The Bay Area Bankruptcy Forum

Beyond Assumption and Rejection: Advanced Issues in Landlord-Tenant Bankruptcies

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Post-Petition, Prior to Assumption or Rejection

I. Following the bankruptcy filing, the bankruptcy estate may either assume or reject the lease. 11 USC §365.

A. If the lease is assumed – or assumed and assigned – all defaults must be cured, and adequate assurances of future performance must be provided. 11 USC §365(b); see, page 4, *infra.*

B. If the lease is rejected, the estate must surrender possession of the premises, and the landlord may file a claim for its damages. 11 USC §365(g); see, page 7, *infra.*

II. 2005 Amendments to § 365(d)(4) limit the debtor's time to assume or reject unexpired nonresidential real property leases.

A. Lease deemed rejected if debtor does not assume or reject the lease by the earlier of (i) 120 days after the date of the order for relief (the petition date in voluntary cases), or (ii) the date of entry of the order confirming a plan (this is not the "effective date" of a confirmed plan but entry of the confirmation order). 11 U.S.C. § 365(d)(4)(A).

B. "Prior to the expiration of the 120-day period" the court may grant an extension on motion of trustee or debtor-lessor for "cause" for up to an additional 90 days. 11 U.S.C. § 365(d)(4)(B)(i).

1. The statute indicates that extensions under Section 365(d)(4)(B) must be granted by the court prior to the expiration of the initial 120-day period. In re Tubular Technologies, Inc., 348 B.R. 699 (Bkrtcy. D. S.C. 2006).

2. The Ninth Circuit has suggested that subsequent extensions are subject to looser time frames. Addressing a somewhat different issue it held that where a bankruptcy court extended a deadline in Section 365, it could thereafter further extend the deadline, even retroactively, because the deadline was now established by order rather than by statute. "Therefore, the bankruptcy court properly extended its own deadline under Rule 9006(b)" *Harkey v. Grobstein (In re Point Ctr. Fin.)*, No. 18-56398, at *19 (9th Cir. Apr. 29, 2020) (finding that once a statutory deadline has been extended, further extensions seek extensions of a court order, and are therefore subject to Rule 9006 and "excusable neglect" retroactive extensions.)

3. Further extensions beyond 210 days (120+90) may be granted "only upon the written consent of the lessor in each instance." 11 U.S.C. § 365(d)(4)(B)(ii).

C. Although questions exist whether motion to assume must be granted, or merely filed, before the expiration of the time period to assume or reject, the weight of the limited authority that exists indicates that filing a motion to assume tolls statutory deadline. See, In re R. Ring Enterprises, Inc., 2009 Bankr. LEXIS 685 (Bkrtcy. N.D. Cal. 2009) Jellen, Bankr. J.) (the *debtor* need only act within the time limitations set forth in the Bankruptcy Code, not the court), Cousins Properties, Inc. v. Treasure Isles HC, Inc. (In re Treasure Isles HC, Inc.), 462 B.R. 645, 649 (B.A.P. 6th Cir. 2011); In re Simbaki, Ltd., 520 B.R. 241, 244 (Bankr. S.D. Tex. 2014)

III. Until the debtor rejects the lease, it must honor the requirements of the lease, i.e., pay full rent at the contract rate. 11 U.S.C. §365(d)(3); *and see*, In re Pacific-Atlantic Trading Company, 27 F.3d. 401 (9th Cir. 1994).

A. Section 365(d)(3) requires that the trustee (or debtor-in-possession) "timely perform all the obligations of the debtor, except those specified in section 365(b)(2), arising from and after the order for relief, arising from and after the order for relief under any unexpired lease of nonresidential real property, until such lease is assumed or rejected, notwithstanding section 503(b)(1) …."

B. The statute expressly provides for a permissive deferral of post-petition rent to the 60th day post-petition, but not further. Section 365(d)(3) ("The court may extend, for cause, the time for performance of any such obligation that arises within 60 days after the date of the order for relief, but the time for performance shall not be extended beyond such 60-day period.")

C. Note that the "current" payment requirement applies only to leases of non-residential real property. Some other executory contracts have some payment requirements; e.g., Section 365(d)(5); Section 1110; but most others do not.

IV. "Stub rent" refers to rent and charges under the lease attributable to the post-petition portion of the first month the debtor files bankruptcy, e.g., where debtor-tenant files its petition on October 15, pro-rated rent and charges from October 15-31 have been described as stub rent. The duty to pay stub rent does not arise from the requirement that the estate "timely perform all obligations… arising [post-bankruptcy] under the lease.

A. Bankruptcy courts have applied different approaches with varying results in the determination of the amount and timing of an "obligation" which must be timely performed under Section 365(d)(3). This characterization impacts the timing and priority of payment for the "stub rent" period.

B. Performance (or billing date) approach: Lessors are entitled to lease payments under Section 365(d)(3) for any payment that becomes due under the lease after the order for relief, even if the lease payments due are attributable to periods prior to the order for relief. The performance date approach is based on a purported "plain meaning" of Section 365(d)(3). See, e.g., In re Montgomery Ward Holding Corp., 268 F.3d 205, 208-209 (3rd Cir. 2001); In re Koenig Sporting Goods, Inc.,

203 F.3d 986, 989-990 (6th Cir. 2000) (Debtor rejected lease on December 2 and, since obligation to pay rent became due December 1, debtor was liable for the full amount of December rent as an administrative priority expense under Section 365(d)(3

1. Performance date jurisdictions allow landlord to assert administrative priority claim for post-petition use and occupancy under Section 503(b).)); In re Goody's Family Clothing, Inc., 610 F.3d 812, 819 (3d Cir. 2010)). See In re Sportsman's Warehouse, Inc., 436 B.R. 308, 311 (Bankr. D. Del. 2009) (applying Section 503(b) to stub rent, "reasonable rent" is not necessarily the same as contract rent where fair market value disputed, requiring case-by-case analysis).

2. Landlords can seek "adequate protection" to ensure that there is a fund to pay their administrative priority claim for stub rent. In *Sports Authority*, Delaware Bankruptcy Judge Walrath declined to approve a DIP lending facility in a liquidating case which did not include a set-aside for $20 million of stub rent.

C. Pro-ration approach: Debtor's post-petition lease obligations are pro-rated to cover only the post-petition, pre-rejection period. See, e.g., In re Handy Andy Improvement Centers, Inc., 144 F.3d 1125, 1127-1129 (7th Cir. 1988); In re Stone Barn Manhattan, LLC, 398 B.R. 604 (Bkrtcy. S.D.N.Y. 2009) (containing extensive discussion of competing views). The pro-ration approach has been described as the rule in the "majority of courts." In re Phar-Mor, Inc., 290 B.R. 319, 323-324 (Bkrtcy. N.D. Ohio 2003).

1. While there is no definitive Ninth Circuit authority endorsing the pro-ration approach (but see dicta in In re TreeSource Industries, Inc., 363 F.3d 994 (9th Cir. 2004)), there are numerous reported examples of bankruptcy judges within the Ninth Circuit utilizing the pro-ration approach. In re National Refractories & Minerals Corp., 297 B.R. 614, 619-620 (Bkrtcy. N.D. Cal. 2003) (Tchaikovsky, Bankr. J.); In re Ernst Home Center, Inc., 209 B.R. 955, 963-964 (Bkrtcy. W.D. Wash. 1997); In re RB Furniture, Inc., 141 B.R. 706, 712 (Bkrtcy. C.D. Cal. 1992).

2. Even where pro-ration approach utilized, timing of payment issues are not clearly established. For example, Judge Huennekens' memorandum opinion in In re Circuit City Stores, Inc., 2009 Bankr. LEXIS 672 (Bkrtcy. E.D. Va.) applied the pro-ration approach under Section 365(d)(3), but found the court had discretion whether to order immediate payment, denying landlord requests for immediate payment in early stages of Chapter 11 case.

Assumption of Unexpired Leases

I. Debtor may assume a lease, within its "business judgment," subject to bankruptcy court approval.

A. The debtor bears the ultimate burden of presentation and persuasion that a lease of nonresidential real property is one subject to assumption and that all requirements for assumption have been met. In re Rachels Industries, Inc., 109 B.R. 797, 802 (Bkrtcy. W.D. Tenn. 1990); In re Memphis-Fridays Associates, 88 B.R. 830, 840-841 (Bkrtcy. W.D. Tenn. 1988).

II. Under Bankruptcy Code section 365(b)(1), if there has been a default under a lease sought to be assumed, in order to assume the lease, the debtor must:

1. cure, or provide adequate assurance of a "prompt" cure, of pre- and post-petition defaults under the lease.

2. compensate, or provide adequate assurance of prompt compensation of, all pecuniary loss resulting from pre- and post-petition defaults; and

3. provide adequate assurance of future performance.

B. Monetary defaults must be cured in order to assume a lease, but certain defaults are excluded from the defaults that must be cured:

1. defaults related to "ipso facto" provisions and penalty rates or provisions.

2. nonmonetary defaults that are impossible to cure by performing nonmonetary acts at or after time of assumption (e.g., violation of continuous operations or "go dark" provisions), except, to the extent such defaults arise from a failure to operate in accordance with the terms of the lease, such defaults must be cured by performance at the time of assumption (e.g., resumption of operations) and landlord must be compensated for any pecuniary loss resulting from the default.

C. Adequate Assurance of Future Performance.

1. The chief determinant of adequate assurance of future performance is whether rent will be paid. In re Bygaph, Inc., 56 B.R. 596, 605 (Bkrtcy. S.D.N.Y. 1986).

