

Bankruptcy Destroyed My Perfect (Landlord-Tenant) Relationship!

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Love, Relationships, and THE LAW.

February brings us Valentine's Day, and we bring you a tale as old as time.

Two people meet, maybe online, maybe at a Chamber of Commerce mixer, maybe over lunch arranged by a broker. They hit it off and commit to a long-term relationship promising mutual benefits and opportunities. They are so smitten with what the other has to offer that

they bind themselves to an arrangement where they will share in obligations under one roof. Did fate, destiny, the stars, or a market analysis and business plan bring them together? We speak, of course, about landlord-tenant relationships.

A sophisticated landlord can set itself up for success by negotiating clear provisions in a commercial lease -- i.e., the lease term, renewal rights, repair, maintenance, operating costs allocated to the landlord or tenant, rights surrounding alterations, subleases, parking and dock door usage, security deposits, reconstruction if a casualty loss occurs, even Force Majeure. The list goes on. After the parties sign the lease, the starry-eyed landlord may believe this is a match made in heaven and nothing could possibly go wrong.

And then the tenant files bankruptcy and the landlord exclaims: "How could he? I thought everything was perfect. How could I be so naïve?" Jilted and betrayed, the landlord wants revenge -- or at least the right to declare an event of default and exercise the default remedies under the lease. Unfortunately for the landlord, the Bankruptcy Code can feel like salt in the wound and landlords must show restraint and comply with the Code or they will make a bad situation worse.

When a tenant files bankruptcy, the "automatic stay" prohibits further collection activity to give the debtor breathing room to reorganize his affairs. That means a landlord can't evict the tenant or demand rent and penalties and damages under the lease. If a landlord willfully violates the stay, it can be held liable for actual and punitive damages, and attorneys' fees. Even an inadvertent stay violation can be considered "willful," so landlords must exercise maximum caution and prudence. Don't engage in the equivalent of yelling "get out and stay out" and throwing the tenant's clothes out the window onto the front lawn.

This warning extends to security deposits. Do not set off a security deposit against rent obligations without court approval. As a general rule, security deposits are property of the debtor's bankruptcy estate.

Landlords should not feel completely despondent. Filing bankruptcy does not give a tenant the automatic right to stop paying rent. In a traditional Chapter 11, the debtor must "assume or reject" its unexpired

leases. There are conditions. First, assumption or rejection is subject to court approval. Second, the debtor must decide within 120 days of filing bankruptcy or the date of an order confirming a plan of reorganization – whichever is earlier. The debtor may get a 90-day extension if he can show good cause to do so, but any further extensions are subject to court approval and the landlord's written consent. Third, to assume a lease, the debtor must cure all defaults. So if the lease is three months past due, the tenant must bring it current as a condition of assumption. Finally, before assuming or rejecting a lease, the debtor must "timely perform" all its other obligations under the lease.

If your tenant files bankruptcy and, after a few months, rejects the lease, then the landlord has an administrative claim for post-petition unpaid rent – a consolation prize redeemed at the end of the case if the debtor confirms a reorganization plan. If the tenant was behind on rent before bankruptcy, then the landlord can file a general unsecured claim for those damages. The Bankruptcy Code also allows a claim for damages under a rejected lease, but caps them at the greater of rent for one year or 15% of the remaining term (not to exceed three years).

Break-ups are messy and complicated, and so is the Bankruptcy Code. This article touches on a few issues in a traditional Chapter 11. But your tenant could file a Subchapter V case, which moves at lightning speed and has different rules from Chapter 11. Or he could file Chapter 7, in which case you will be dealing with a Trustee and not your tenant. If your tenant files bankruptcy, immediately consult counsel to advise you and protect your interests.

And finally, if your tenant leaves you for bankruptcy and you are angry and don't know what to do, we get it. We've been there. No one likes being rejected. But our advice is: "Don't dwell on it. Move on! There are plenty of fish in the sea ready to sign a triple-net lease for your class-A office space."

This is a part of our February series: "Love, Relationships, and the Law." For more insights, click here.

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