

Pre-Bankruptcy Considerations for Commercial Landlords

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The following is the first in what will be a series of posts addressed to commercial landlords regarding bankruptcy.

As many landlords are learning, unexpected circumstances can cause a good tenant to become a non-performing tenant almost instantly. Landlords will likely be more conservative in their dealings in order to protect themselves from unexpected bankruptcies. The following commentary addresses several ways that a landlord may seek to protect themselves from such financial distress and resulting bankruptcy cases.

There are four main approaches for a landlord to protect at least a portion of their recovery rights in a bankruptcy case.

- First, there is a **cash security deposit**. This is the most liquid way to protect against a default. The drawback to a cash security deposit is that it technically remains a part of the bankruptcy estate until the landlord files a motion for relief from the automatic stay to cash it, or the case is over. The advantage in the bankruptcy case is the security deposit provides for a secured claim that should be paid in full in the amount of the deposit.
- Second, a **line of credit** may be a good option. As a general rule, the exercise of a line of credit is not stayed by the automatic stay in a bankruptcy case because it is the independent obligation of the issuer of the letter of credit. This type of security is more complicated than a security deposit and the landlord should structure the line of credit to avoid any approvals required by the debtor to exercise the letter of credit. Some bankruptcy courts also consider other factors with respect to the appropriate exercise of a line of credit. While the letter of credit can provide excellent protection, especially in larger transactions, it does require more scrutiny and attention than a cash security deposit.
- Third, the **third-party guaranty** may also provide some protection. The guaranty does not provide an immediate recovery, but it does discourage the equity holder of a debtor from defaulting or causing a tenant to file bankruptcy because they may be personally liable for the unpaid rent. As a general rule, the automatic stay does not apply to third-party non-debtors and a landlord can seek relief from the guarantor. A note of caution, the guaranty should be unconditional and not require that the landlord first look to the tenant upon a default.

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- Finally, a landlord can avoid being sideswiped by an unexpected bankruptcy by including **financial disclosure requirements in the lease and monitoring a tenant's finances**. This may allow a landlord to anticipate a potential default and act accordingly. Coupling financial requirements with termination provisions may also provide some protection.

Although none of the above options offer complete protection against a defaulting tenant, they do at least provide for either some recovery or information to allow for informed decisions. These options with a little elbow grease by the landlord to find new tenants may significantly help the bottom line.

While many of these discussed concepts are treated in a similar fashion by most bankruptcy courts, there may be courts that differ. Landlords should discuss their options with legal counsel when developing their pre-bankruptcy protection strategies.

About James A. Timko

[James A. Timko](#) is a partner in the Orlando office of Shutts & Bowen, where he is a member of the Creditors' Rights/Bankruptcy Practice Group and a business litigator. James has received Martindale-Hubbell's highest rating as an attorney whose practice involves distressed assets, bankruptcy and commercial litigation. He's also a certified circuit civil mediator. James represents creditors, debtors, secured, lenders, mortgage companies, landlords, franchisors, bankruptcy trustees and other business enterprises in chapter 7 and chapter 11 bankruptcy cases and in assignment for the benefit of creditors' cases. James also has significant experience resolving general commercial disputes, including copyright disputes. He's also represented institutional lenders in connection with asset based lending transactions and real estate transactions.

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