2. The factors bankruptcy courts have considered are whether the debtor is able to provide adequate assurance include the present status of the debtor's' obligations under the lease sought to be assumed, the remaining term of the lease, the prospects for reorganization, and what landlord can look to for sufficient adequate assurance of future performance. In re Hub of Military Circle, Inc., 19 B.R. 460, 461 (Bkrtcy. E.D. Va. 1982).

3. It has been held that the best form of adequate assurance of future performance is advance rent or a deposit. In re Hub of Military Circle, Inc., supra, 19 B.R. at 461.

4. Adequate assurances of future performance may also include "sufficient financial backing, escrow deposits or other forms of security or guaranty", In re Gold Standard at Penn, Inc., 75 B.R. 669, 674 (Bkrtcy. E.D. Pa. 1987), sound financial statements and a substantial net worth, In re Taylor Manufacturing, Inc., 6 B.R. 370, 372 (Bkrtcy. N.D. Ga. 1980), projected sales proceeds sufficient for and earmarked for payment of rent, Buchakian v. Musikahn Corp., 69 B.R. 55, 56 (E.D.N.Y. 1986), and a substantial cash reserve, a favorable market outlook and the history of prompt payment, Seacoast Products, Inc. v. Spring Valley Farms, Inc., 34 B.R. 379, 381 (M.D.N.C. 1983).

D. There are "heightened requirements" with respect to debtor's assumption (and assignment) of a lease in a "shopping center." 11 USC §356(b)(3).

1. The debtor is required to demonstrate adequate assurance:

a) of the source of rent and other consideration due under the lease.

b) that any percentage rent due under the lease will not decline substantially.

c) of compliance with all lease provisions, including those regarding radius, location, use and exclusivity, as well as compliance with such provisions in other shopping center leases, financing agreements and master agreements relating to the shopping center; and

d) of no disruption of tenant mix or balance in shopping center.

2. While there is no definition of "shopping center" in the Bankruptcy Code, it has been developed through case law. In re Joshua Slocum, Ltd., 922 F.2d 1081, 1086-1087 (3d Cir. 1990); In re Three A's Holdings, LLC, 364 B.R. 5500 (Bankr, D. Del. 2007).

III. “Terminated” Leases

A. Termination of a lease under State law may be avoidable under State law.

1. California, for example, has a “relief from forfeiture” statute, which permits relief from the termination of a lease at any time prior to the transfer of possession to the landlord. Cal. Code Civ. P,. 1179.

2. Where a bankruptcy case has been filed prior to the transfer of possession (although after acts which would terminate the lease under applicable state

law), the question is whether the estate could avail itself of the relief from forfeiture statute in order to retain, and potential assign, the lease. In re Windmill Farms, Inc., 841 F.2d 1467, 1472 (9th Cir. 1988) (The Bankruptcy Court should "determine whether the termination could have been reversed under a state anti-forfeiture provision or other applicable state law.")

B. Termination of the lease may be avoidable as a preference or a fraudulent transfer.

1. A lease termination may be avoided as a preference if it was a transfer on account of an antecedent debt made within 90 days of the bankruptcy filing (one year if the transferee was an insider). Official Committee of Unsecured Creditors of Great Lakes Quick Lube LP v. T.D. Investments I, LLP (In re Great Lakes Quick Lube LP), 816 F.3d 482, 486 (7th Cir. 2016)

2. Since the premise of avoidance would be that the debtor-tenant received less that reasonably equivalent value in return for the termination of a below-market lease, it would seem that a fraudulent transfer theory would be available, with a 4 year look-back under California law.

3. One solution might be to provide for an "unwind right," at least until the premises are relet, under which the tenant would regain the premises as the cost of all unpaid rent.

IV. Assignment of Unexpired Leases

A. Debtor may assign a lease notwithstanding lease provisions that purport to prohibit, restrict or condition assignment. 11 U.S.C. § 365(f)(2).

1. In re Standor Jewelers West, Inc. 129 B.R. 200, 203 (BAP 9th Cir. 1991) (invalidating lease provisions under which the bankrupt tenant is required to share the profits associated with the assignment or sublease of premises with the landlord.)

B. Requirements for assignment: In order to assign a lease, it must be assumed pursuant to Section 365(a).

1. In addition, Section 365(f)(2)(B) provides that a trustee or debtor-in-possession may assign an unexpired nonresidential lease only if "adequate assurance of future performance by the assignee of such contract or lease is provided, whether or not there has been a default in such contract or lease." See In re Sun TV and Appliances, Inc., 234 B.R. 356, 370 (Bkrtcy. D. Del.)

2. In the event of an assignment, the landlord may "require a deposit or other security for the performance of the debtor's obligations" from the assignee

"substantially the same as would have been required by the landlord upon the initial leasing to a similar tenant." 11 U.S.C. § 365(l).

C. In the case of an assignment of shopping center lease, Section 365(b)(3) requires that a showing that "the financial condition and operating performance of the proposed assignee (and its guarantors, if any) is similar to the financial condition and operating performance of the debtor (and its guarantors, if any) as of the time debtor became the lessee under the lease."

1. Recently, an appellate court overruled the assignment of a Sears lease in the Mall of America on the grounds that the assignee's financial condition was not comparable to Sears in 1991. "Congress in its wisdom decided that only an assignee with a financial condition and operating performance that resembled the debtor's ab initio would provide a shopping center landlord with "adequate assurance" that the bargain originally struck would be performed by the lease's assignee. " MOAC Mall Holdings LLC v. Transform Holdco LLC (In re Sears Holdings Corp.), No. 19 Civ. 09140 (CM), at *40 (S.D.N.Y. Feb. 27, 2020)

D. Assignment of lease under Bankruptcy Code section 365(f) relieves bankruptcy estate of all claims resulting from a subsequent breach of the lease. 11 U.S.C. 365(k).

Rejection of Unexpired Leases

I. The Bankruptcy Code permits debtors freely to terminate ("reject") their leases.

A. The decision to reject is subject only to a "business judgment" test. See, e.g., In re Florence Chi-Feng Huang, 23 B.R. 798, 803 (BAP 9th Cir. 1982); In re G. I. Indust., 204 F.3d. 1276 (9th Cir. 2000).

B. Upon rejection the debtor "shall immediately surrender" the premises to the landlord. 11 U.S.C. §365(d)(4).

1. The court may summarily issue a writ of execution for possession in order to enforce this requirement. Bankruptcy Code section 365(d)(4) prevails over contrary state law, and the landlord is not required to resort to state law eviction procedures. In re Elm Inn, 942 F.2d. 630, 634 (9th Cir. 1991).

2. After rejection, until possession is surrendered, the landlord will have an administrative rent claim for "the reasonable value of the use and occupancy of the premises."

3. Note that if the trustee rejects an office lease and then uses the premises to store assets pending sale, administrative rent will accrue at the rate for warehouse space rather than office space.

C. Bankruptcy courts have discretion to permit retroactive rejection of leases.

1. Because retroactive rejection is not expressly permitted by the governing statutes, the Ninth Circuit has held that it should be allowed only under "exceptional circumstances." In re At Home Corp., 392 F.3d 1064, 1072 (9th Cir. 2004); cf. In re Thinking Machines Corp., 67 F.3d 1021, 1028 (1st Cir. 1995) ("bankruptcy courts may enter retroactive orders of approval, and should do so when the balance of equities preponderates in favor of such remediation.").

2. The Ninth Circuit in At Home applied the analytical framework used by Judge Carlson, determining that four factors justified retroactive rejection: "(1) the immediate filing of Debtor's motion to reject the leases; (2) Debtor's prompt action in setting that motion for hearing; (3) the fact that Debtor never occupied the premises; and (4) [Landlord's] motivation in opposing rejection of the leases nunc pro tunc to the motion filing date." In re At Home Corp., supra, 392 F.3d at 1072.

3. The Delaware courts apply a more objective test for retroactive lease rejection; *In re Namco Cybertainment, Inc.*, Case No. 98-00173 (PJW) (Bankr. D. Del. Jan. 21, 1998); holding that an effective rejection date prior to the hearing to consider rejection is permissible when:

a. Prior to the filing of the motion, the keys were surrendered, and the premises surrendered with an unequivocal statement to the landlord of abandonment

b. The motion is served and filed on the landlord;

c. The motion states that the Committee agrees with the motion; and

d. The debtor acknowledges that it will not have the right to withdraw the motion prior to the hearing.

4. The Tenant's surrender of possession to the Landlord is a key factor in equitable considerations regarding retroactive rejection. See, e.g., In re Chi-Chi's, Inc., 305 B.R. 396 (Bankr. D. Del. 2004) (refusing to allow retroactive rejection where possession had not been surrendered on or before the petition date); In re Cafeteria Operators, L.P., 299 B.R. 384 (Bankr. N.D. Tex. 2003) (allowing retroactive rejection of lease for premises that had been vacated, but not for premises that were still occupied).

II. *Overview: Calculation of the Landlord's Rejection Claim*:

A. Rejection of a lease constitutes a breach, entitling the landlord to a claim for damages. Wainer v. A. J. Equities, Ltd., 984 F.2d 679 (5th Cir. 1993).

B. The amount of the landlord's claim for lease rejection damages ("for damages resulting from the termination of a lease of real property") is subject to a two-step analysis.

1. First, the claim is limited to the damages which would otherwise be allowable under applicable state law. In re McSheridan, 184 B.R. 91, 96 (BAP 9th Cir. 1995); In re Iron-Oak Supply Corp., 169 B.R. 414, 417 (Bkrtcy. E.D.Cal. 1994) (Klein, Bankr. J.)

