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COMMERCIAL REAL ESTATE LEASES IN BANKRUPTCY: WHAT TO EXPECT WHEN YOUR TENANT FILES FOR CHAPTER 11

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With widespread disruption from the COVID-19 crisis to retail stores, salons, restaurants, bars and other businesses that lease space for operations, it is expected that more and more business owners will seek bankruptcy relief through Chapter 11. Commercial landlords should be aware of the impact that a Chapter 11 filing has on their rights under a lease and their ability to exercise remedies, as well as bankruptcy provisions that uniquely impact landlords. Landlords should be mindful that:

- When a Chapter 11 petition is filed, the automatic stay generally prevents the landlord from starting or continuing any action to collect delinquent rent, terminate the lease, or evict the tenant.
- Where a lease was terminated prior to bankruptcy, the landlord may continue actions to regain possession of the leased premises without obtaining relief from stay, but should proceed cautiously with respect to tenant property left at the location and other actions to be sure they are not violating the automatic stay.
- Lease provisions providing for a default or termination due to the bankruptcy or insolvency of the tenant are not enforceable.
- The tenant is obligated to perform all obligations under the lease that arise after the bankruptcy filing, but not those that arose before the bankruptcy filing. In some instances, the bankruptcy court may permit the tenant to defer lease obligations for the first 60 days of the bankruptcy case. These deferred lease obligations are entitled to priority treatment as administrative expense claims and must be paid in full promptly through a plan of reorganization.
- Tenants must decide within 120 days of the filing whether or not to assume or reject the lease. The court may extend this deadline by up to 90 days. All further extensions of the deadline require the landlord's consent. Leases that are not otherwise assumed or rejected by the statutory deadline are automatically rejected.
- Where a lease is rejected, the landlord is entitled to file a claim for damages for the tenant's termination of the lease. Rejection damages include rent (which is capped at the greater of 1 year or 15% of the remaining rent due under the lease, up to a maximum of 3 years' rent), as well as removal costs, cleanup costs, compensation for any damage to the premises, and other amounts owed under the lease.
- All real estate leases (including those that are in default) may be assumed by the tenant in bankruptcy and, where appropriate, assigned to third parties. To assume (and assign) a lease, the tenant must cure all existing defaults (even prepetition defaults) and provide the landlord with adequate assurance that the tenant will be able to perform under the lease. In some instances, such adequate assurance may require an additional security deposit to protect the landlord's interests.



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- Security deposits are considered property of the bankruptcy estate and cannot be accessed by the landlord to offset rent or other obligations without court approval.
- The landlord and tenant also have the option to modify an existing lease or enter into a new lease during the bankruptcy to resolve claims between them.

To ensure that their interests are properly protected during a tenant bankruptcy, commercial landlords are encouraged to seek legal counsel to navigate these issues. When negotiating new leases or lease renewals in these uncertain times, commercial landlords should consider asking for larger security deposits, third party guarantees, or letters of credit to provide additional security should a tenant file for bankruptcy.

For further information about protecting your interests when a tenant files for bankruptcy, please contact Jennifer L. Maleski, [Anne M. Aaronson](#), [Yonit A. Caplow](#), or any of the attorneys in our [Bankruptcy Group](#).