administrative expenses post-petition. Be aware of any bar-dates the court may set for filing a proof of claim.

5. **Monitor the dates.** A strict timeline exists in which a debtor must reject, assume or assign an unexpired lease. Be aware of timeline differences based on the property involved (residential versus commercial property).

6. **Consult an expert.** If in doubt, contact an experienced bankruptcy attorney to determine what rights you have and whether or not these rights are worth pursuing.
Author Biography

Dawn Cica is a partner in Lewis and Roca LLP’s Bankruptcy Practice Group in Las Vegas. She has over 20 years of experience in all aspects of transactional work, including financing transactions, gaming transactions, real estate transactions and all transactional matters related to restructuring and bankruptcy, including negotiating and documenting strategic resolutions, cash collateral matters, debtor in possession financings and asset sales. Ms. Cica has been involved in the bankruptcies of major Nevada resort properties, including Station Casinos, the Aladdin Resort, Riviera and Resort at Summerlin. She works with the Lewis and Roca's Gaming Practice Group in relation to gaming transactions, including lending, leasing, management agreements, acquisitions and sales and casino related restructuring matters.