2. Second, the Bankruptcy Code provides a statutory ceiling or "cap" for the amount of that claim, often referred to as the "Landlord's Cap.." §502(b)(6).

a) "Section 502(b)(6) is designed to 'compensate a landlord for his loss while not permitting a claim so large (based on a long term lease) as to prevent other general unsecured creditors from recovering a dividend from the estate.'" In re Lomax, 194 B.R. 862, 865 (BAP 9th Cir. 1996), quoting legislative history.

b) §502(b)(6) 'was not intended to measure damages, but to cap them." In re Financial News Network, Inc., 149 B.R. 348, 351 (Bkrtcy. S.D.N.Y. 1993)

c) The legislative "compromise [reflected in Section 502(b)(6)] sacrificed the precise calculation of contingent future rentals in favor of the benefits of a quickly calculable estimated claim. The vicissitudes of those future rentals, both in good and bad fortune, is *already* reflected in the compromise which is now the cap of § 502(b)(6). In re All For A Dollar, Inc., 191 B.R. 262, 264 (Bkrtcy. D. Mass. 1996).

C. "Thus, the landlord's allowable damages are the lower of (1) the statutory cap [under] section 502(b)(6) ignoring mitigation or (2) total rejection damages, which take mitigation into account, available under nonbankruptcy law." Iron-Oak, supra, 169 B.R. at 420.

1. Bob's Sea Ray Boats, Inc., 143 B.R. 229, 231 (Bkrtcy. D.N.D. 1992) (Post termination successes in mitigation "are deducted from the landlord's total actual lease termination damages, before the section 502(b)(6) cap is applied."); In re All for a Dollar, Inc., 191 B.R. 262, 264 (Bkrtcy. D. Mass. 1996) (same).

2. "Bankruptcy courts are not free to engage in a balancing of the equities in order to avoid the application of §502(b)(6)'s plain, unambiguous language." In re Federated Department Stores, Inc., 131 B.R. 808, 817 (S.D.Oh. 1991) (affirming application of cap).

III. Accrued Pre-Bankruptcy Rent

A. In all cases, the landlord will be entitled to a claim for unpaid pre-bankruptcy, pre-surrender rent. Cal. Civ. Code §1951.2(a)(1); Bankruptcy Code §502(b)(6)(B).

1. This element of damages accrues only up until the earlier of the bankruptcy filing or the surrender of the leasehold. "Although Congress sought to limit the amount of damages that a landlord could recover from a bankrupt debtor, Congress only placed said limitations on a landlord's claims for post-petition damages, 11 U.S.C. §502(b)(6)(A), while ensuring that said landlord recovers on those damages incurred up to the earlier of lease termination or the petition filing." In re Smith, 249 B.R. 328, 334 (Bkrtcy. S.D. Ga. 2000)

2. Note: Surrender is determined under applicable state law, but generally requires landlord's consent. Iron-Oak, supra, 169 B.R. at 418; Smith, supra, 249 B.R. at 335 ("State law determines whether real estate was surrendered to a lessor for the purposes of §502(b)(6)). This date is the same as 'that date upon which the lease was terminated under state law.'"); In re Blatstein, 1997 WL 560119 (E.D. Pa. 1997) (appeal from bankruptcy court).

a) In Iron-Oak, supra, Judge Klein held that surrender requires the landlord's acceptance under California law. *Accord*, Lomax, supra, 194 B.R. at 865-6, analyzing California law regarding surrender and the termination of leases. See also, In re Southern Cinemas, Inc., 256 B.R. 520 (Bkrtcy. M.D. Fla. 2000) (applying comparable "surrender" analysis).

b) Acceptance can be inferred from landlord's conduct inconsistent with continued possession by the tenant.

(i) Landlord's issuance of a "Notice of Belief of Abandonment" constituted acceptance of the debtor's offer of surrender under California law. Lomax, supra, 194 B.R. at 866.

(ii) Does service of a 3 Day Notice with an election of forfeiture constitute an acceptance of a prior surrender offer? Is it sufficient in itself to set the "date on which the lessor repossessed, or the lessee surrendered, the leased property"?

c) Prior state court judgment may be *res judicata* as to surrender and pre-surrender damages. Blatstein, supra, 1997 WL 560119 at 10-11.

B. As a practical matter, the key issue under both state law and the Bankruptcy Code is the amount of the landlord's prospective damages.

IV. Limitations on the Landlord's Prospective Damages ("Rejection Damages")

A. Under California law, prospective damages are measured by a hypothetical offset.

1. The "worth… of the unpaid rent which would have been earned" after the lease termination is offset against "the amount of such rental loss… which could reasonably have been avoided." Cal. Civ. Code §1951.2(a)(2) and (3).

2. The tenant has the burden of proof respecting the amount of mitigation which the landlord might have achieved.

B. Where the lease is below market, the landlord will ordinarily have no prospective damages. In re Highland Superstores, Inc., 154 F.3d. 573, 577 (6th Cir. 1998) ("if the lessor has relet the premises at a higher rent, it generally will have no … claim")

1. An exception would be a case in which the lease was only slightly below market and the costs of reletting (e.g., broker's commissions, make ready expenses) would exceed the "profit" in the new lease.

2. If the landlord nonetheless suffered some cognizable loss, recompense might be awarded under Civ. Code §1951.2(a)(4) ("Any other amount necessary to compensate the lessor for all the detriment proximately caused by the lessee's failure to perform his obligations under the lease…")

C. Bankruptcy Code §502(b)(6): ceiling on landlord claims for prospective damages:

1. The Statutory Cap:

A landlord's claim "for [prospective] damages resulting from the termination of a lease of real property" shall be limited to "the rent reserved under such lease, without acceleration for the greater of [a] one year, or [b] 15 percent, not to exceed three years, of the remaining term of such lease" measured from the earlier of the bankruptcy filing or the surrender of the leasehold. §502(b)(6).

2. Policy justification:

"Section 502(b)(6) is designed to compensate a landlord for the loss suffered upon termination of a lease, while not permitting large claims for breaches of long-term leases, which would prevent other general unsecured creditors from recovering from the estate." In re McSheridan, 184 B.R. 91 (BAP 9th Cir. 1995).

3. Time for calculation

a) The "start date" for rejection damages under Section 502(b)(6) is *not* the effective date of rejection of the lease. The statute requires measuring the rent which will arise "following" the filing of the petition (or the earlier date of lease termination). Thus, rent increases and decreases which would take effect during the year following the commencement of the bankruptcy case are given effect when calculating the cap.

b) Accord, In re First Alliance Corp., 140 B.R. 531, 532-3 (9th Cir. BAP 1992); In re McLean Enterprises, Inc., 105 B.R. 928 (Bkrtcy. W.D. Mo. 1989); Iron-Oak, supra.

4. What is the "rent reserved"?

a) McSheridan Test

"We hold that the following three-part test must be met for a charge to constitute "rent reserved" under §502(b)(6)(A):

1. The charge must: (a) be designated as 'rent' or 'additional rent' in the lease; or (b) be provided as the tenant's/lessee's obligation in the lease.

2. The charge must be related to the value of the property or the lease thereon; and

3. The charge must be properly classifiable as rent because it is a fixed, regular or periodic charge."

In re McSheridan, 184 B.R. 91, 99-100 (BAP 9th Cir. 1995).

b) Application:

(i) "Rent reserved" ordinarily includes "triple net" charges like taxes, insurance and CAM. McSheridan, supra, 184 B.R. at 100; In re Rose's Stores, Inc., 179 B.R. 789 (Bkrtcy. E.D. N.C. 1995)

(ii) "Rent reserved" includes amortized improvement costs. Blatstein, supra, 1997 WL 560119 at p. 14.

(iii) In Smith, supra, 249 B.R. at 338-9, the Court concluded that a rent recapture (free rent, recaptured in the event of a default) did not constitute "rent reserved under the lease", applying the McSheridan test.

(iv) Service charges, reletting costs and liquidated damages are not included in rent reserved, applying the McSheridan test. In re Fifth Avenue Jewelers, Inc., 203 B.R. 372 (Bkrtcy. W.D.Pa. 1996)

(v) Attorneys' fees are not "rent reserved," applying the McSheridan test. In re Pacific Arts Publishing, Inc., 198 B.R. 319 (Bkrtcy. C.D. Cal. 1996) (Donovan, Bankr. J.)

c) Compare Cukierman:

(i) In re Cukierman, 265 F.3d 846 (9th Cir. 2001). The lease provided for repayment of tenant improvement expenses, characterized by tenant in the nature of a promissory note

to its landlord, and the lease characterized such payments as "further rent."

(ii) The Ninth Circuit held that the note payments were included among the obligations which must be performed post-petition pursuant to Section 365(d)(3) and hence were entitled to administrative claim status.

(iii) Arguably the promissory note payments would also constitute "rent reserved" under the McSheridan test. See, Blatstein, supra, 1997 WL 560119 at p. 14. ("Rent reserved" includes amortized improvement costs.)

d) Other cases:

(i) Applying a somewhat different test, one court allowed utility charges incorporated in the lease as "rent reserved," but rejected charges which would arise only upon certain contingencies, such as attorneys' fees. In re Conston Corporation, 130 B.R. 449, 455 (Bkrtcy, E.D. Pas. 1991).

(ii) A prior state court judgment does not have *res judicata* effect so as to override the §502(b)(6) cap. Fifth Avenue Jewelers, supra, 203 B.R. at 382.

(iii) §502(b)(6) applies only to post-termination damages and "only includes damages anticipated to result from a tenant's failure to fill out the lease term. It does not address damages wholly collateral to the termination event – such things as waste, destruction or removal of leasehold property… damages caused by a tenant's failure to properly repair and maintain the premises are not subject to section 502(b)(6) since that is a separate obligation imposed on a tenant…") Bob's Sea Ray Boats, supra, 143 B.R. at 231.

