



Stein Law, PLC Recent Developments

June 2009

Losing Ground: Landlord Bankruptcy/Foreclosure Consequences on Leases

Given the modest success rate for small businesses and startups, landlords have well-founded concerns about the viability of their commercial tenants. In today's uncertain times, with the publicized bankruptcies and foreclosures by commercial landlords, many tenants are now wondering what would happen if their landlord filed for bankruptcy or was bankrupted upon by the landlord's lender.

Foreclosure. In most cases, a landlord's foreclosing lender is not obligated to recognize a tenant's lease absent an executed Non-Disturbance and Attornment Agreement (NDA). A NDA signed by the landlord's lender ensures that a lease will continue in full force and effect after the landlord's interest is acquired by the foreclosing lender and that the tenant's right to occupy the premises will not be disturbed, usually so long as the tenant is not in default under the lease. Often times, the lenders require that the tenant agree to subordinate its interest in the premises to the lender in exchange for the NDA. A well drafted lease should address the efforts a landlord must undertake to ensure that its tenant receives a NDA from the landlord's existing lender as well as any future lenders and consequences if one is not obtained.

Bankruptcy. Special bankruptcy rules apply for commercial real estate leases. In general, when a landlord is a debtor in a bankruptcy proceeding, it cannot use the bankruptcy to evict a tenant that prefers to stay in possession of the leased premises. Section 365 of the Bankruptcy Code allows a bankrupt landlord to either assume or reject a lease. Ordinarily, landlords elect to assume the lease (especially when it generates income), in which case the lease will continue in effect. If the landlord rejects the lease, the tenant then has the right to either continue or terminate the lease. If the tenant elects to terminate the lease, it can enter a claim for damages against the landlord's bankruptcy estate, getting in line with the landlord's other creditors. If the tenant elects to continue the lease, it can remain in possession, but the landlord is released from its lease obligations. Section 363 of the Bankruptcy Code allows a bankrupt landlord to sell its assets free and clear of any interest in the properties, including leases, subject to specific conditions. Tenants, however, are allowed to request that the bankruptcy court prohibit or condition any sale to protect its interest under a lease.

A tenant concerned about the financial stability of its landlord should be proactive and take precautions to protect their rights against a landlord's bankruptcy or foreclosure, including having your existing lease reviewed by an experienced real estate attorney. We help landlords and tenants make the right strategic decision in connection with negotiating their leases and protecting their assets and ability to reach their business goals.

For more information about this topic and other *Recent Developments* impacting your business please contact Scott J. Stein at (480) 889-8948 / scott@steinlawplc.com.

Upcoming Speaking Engagements

Scott J. Stein will be speaking to the West Valley Commercial Group of the West Maricopa Regional Association of Realtors' (WEMAR) (www.wemar.org) on June 19 and discussing the impact that the Federal stimulus package is having on commercial real estate.

Scott J. Stein will be an instructor, together with Michelle Lind (AAR General Counsel), for the Arizona Association of Realtors' (www.aaronline.com) Risk Management Certification Elective Course (www.aaronline.com/documents/062609.pdf) on the subject of Short Sales, REO's and Foreclosures. The course is being held on June 26 at the Phoenix Association of Realtors (5033 N. 19th Ave., Phoenix).

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