(iv) But see the Court's extraordinary analysis in Fifth Avenue Jewelers, supra, 203 B.R. at 379-381: If the date of surrender is the same as "termination of the lease", nothing can be allowed on account of the "rent reserved" *after* the date of surrender, because there is no rent due under a lease after it has been terminated. Applying this analysis, the cap applies only in bankruptcy rejection cases, because in those cases the rejection has retroactive effect; there will be rent reserved under the lease following the date on which the petition was filed.

D. How do you measure the 15% Alternative Cap?

1. The 15% Alternative: Instead of applying the "12 Months' Rent" cap, a landlord may elect to limit its claim to rent for "15%, not to exceed three years, of the remaining term" of the lease. (Thus, where rent is flat, the "three years" limitation comes into play only if the remaining term exceeds 20 years.)

2. *Slight Majority Rule – Time*: Next 15% of the months remaining on the lease.

a) Iron-Oak, supra, 169 B.R. at 420 ("The correct interpretation, however, is that Congress intended that the phrase "remaining term" be a measure of time, not rent.")

(i) Judge Klein supports his analysis with the argument that the phrase "without acceleration" is meaningful only if the measurement is of time, not rent.

(ii) His conclusion was adopted in In re Contectix Corp. 372 B.R. 488 (Bkrtcy. N.D.Cal. 2007) (Morgan, J.) and In re Heller Ehrman (unpublished, Bkrtcy. N.D.Cal. 2010) (Montali, J.)

(iii) Other courts have adopted the same analysis. See careful analysis in Blatstein, supra, 1997 WL 560119 at p. 12-3.

b) Application: multiply the remaining months of the lease by 15%; sum up the rent which will accrue over those next months, giving effect to escalators and scheduled free or reduced rent which will arise during those months.

3. *Slight Minority Rule – Rent*: 15% of the total rent to be paid over the remaining term of the lease.

a) In re Gantos, 176 B.R. 793 (W.D. Mich. 1995) (noting anomalies in the alternative rule where rent fluctuates over the lease term).

b) In re New Valley Corporation, 2000 WL 1251858 (D. N.J. 2000) *aff'ing* bankruptcy court decision adopting the majority view ("the '15 percent' does not refer to time; it stands alone without reference to time or rent.")

E. When should you choose the 15% limitation instead of one year's rent?

1. Where rent is flat, if more than 6 ½ years remain in the term.

2. If rent is back-end loaded and the Court has adopted the majority view (i.e., 15% of total rent, not time).

V. Landlord Claims that are not subject to the Cap

A. The Landlord's Cap applies only to claims, "for damages resulting from the termination of a lease of real property." If the landlord has other claims against the tenant, those claims are not limited by Section 502(b)(6).

B. "[A] lessor may have an un-capped claim for something other than damages resulting from the termination of a lease." In re JSJF Corporation, 344 B.R. 94, 101 (BAP 9th Cir. 2006) (attorneys fees incurred in pre-rejection litigation), *aff'd* 277 Fed. Appx. 718 (2008)

C. In re El Toro Materials Co., Inc., 504 F.3d 978, 981-82 (9th Cir.2007) provided a striking example of this principle: There, the debtor engaged in mining operations, and was required to restore the land to its pre-existing condition at the end of the lease. The Ninth Circuit concluded that damages caused by stockpiling waste occurred prior to rejection or termination and are thus not damages "resulting from termination" subject to damages cap.

Security Deposits, Guarantees and the Landlord's Cap

I. Security Deposits and other tenant collateral for lease obligations.

A. A security deposit must be *applied to claim as capped* by §502(b)(6).

1. Oldden v. Tonto Realty Co., 143 F.2d. 916 (2nd Cir. 1944).

2. Legislative history of §502(b)(6) suggests Oldden will remain good law under the Bankruptcy Code. See extensive discussion in All for a Dollar, supra, 191 B.R. at 264; Conston Corporation, supra, 130 B.R. at 452.

3. "[T]he landlord will not be permitted to offset his actual damages against his security deposit and then claim for the balance under [the §502(b)(6) cap]. Rather, his security deposit will be applied in satisfaction of the claim that is allowed under [§502(b)(6)]." Blatstein, supra, 1997 WL 560119 at p. 17.

4. But see, St. James, "*Oldden,* Letters of Credit and Section 502(b)(6)" 26 CAL. BANKR. J. 307 (2003) (Arguing that *Oldden* is analytically flawed and should be limited or rejected entirely)

B. Analytically, this result arises because the cap established by §502(b)(6) governs the landlord's entire claim, not merely its unsecured claim.

1. A security deposit constitutes collateral provided *by the tenant* to secure performance of *the tenant's obligations* under the lease.

2. Since the landlord's claim *against the tenant* is capped, it is also capped against the tenant's property, i.e., collateral posted by the tenant. In re Handy Andy Home Improvement Centers, Inc., 222 B.R. 571, 574-75 (Bkrtcy. N.D. Ill. 1998)

3. A cash security deposit is merely a type of collateral provided by the tenant (potentially governed by more restrictive provisions of California law; see below).

C. Instructive is the case of In re Bank of New England Corporation, 187 B.R. 405 (Bkrtcy. D. Mass. 1995), addressing a comparable cap on employee termination claims. §502(b)(8).

1. In Bank of New England, the debtor had fully collateralized a severance obligation to its manager. The Court determined that the severance claim was limited by the amount of the statutory cap; one year's compensation pursuant to §502(b)(7); which was less than the amount of the collateral.

2. The Court required a surrender of the excess collateral to the debtor's trustee, but allowed the manager interest and attorneys fees on his (reduced) claim as an oversecured creditor. §506(b).

D. Consequence: A landlord who holds a security deposit in excess of one year's rent must expect to surrender that excess if the tenant files bankruptcy.

1. See, In re Onecast Media, Inc., 439 F.3d 558 (9th Cir. 2006) ("[T]he trustee was entitled to recover the difference between the landlord's damages and the [security deposit], since that amount was property of the estate.

2. In hot, high tech markets, landlords sometimes build campuses for tenants, premised upon a 12-15 year lease and a 3 year security deposit. Those landlords face substantial exposure in a tenant bankruptcy.

E. Note: there may be additional restrictions on the use of a security deposit under California law. See, St. James, "Landlord Beware: Will a Security Deposit Survive a Bankruptcy?" 26 CAL. BANKR. J. 44 (2001); adopted in *250 LLC v. Photopoint Corp. (USA)* 131 Cal. App. 4th 703, 712; 32 Cal. Rptr. 3d 296, 301-2 (1st Dist. Ct. App. 2005).

II. Guarantees and Third Party Pledges of Collateral

A. Ordinarily, a third-party guarantee or a pledge of a third party's assets to secure such a guarantee should *not* be affected by §502(b)(6) and the tenant's bankruptcy case.

1. This is so because a guarantee is a separate and independent obligation, not (necessarily) affected by a change in the obligation of the primary obligor.

2. Analytically, a bankruptcy discharge is viewed as releasing the primary obligor of its personal liability rather than extinguishing the underlying debt, so as to leave the obligations of the guarantor unaffected. Matter of Edgeworth, 993 F.2d. 51, 53 (5th Cir. 1993); Star Phoenix Mining Co. v. West Bank One, 147 F.3d. 1145 (9th Cir. 1998).

3. Thus, state law holds that "rejection of a lease in bankruptcy does not alter the contract rights of non-debtors;" Vallely Investments, L.P. v. BancAmerica Commercial Corp., 88 Cal. App. 4th 816, 828-29, 106 Cal. Rptr. 2d. 689, 699 (4th Dist Ct. App. 2001) (holding that assignee of lease who expressly assumed all of the tenant's obligations can be held to those obligations notwithstanding subsequent rejection by subsequent assignee); *compare*, Syufy Enterprises v. City of Oakland, 104 Cal.App.4th 869, 128 Cal.Rptr.2d 808 (1st Dist. Ct. App. 2002) (since rejection terminated

tenant's right to possession, it terminated sub-tenant's right to possession, and hence terminated sub-tenant's obligations under sublease.)

B. Thus, it is well established as a general matter within the Ninth Circuit that the bankruptcy of the primary obligor cannot affect the obligation of the guarantor. "A bankruptcy court does not have the power to discharge the liabilities of a bankrupt's guarantor." Star Phoenix Mining Co. v. West Bank One, 147 F.3d. 1145 (9th Cir. 1998); see also, Underhill v. Royal, 769 F.2d. 1426 (9th Cir. 1985) (Provision of confirmed Chapter 11 Plan which prevented collection from guarantor was unenforceable); and see, United States v. Tharp (8th Cir. 1992) (confirmed "eat dirt" plan did not extinguish deficiency claim against guarantors).

1. In the context of a real property lease and the application of §502(b)(6) to a rejection damages claim against the tenant's bankruptcy estate, it has been expressly held that "the liability of a guarantor for a debtor's lease obligations is not altered by the Trustee's rejection of the lease." In re Modern Textile, Inc., 900 F.2d. 1184, 1191 (8th Cir. 1990)

   a) In re Western Real Estate Fund, Inc. 922 F.2d. 592, 601 (10th Cir. 1990) (bankruptcy does not "bar litigation against third parties for the remainder of the discharged debt… [even where] the creditor's claim is based on an executory contract that is both rejected under section 365(a) and subject to limitation in amount [by §502(b)(6)]";

   b) Bel-Ken Associates, Ltd. Partnership v. Clark, 83 B.R. 357 (D. Md. 1988) (guarantor obligation not affected by tenant's bankruptcy and its invocation of §502(b)(6)).

C. Where the Debtor is the lease guarantor, the cap will be applied to the guarantee claim.

1. The guarantor, if a debtor in a bankruptcy case, may independently avail itself of the §502(b)(6) limitation with respect to the lease guarantee claim, regardless of whether the tenant itself is in bankruptcy. In re Arden, 176 F.3d 1226 (9th Cir. 1999).

2. In re Revco, 138 B.R. 528, 532 (Bkrtcy. N.C. Ohio 1991) (applying cap to landlord's claim against a guarantor / debtor based on the policy of the cap to prevent large lease damages claims from swamping bankruptcy estates)

3. See also, In re Southern Cinemas, Inc., 256 B.R. 520 (Bkrtcy. M.D. Fla. 2000) (collecting authorities and holding that the cap applies to the indemnity claim of an assignor against the assignee / debtor).

D. What happens when there are multiple debtor respondents?

1. Analytical alternatives: Assume the debtor and its parent / guarantor both file bankruptcy cases.

a) May the landlord file separate capped claims in each case?

b) Is the landlord limited to filing a single capped claim in the case of its choice?

c) Is the landlord free to file multiple claims, but limited to a maximum aggregate recovery in the amount of the cap?

2. Multiple capped claims:

a) At least where the differing bankruptcy cases are not substantively consolidated, allowing separate capped claims in each case appears most consistent with the language of the statute and its purpose.

b) Greer, Brian & Moss, Joel "Guaranties in Bankruptcy: A Primer" 16 J. BANKR. L. & PRAC. 3 (2007)

> "The general principle that is applicable when multiple parties are liable to a holder of a bankruptcy claim is that the holder of such claim may prove its entire claim against the estate of any obligors that become bankrupt and recover distributions from the debtor's estate on the basis of the full claim as it existed when the petition was filed. The holder of the claim does not need to reduce its claims to reflect any partial payments made by other obligors until the claim has been paid in full. The creditor also generally need not first pursue any third-party collateral or guaranties prior to returning to the debtor's estate for satisfaction of the remainder. Instead, the creditor can seek to prove its full claim in the debtor's case without regard to the existence of collateral or guaranties or proceeds received there from."

c) Ivanhoe Bldg & Loan Ass'n v. Orr, 295 U.S. 243, 245-46 (1935) (holding that the presence of and realization on third party collateral securing an unsecured claim against the debtor does not diminish a creditor's allowed unsecured claim against the bankruptcy estate).

3. Single capped claim:

a) Fischer v. Lee Brothers Value World (9th Cir. 1973) (Predecessor of §502(b)(6) under the Bankruptcy Act limited "the aggregate

amount" of the landlord's allowable claims, even if it held claims against both the debtor entities, to a single bankruptcy cap.)

b) Ninth Circuit dicta would permit a broad application of the Section 502(b)(6) statutory cap, so as to incorporate within the capped claim all sources of recovery to the landlord, including recoveries from guarantors, focusing on the landlord's claim, rather than the guarantor's obligation.

(i) See, In re Arden, 176 F.3d. 1226, 1229 (9th Cir. 1999):

"A plain reading of the section underscores that *it is the claim of the lessor, not the status of the lessee – or its agent or guarantor* – that triggers application of the [Section 502(b)(6)] Cap. The section has [only] two predicates: 'claim of a lessor' and 'damages resulting from the termination of a lease or real property.'"

(ii) See also, In re Interco, 137 B.R. 1003 (Bkrtcy. E.D. Mo. 1992) (§502(b)(6) limits the landlord's claim, "regardless of the identity of the entity that is the debtor".)

E. *Conclusion*: For present purposes, the weight of authority suggests that third party obligations such as guarantees are not affected by the Section 502(b)(6) Cap unless the guarantor himself is the debtor in bankruptcy.

1. On the other hand, even this issue is not free from question in the face of conflicting Ninth Circuit *dicta* which focuses on Section 502(b)(6) as limiting the landlord's claim rather than the debtor's liability.

2. More importantly, the treatment of guarantors is so intertwined with the treatment of Letters of Credit that an appellate court decision on that issue, which might be adverse to the landlord, might well affect the treatment of guarantor claims in manners presently not anticipated.

Letters of Credit

I. The Benefits of Letters of Credit

A. Analytically, Letters of Credit are viewed as comparable to guarantees they are the obligations of third parties (the issuing banks).

B. As a general rule, Letters of Credit are completely unaffected by the tenant's bankruptcy filing. See generally, Winick, "Tenant Letters Of Credit; Bankruptcy Issues For Landlords And Their Lenders" 9 AM. BANKR. INST. L. REV 733 (2001)

1. Letters of Credit are governed by the "independence principle," which holds that the obligations of the Bank to the landlord are entirely independent of the obligations of the Tenant to the landlord.

a) Matter of Compton Corp., 831 F.2d. 586, 590 (5th Cir. 1987) ("[T]he independence principle is necessary to insure 'the certainty of payments for services or goods rendered regardless of any intervening misfortune which may befall the other contracting party.'")

b) "Property of the estate does not include the proceeds of a letter of credit paid to a creditor of the debtor who is the beneficiary of the letter." 5 COLLIERS ON BANKRUPTCY, ¶ 549.04[1] (15th ed. 2000).

c) In re Farm Fresh Supermarkets of Maryland, Inc., 257 B.R. 770 (Bkrtcy. MD. 2001) (holding that trustee in bankruptcy could not recover proceeds of landlord's draw under a letter of credit; curiously, the lease had previously been assumed and assigned, presumably curing the default which had justified the call on the letter of credit.)

2. Thus, the automatic stay does not prevent post-bankruptcy draws on a Letter of Credit. Willis v. Celotex Corporation, 978 F.2d. 146 (4th Cir. 1992)

II. Are Letters of Credit subject to the §502(b)(6) limitation?

A. Landlords have generally argued that as a result of the independence principle, the proceeds of a letter of credit may not be applied against the capped claim. Rather, they must be treated in the same manner as collections on guarantees: entirely separate from and unaffected by the bankruptcy process. See generally, St. James, "*Oldden*, Letters of Credit and Section 502(b)(6)" 26 CAL. BANKR. J. 307 (2003).

1. Compare, Roth, "Landlords Use Letter of Credit to Bypass the Claim Cap of Section 502(b)(6), *ABI Journal* (2001), p. 222, with In re Southern Cinemas, Inc., 256 B.R. 520 (Bkrtcy. M.D. Fla. 2000) ("To circumvent the purpose of the statute on account of "labels" would encourage crafty drafters to invent relationships that fall outside the scope of the lessor-lessee contract and limit the reach of §502(b)(6)").

B. Over the past decade, Circuit-level decisions have consistently rejected the landlords' contentions and concluded that Letters of Credit are substantively equivalent to security deposits, i.e., each will be applied first against the Capped claim, and any excess after satisfaction of the entire Capped claim must be returned to the bankruptcy estate.

1. The Third and Ninth Circuits squarely so held: In re PPI Enterprises (U.S.), Inc., 324 F.3d. 197 (3rd Cir. 2003) (landlord's letter of credit applied against the capped §502(b)(6) claim); 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) (same).

2. The Bankruptcy Appellate Panel for the Ninth Circuit took a somewhat more nuanced approach, concluding that "the appropriate analysis looks to the impact that the draw upon the letter of credit has on property of the estate." Redback Networks, Inc. v. Mayan Networks Corporation (In re Mayan Networks Corporation), 306 B.R. 295, 299-300 (BAP 9th Cir. 2004). In *Mayan Networks*, a certificate of deposit had been pledged by the tenant as collateral for the letter of credit, so the effect of the draw on the letter of credit was identical to the application of a security deposit, and so the proceeds of the letter of credit were treated as reducing the Landlord's Cap; had there been no pledge of property of the estate to secure the letter of credit, the opposite result would obtain.

3. Finally, the Fifth Circuit adopted a formal approach: if the landlord files a proof of claim, the Landlord's Cap applies; if the landlord does not file a proof of claim, the bankruptcy process does not interact with the landlord or the letter of credit; i.e., the landlord keeps the proceeds of the letter of credit, even if they exceed the Capped claim. EOP-Colonnade of Dallas Limited Partnership v. Dennis Faulkner (In re Stonebridge Technologies, Inc.) 430 F.3d. 260 (5th Cir. 2005).

4. See generally, St. James, "Are Letters of Credit Covered by the Landlord's Cap?," 25 Am. Bankr. Inst. J. 40 (Feb., 2006)

5. While it seems clear that a letter of credit is not property of the estate and drawing on it ordinarily will not violate the automatic stay, if notice to the debtor is required to effect a draw, that notice will likely violate the automatic stay and thereby taint the draw.

III. Problems with Premature Draws on Letters of Credit.

A. Example: As a technical matter a landlord may often be entitled to draw the entire letter of credit immediately upon the occurrence of a bankruptcy filing, even though the lease is current.

1. This is so because most leases include a bankruptcy filing as an event of default and most letters of credit permit a draw upon certification that an event of default has occurred.

2. Even though the bankruptcy default is ineffective against the tenant (due to Section 365(e)(1)'s invalidation of so called *ipso facto* clauses), the principle of independence permits the landlord to invoke it against the Bank in order to draw on the letter of credit.

3. Note: One court enjoined the landlord from drawing on the letter of credit where there was no monetary default and the sole basis for the draw was breach of the *ipso facto* clause. In re Metrobility Optical Systems, Inc., 268 B.R. 326 (Bkrtcy. D. N.H. 2001)

B. Analysis: What is the "excess draw"?

1. Most leases require funds drawn from a Letter of Credit to be applied against damages suffered by the landlord. Where the landlord has suffered no monetary damages – or its damages have been much less than the amount drawn on the Letter of Credit (or arguably so, due to a dispute with the Tenant about those damages) – what becomes of the "excess draw"?

a) While leases are often silent, they do not seem to contemplate that the landlord may keep the excess draw as a "bonus."

b) Rather, the excess draw is almost certainly analyzed as "cash collateral" for bankruptcy purposes; see, Bankruptcy Code Section 363(a); and as a cash security deposit under state law. See, Civil Code Section 1951.7 (defining "security deposit" as "any payment or deposit of money the primary function of which is to secure the performance of the rental agreement….")

C. Converting an excess draw on a letter of credit into a cash security deposit is ordinarily undesirable for the landlord.

1. A cash security deposit may be limited in its utility as a matter of state law, e.g., may not be applied against prospective damages. See, St. James, "Landlord Beware: Will a Security Deposit Survive a Bankruptcy?" 26 CAL. BANKR. J. 44 (2001). A lease might resolve this problem by drafting appropriate waivers with respect to excess draws on letters of credit, but few do.

2. The landlord may not apply cash collateral against its damages without relief from stay.

3. A Chapter 11 tenant may seek to "use" cash collateral. While the standards are difficult to satisfy; Section 363(c)(2); those standards may be met if the lease is materially below market or other unusual circumstances apply.

4. The landlord is ordinarily better served by avoiding all of the issues raised by an excess draw on a letter of credit.

D. Forcing a Premature Draw on a Letter of Credit

1. Most letters of credit require annual (automatic) renewals and provide that the letter may be drawn upon notice that it will not be renewed.

2. Can a tenant convert a letter of credit into a cash security deposit by causing the issuing bank not to renew the letter of credit, thereby requiring the landlord either to draw the letter of credit and convert it to a cash security deposit or to waive the protection?

IV. Other Letter of Credit Issues

A. Applying the security deposit against outstanding rent before the tenant files a bankruptcy petition reduces the landlord's pre-petition damages claim and leaves the landlord with a smaller security deposit to apply against its rejection damages.

B. Where funds are received directly from the tenant, the existence of a Letter of Credit may have no beneficial effect. See, In re Powerine Oil Company (Creditors Committee v. Koch Oil Co.) 59 F.3d. 969 (9th Cir. 1995) (Creditor who held a letter of credit accepted money from the debtor in lieu of a draw on the letter of credit; held, the payment may be avoidable as a preference).

C. Likewise, if the letter of credit is provided in an attempt to make a preference, it may be avoidable. Matter of Compton Corp., 831 F.2d. 586, 590 (5th Cir. 1987) (Where creditor obtained a letter of credit from debtor in order to receive a preference, indirect preference could be recovered from creditor without impairing the independence principle); In re Richmond Produce Co., Inc., 118

B.R. 753, 760-61 (Bkrtcy. N.D. Cal. 1990) (Tchaikovsky, Bankr. J.) (Where fraudulent conveyance was effected through the medium of a letter of credit, indirect transfer could be recovered from the beneficiary of the letter of credit without impairing the independence principle.)

D. More generally, the independence principle only ensures that the letter of credit will be paid directly to the beneficiary; if the underlying contract indicates that the beneficiary is not entitled to keep the funds, the independence principle does not prevent a suit to recover the proceeds of the letter of credit. Two Trees v. Builders Transport, Inc. (In re Builders Transport, Inc.) 471 F.3d 1178 (11th Cir.2006), *cert. den,* 127 U.S.2112, 127 S.Ct. 2112, 167 L.Ed.2d 814 (2007).

Tenant Issues in a Landlord Bankruptcy Case

I. Tenant Protections

A. Market

1. The value of most property to landlords is measured by rental income, so a landlord has a natural incentive to honor and preserve the lease so as to preserve the value of the property.

2. Notably, this incentive is dominant where the lease is at or above market rates, and drops and the lease falls below current market rates.

3. If the landlord is motivated by this incentive, it will assume the lease, so as to "lock in" both the landlord and the tenants.

a) The *General Growth* Chapter 11 case, for example, assumed substantially all of its shopping center leases.

b) The tenant should consider using the assumption motion as an opportunity to require protection for its security deposit in the form of a demand for "adequate assurances for future performance;" e.g., a segregated deposit account in which it has a security interest.

B. Statutory Protection for Tenant in Possession

1. Retention of Tenancy

a) Under Section 365(h), even if the landlord rejects the lease, the tenant may retain possession for the balance of the lease term.

(i) The landlord need not continue to provide services or other benefits in addition to possession.

(ii) Tenant may offset its damages against rental payments.

b) Not self-executing: in many bankruptcy cases, the Debtor assumes away these rights, and in the absence of opposition, tenants in possession are required to relocate.

c) If tenant asserts rights as a tenant in possession. Those rights should be honored.

2. Sale free and clear

a) Recent decisions permit a sale free and clear of a tenant's rights as a tenant in possession. Pinnacle Res. at Big Sky, LLC v. CH SP Acquisitions, LLC (*In re* Spanish Peaks Holdings II, LLC), 862 F.3d 1148 (9th Cir. 2017); Precision Indus. v. Qualitech Steel SBQ, LLC, 327 F.3d 537 (7th Cir. 2003); see generally, St. James "Throwing Tenants Off Spanish Peaks" 34 CAL. BANKR. L.J. 243 (1918)

b) Effectively, such a sale means that the tenant's rights to possession are terminated and the buyer acquires the property as if vacant. The tenant has a claim for damages against the landlord's bankruptcy estate, but in each of these cases, the claim was valueless since the secured creditor would not be paid in full.

c) The cases are driven by bad facts, and presume inaction by the landlord, but establish markers which can only be addressed by active opposition on the part of the tenant. For example, they suggest that a timely motion for "adequate protection" brought by the tenant would likely solve the problem.

C. Sublessees

1. Rejection of the lease between the master lessor and the master lessee "terminates" the lease.

2. Putting aside contractual rights of attornment, there is authority supporting the position that the subtenant may treat its obligations as terminated. Syufy Enterprises v. City of Oakland, 104 Cal.App.4th 869, 128 Cal.Rptr.2d 808 (1st Dist. Ct. App. 2002) (since rejection terminated tenant's right to possession, it terminated sub-tenant's right to possession, and hence terminated sub-tenant's obligations under sublease); Rose, LLC v. Treasure Island, LLC, 445 P.3d 860, 869 (Nev. App. 2019) (same)

3. Significantly, and unlike Section 365(h), there is no ability of hold the master landlord to the terms of the sublease. The subtenant is limited to its contractual rights. In re Great Atl. & Pac. Tea Co., 544 B.R. 43, 53 (Bankr. S.D.N.Y. 2016) (well-reasoned opinion which concludes: "section 365(h) does not give the subtenant a meaningful election to remain in its former subtenancy when the debtor has rejected the overlease first or simultaneously with the sublease.")

4. The Delaware Courts have adopted a seeming minority view that, in order to surrender possession as part of rejecting the lease, the tenant/sub-landlord must evict the sub-tenant. In re Amicus Wind Down Corp., 2012 Bankr. LEXIS 665, 2012 WL 604143, *7 (Bankr. Del. Feb. 24, 2012). The Delaware Courts do not suggest that the sub-tenant enjoys any

material rights to an ongoing tenancy – e.g., Section 365(h) – but instead rather formally talk about surrendering possession. *SubCulture, LLC v. Rogers Invs. (In re Culture Project)*, 571 B.R. 555, 559-60 (Bankr. S.D.N.Y. 2017) ("even in the *Amicus Wind Down* case the subtenant's rights were quite limited. The court did not hold that the subtenant could stay in possession indefinitely. Instead, the court imposed an obligation on the debtor to evict the subtenant in order to fulfill the debtor's obligation to surrender the property.")

5. Similarly, the subtenant's claims for a return of its security deposit will be treated as a general unsecured claim in the sublandlord's case, unless the jurisdiction requires security deposits to be maintained in a segregated trust account.

Appendix

Copies of Primary Restrictions Regarding Commercial Evictions and Security Deposits (San Francisco and Oakland)

All of the San Francisco Mayoral Declarations are collected at:

https://sfmayor.org/mayoral-declarations-regarding-covid-19

OFFICE OF THE MAYOR
SAN FRANCISCO

LONDON N. BREED
MAYOR

FOURTH SUPPLEMENT TO MAYORAL PROCLAMATION DECLARING THE EXISTENCE OF A LOCAL EMERGENCY DATED FEBRUARY 25, 2020

WHEREAS, California Government Code Sections 8550 et seq., San Francisco Charter Section 3.100(14) and Chapter 7 of the San Francisco Administrative Code empower the Mayor to proclaim the existence of a local emergency, subject to concurrence by the Board of Supervisors as provided in the Charter, in the case of an emergency threatening the lives, property or welfare of the City and County or its citizens; and

WHEREAS, On February 25, 2020, the Mayor issued a Proclamation (the "Proclamation") declaring a local emergency to exist in connection with the imminent spread within the City of a novel (new) coronavirus ("COVID-19"); and

WHEREAS, On March 3, 2020, the Board of Supervisors concurred in the Proclamation and in the actions taken by the Mayor to meet the emergency; and

WHEREAS, On March 4, 2020, Governor Gavin Newsom proclaimed a state of emergency to exist within the State due to the threat posed by COVID-19; and

WHEREAS, On March 6, 2020, the Local Health Officer declared a local health emergency under Section 101080 of the California Health and Safety Code, and the Board of Supervisors concurred in that declaration on March 10, 2020; and

WHEREAS, On March 6, 2020, the City issued public health guidance to encourage social distancing to disrupt the spread of COVID-19 and protect community health; and

WHEREAS, On March 7, 2020, the Local Health Officer ordered certain City facilities not to hold non-essential group events of more than 50 people for the two weeks from the date of the order and prohibited visitors from Laguna Honda Hospital; and

WHEREAS, On March 7, 2020, the Department of Human Resources issued guidance to minimize COVID-19 exposure risk for City employees who provide essential services to the local community, in particular during the current local emergency; and

WHEREAS, On March 11, 2020, March 13, 2020, and March 17, 2020, the Mayor issued supplements to the Proclamation, ordering additional measures to respond to the emergency; and

WHEREAS, On March 16, 2020, the Local Health Officer issued an order requiring most people to remain at home subject to certain exceptions including obtaining essential goods such as food and necessary supplies, and requiring the closure of non-essential businesses, through April 7, 2020; and

WHEREAS, On March 16, 2020, the Governor issued Executive Order N-28-20, finding that it is necessary to promote stability among commercial tenancies to further public health and mitigate the economic pressures of the emergency, and waiving certain provisions of state law so that local jurisdictions may achieve these purposes; and

WHEREAS, There are currently 51 confirmed cases of COVID-19 within the City, more than 850 confirmed cases in California, and there have been 15 COVID-19-related deaths in California; and

WHEREAS, COVID-19 is causing and is expected to continue to cause abrupt serious negative impacts on the local economy and abrupt serious negative financial impacts to local businesses, including, but not limited to, reductions in income due to lower customer demand or forced closures; and

WHEREAS, These abrupt serious negative impacts will irreparably harm local businesses and the residents they employ, and will jeopardize public health; and

WHEREAS, It is in the public interest to take immediate steps to ensure that local businesses can continue to operate, either as essential businesses now under the shelter in place order or after the restrictions in the shelter in place order are lifted; and

WHEREAS, The Mayor proclaims that the conditions of extreme peril exist and continue to warrant and necessitate the existence of a local emergency,

NOW, THEREFORE,

I, London N. Breed, Mayor of the City and County of San Francisco, proclaim that there continues to exist an emergency within the City and County threatening the lives, property or welfare of the City and County and its citizens;

In addition to the measures outlined in the Proclamation, in the March 11, 2020 Supplement to the Proclamation, the March 13, 2020 Second Supplement to the

Proclamation, and the March 17, 2020 Third Supplement to the Proclamation, it is further ordered that:

A temporary moratorium on eviction for non-payment of rent by commercial tenants directly impacted by the COVID-19 crisis is imposed as follows:

(a) This Order applies only to commercial tenants registered to do business in San Francisco under Article 12 of the Business and Tax Regulations Code with 2019 combined worldwide gross receipts for tax year 2019 for purposes of Article 12-A-1 of the Business and Taxation Code equal to or below $25 million. This figure shall be pro-rated in the case of businesses that were not operating for the entire 2019 tax year.

(b) If a covered commercial tenant fails to make a rent payment that was due on or after March 17, 2020, then the landlord may not recover possession of the unit due to the missed or delayed payment, without first providing the tenant written notice of the violation and an opportunity to cure the violation, as set forth in subsection (c).

(c) The written notice from the landlord required under subsection (b) shall specify a cure period of at least one month from the date the tenant receives the notice, but landlords are encouraged to offer a longer period. Upon receipt of the notice, the tenant shall have the full cure period to either (1) pay the rent, or (2) provide documentation to the landlord showing that the tenant is unable to pay the rent due to a financial impact related to COVID-19. For purposes of this Order, the term "financial impact" means a substantial decrease in business income due to illness or other disruption, reduced open hours or reduced consumer demand, or temporary closure of the business, including temporary closure required to comply with restrictions or in response to restrictions under the shelter in place or other orders of the Health Officer. A financial impact is "related to COVID-19" if caused by the COVID-19 pandemic, or by any local, state, or federal government response to COVID-19.

(d) If the tenant provides the landlord documentation of the tenant's inability to pay rent due to a financial impact related to COVID-19, then the cure period shall be extended by one month, so that the landlord and tenant can discuss the matter in good faith and attempt to develop a payment plan for the tenant to pay the missed rent. If the landlord and tenant cannot agree to a payment plan, then the tenant shall, on or before the new date that the cure period will expire, at the one-month mark, either (1) pay the rent, or (2) provide additional documentation of its continuing inability to pay due to a

financial impact related to COVID-19, in which case the cure period shall extend by one more month. Thereafter, the tenant may obtain additional monthly extensions of the cure period by providing updated documentation each month, but under no circumstances shall the landlord be prohibited from evicting for non-payment for more than six months after the date the rent was originally due. If the tenant has not paid all outstanding rent at the end of the applicable cure period, then the landlord may proceed with the eviction for non-payment.

(e) Nothing in this Order relieves a tenant of the obligation to pay rent, nor restrict a landlord's ability to recover the rent due through means other than an eviction for non-payment.

(f) This Order will last for a period of 30 days, until the Proclamation of Local Emergency is terminated, or upon further Order from the Mayor, whichever occurs sooner. The cure period requirements of subsections (c) and (d) shall survive the expiration or termination of this Order for any missed rent payment that occurred prior to the expiration or termination of the Order. The Mayor may extend this Order by an additional period of 30 days if emergency conditions at that time warrant extension. The Mayor shall provide notice of the extension through an Executive Order posted on the Mayor's website and delivered to the Clerk of the Board of Supervisors.

(g) The Office of Economic and Workforce Development ("OEWD") is delegated authority to adopt regulations and to develop and publish guidelines consistent with this Order, including forms and recommendations of the types of documentation that may show financial impacts related to COVID-19. OEWD shall also have the authority to grant waivers from this Order to landlords who can demonstrate that being unable to evict would cause them a significant financial hardship (for example, default on debt or similar enforceable obligation).

DATED: March 18, 2020

London Breed

London N. Breed
Mayor of San Francisco

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EIGHTH SUPPLEMENT TO MAYORAL PROCLAMATION DECLARING THE EXISTENCE OF A LOCAL EMERGENCY DATED FEBRUARY 25, 2020

WHEREAS, California Government Code Sections 8550 et seq., San Francisco Charter Section 3.100(14) and Chapter 7 of the San Francisco Administrative Code empower the Mayor to proclaim the existence of a local emergency, subject to concurrence by the Board of Supervisors as provided in the Charter, in the case of an emergency threatening the lives, property or welfare of the City and County or its citizens; and

WHEREAS, On February 25, 2020, the Mayor issued a Proclamation (the "Proclamation") declaring a local emergency to exist in connection with the imminent spread within the City of a novel (new) coronavirus ("COVID-19"); and

WHEREAS, On March 3, 2020, the Board of Supervisors concurred in the Proclamation and in the actions taken by the Mayor to meet the emergency; and

WHEREAS, On March 4, 2020, Governor Gavin Newsom proclaimed a state of emergency to exist within the State due to the threat posed by COVID-19; and

WHEREAS, On March 6, 2020, the Local Health Officer declared a local health emergency under Section 101080 of the California Health and Safety Code, and the Board of Supervisors concurred in that declaration on March 10, 2020; and

WHEREAS, On March 6, 2020, the City issued public health guidance to encourage social distancing to disrupt the spread of COVID-19 and protect community health; and

WHEREAS, On March 7, 2020, the Local Health Officer ordered certain City facilities not to hold non-essential group events of more than 50 people for the two weeks from the date of the order and prohibited visitors from Laguna Honda Hospital; and

WHEREAS, On March 7, 2020, the Department of Human Resources issued guidance to minimize COVID-19 exposure risk for City employees who provide essential services to the local community, in particular during the current local emergency; and

WHEREAS, On March 11, 2020, March 13, 2020, March 17, 2020, March 18, 2020, and March 23, 2020, the Mayor issued supplements to the Proclamation, ordering additional measures to respond to the emergency; and

WHEREAS, On March 16, 2020, the City's Health Officer issued a stay safe at home order, Health Officer Order No. C19-07 (the "Stay Safe At Home Order"), requiring most people to remain in their homes subject to certain exceptions including obtaining essential goods such as food and necessary supplies, and requiring the closure of non-essential businesses, through April 7, 2020, and on March 31, 2020, the Health Officer extended the Stay Safe At Home Order through May 3, 2020; and

WHEREAS, On March 19, 2020, the Governor issued Executive Order N-33-20 and the California Public Health Officer issued a corresponding order requiring people to stay home except as needed subject to certain exceptions; and

WHEREAS, There are currently 434 confirmed cases of COVID-19 within the City and there have been 7 COVID-19-related deaths in the City; there are more than 9,500 confirmed cases in California, and there have been 204 COVID-19-related deaths in California; and

WHEREAS, This order and the previous orders issued during this emergency have all been issued because of the propensity of the virus to spread person to person and also because the virus physically is causing property loss or damage due to its proclivity to attach to surfaces for prolonged periods of time; and

WHEREAS, On March 17, 2020, the Mayor issued the Third Supplement to the Emergency Proclamation, which contained an order prohibiting meetings of City boards, commissions, and advisory bodies, other than the Board of Supervisors, through April 7, 2020, unless authorized by the Mayor or the Board of Supervisors; given the extension of the Stay Safe At Home Order through May 3, 2020, it is necessary to continue the restrictions on meetings of these bodies through May 3, 2020; and

WHEREAS, On March 18, 2020, the Mayor issued the Fourth Supplement to the Emergency Proclamation, imposing a temporary moratorium on eviction for non-payment of rent by commercial tenants directly impacted by the COVID-19 crisis, and it is necessary to clarify how the moratorium is intended to apply; and

WHEREAS, The Mayor proclaims that the conditions of extreme peril exist and continue to warrant and necessitate the existence of a local emergency,

NOW, THEREFORE,

I, London N. Breed, Mayor of the City and County of San Francisco, proclaim that there continues to exist an emergency within the City and County threatening the lives, property or welfare of the City and County and its citizens;

In addition to the measures outlined in the Proclamation and in the Supplements to the Proclamation dated March 11, March 13, March 17, March 18, March 23, March 27, and March 31, 2020, it is further ordered that:

(1) Section 5 of the Third Supplement to the Emergency Proclamation dated March 17, 2020, is revised and replaced as follows: From March 18, 2020 through May 3, 2020, City policy and advisory bodies shall not hold public meetings, unless the Board of Supervisors, acting by written motion, or the Mayor or the Mayor's designee directs otherwise, based on a determination that a policy body has an urgent need to take action to ensure public health, safety, or essential government operations. This order applies to all City commissions, boards, and advisory bodies other than the Board of Supervisors and its committees.

(2) The Fourth Supplement to the Emergency Proclamation dated March 18, 2020 (the "Fourth Supplement"), imposing a temporary moratorium on eviction for non-payment of rent by commercial tenants directly impacted by the COVID-19 crisis, is amended as follows:

(a) Notwithstanding the word "eviction" in subsection (d) of the Fourth Supplement, the moratorium applies to all attempts to recover possession of a unit due to non-payment, including situations where the tenant is occupying the unit on a month-to-month periodic tenancy, holdover basis, or similar arrangement, and including where the landlord has the right to terminate or not renew the agreement at the landlord's discretion. In such situations, if a tenant misses a payment due to COVID-19, the moratorium against recovering possession due to non-payment shall apply, unless the landlord can demonstrate an alternative, non-pretextual reason for recovering possession of the unit (e.g., turning the unit over to a new tenant under a previously executed agreement, planned renovations, or previous agreement to turn over the unit vacant to a new owner).

(b) The moratorium is also intended to cover security deposits. The moratorium does not prohibit a landlord from drawing from an existing security deposit, in the event

the tenant has missed a rent payment and the agreement allows the landlord to deduct rent from the security deposit. However, a landlord may not require a tenant described in subdivision (a) of the Fourth Supplement to increase the security deposit. If an existing agreement contains a provision requiring a tenant to replenish a security deposit that the landlord has drawn from, the landlord shall not attempt to recover possession of the unit due to the tenant's inability to replenish the security deposit, if the tenant was unable to do so because of the financial impacts of COVID-19. In such event, the landlord and tenant shall follow the notice and cure requirements set forth in subdivisions (c) and (d) of the Fourth Supplement with regard to replenishment of the security deposit. Any failure to replenish a security deposit as set forth in an existing agreement shall not be a basis to recover possession of the unit until six months after the moratorium expires. Notwithstanding the foregoing, landlords are discouraged from using tenants' security deposits to cover missed rent payments during the moratorium.

(c) The foregoing provisions are incorporated into the Fourth Supplement as though set forth directly therein, and shall expire at the same time that the Fourth Supplement expires. If the Fourth Supplement is renewed, the foregoing provisions shall also renew.

DATED: April 1, 2020

London N. Breed
Mayor of San Francisco

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OFFICE OF THE MAYOR
SAN FRANCISCO

LONDON N. BREED
MAYOR

EXECUTIVE ORDER
EXTENDING COMMERCIAL EVICTION MORATORIUM

On February 25, 2020, under California Government Code Sections 8550 et seq., San Francisco Charter Section 3.100(14) and Chapter 7 of the San Francisco Administrative Code, I issued a Proclamation (the "Proclamation") declaring a local emergency to exist in connection with the imminent spread within the City of a novel (new) coronavirus ("COVID-19"). I issued the Fourth Supplement to the Proclamation on March 18, 2020, imposing a temporary moratorium on eviction for non-payment of rent by commercial tenants directly impacted by the COVID-19 crisis. The Board of Supervisors concurred in this action on March 31, 2020. On April 1, 2020, I issued the Eighth Supplement to the Proclamation, which contained an order clarifying the scope of the temporary moratorium. The Board of Supervisors concurred in this action on April 14, 2020.

The Fourth Supplement provides that the order imposing a commercial eviction moratorium will last for an initial period of 30 days, expiring on April 17, 2020, and further provides that "Mayor may extend this Order by an additional period of 30 days if emergency conditions at that time warrant extension. The Mayor shall provide notice of the extension through an Executive Order posted on the Mayor's website and delivered to the Clerk of the Board of Supervisors." The Eighth Supplement provides that its terms are incorporated into the Fourth Supplement and that renewal of the Fourth Supplement shall also cause the Eighth Supplement to be renewed. On April 15, 2020, I issued an executive order extending the commercial eviction moratorium 30 days to May 17, 2020.

I find that emergency conditions continue to exist due to the ongoing public health crisis arising from COVID-19 and the economic impacts it has caused, warranting extension of the moratorium. Therefore, I hereby extend the commercial eviction moratorium in the Fourth Supplement and Eighth Supplement for an additional 30 days through June 16, 2020.

DATED: May 14, 2020

London N. Breed
Mayor of San Francisco

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FILED
OFFICE OF THE CITY CLERK
OAKLAND

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APPROVED AS TO FORM AND LEGALITY

CITY ATTORNEY'S OFFICE

INTRODUCED BY COUNCILMEMBER NIKKI FORTUNATO BAS,
COUNCIL PRESIDENT PRO TEMPORE DAN KALB,
CITY ATTORNEY BARBARA J. PARKER,
COUNCILMEMBER NOEL GALLO,
COUNCILMEMBER LYNETTE GIBSON MCELHANEY,
COUNCIL PRESIDENT REBECCA KAPLAN,
VICE MAYOR LARRY REID,
COUNCILMEMBER LOREN TAYLOR, AND
COUNCILMEMBER SHENG THAO

OAKLAND CITY COUNCIL

ORDINANCE NO. 13589 C.M.S.

Six Affirmative Votes Required

EMERGENCY ORDINANCE (1) IMPOSING A MORATORIUM ON RESIDENTIAL EVICTIONS, RENT INCREASES, AND LATE FEES DURING THE LOCAL EMERGENCY PROCLAIMED IN RESPONSE TO THE NOVEL CORONAVIRUS (COVID-19) PANDEMIC; (2) PROHIBITING RESIDENTIAL AND COMMERCIAL EVICTIONS BASED ON NONPAYMENT OF RENT THAT BECAME DUE DURING THE LOCAL EMERGENCY WHEN TENANT SUFFERED A SUBSTANTIAL LOSS OF INCOME DUE TO COVID-19; (3) PROHIBITING RESIDENTIAL EVICTIONS FOR NON-PAYMENT OF RENT WHERE THE LANDLORD IMPEDED THE PAYMENT OF RENT; AND (4) CALLING ON STATE AND FEDERAL LEGISLATORS AND FINANCIAL INSTITUTIONS TO PROVIDE RELIEF TO LOW-INCOME HOMEOWNERS AND LANDLORDS

WHEREAS, COVID-19 is a respiratory disease which was first detected in China and has now spread across the globe, with multiple confirmed cases in California, including the Bay Area; and

WHEREAS, On March 1, 2020, Alameda County Interim Health Officer Erica Pan, MD, MPH, FAAP declared a Local Health Emergency, and

WHEREAS, on March 4, 2020, California Governor Gavin Newsom proclaimed that a State of Emergency exists in California as a result of the threat of COVID-19; and

WHEREAS, Oakland is experiencing a severe housing affordability crisis and 60 percent of Oakland residents are renters, who would not be able to locate affordable housing within the City if they lose their housing; and

WHEREAS, in the City of Oakland, more than 4000 of our community members are homeless and live outdoors, in tents or in vehicles; and

WHEREAS, because homelessness can exacerbate vulnerability to COVID-19, it is necessary to take measures to preserve and increase housing security for Oakland residents; and

WHEREAS, the World Health Organization announced on March 11, 2020, that it has characterized COVID-19 as a pandemic; and

WHEREAS, on March 9, 2020, the Oakland City Administrator issued a proclamation of Local Emergency which was ratified by the Oakland City Council on March 12, 2020; and

WHEREAS, at the City Council's Special Meeting on March 12, 2020, numerous members of the public gave commentary about the need to prevent residential evictions during the COVID-19 crisis; and

WHEREAS, on March 16, 2020, Alameda County Interim Health Officer Erica Pan, MD, MPH, FAAP issued a Shelter-in-Place Order, requiring all Alameda County Residents to stay in their homes and leave only for specified essential purposes; and

WHEREAS, on March 17, 2020, the California Public Utilities Commission's (CPUC) Executive Director determined that energy, water, sewer, and communications companies under CPUC jurisdiction should halt customer disconnections for non-payment as a result of the State of Emergency called by Gov. Gavin Newsom. (Source: http://docs.cpuc.ca.gov/PublishedDocs/Published/G000/M329/K673/329673725.PDF); and

WHEREAS, the following California cities have enacted emergency eviction moratoriums: San Francisco, Berkeley, Emeryville, Alameda, San Jose, Los Angeles and San Diego, among others; and

WHEREAS, many Oakland residents are experiencing substantial losses of income as a result of business closures, the loss of hours or wages, or layoffs related to COVID-19, hindering their ability to keep up with rent payments; and

WHEREAS, many Oakland businesses are suffering economic losses related to COVID-19, in particular since the March 16, 2020, Shelter in Place Order; and

WHEREAS, the City of Oakland is supporting its small businesses and workers during this crisis by maintaining a new web page (www.oaklandbusinesscenter.com) to serve as a portal for all the local, state and federal resources available to support small businesses and workers during this crisis. These resources include assistance with small business taxes, loan programs, worker benefits programs, and other direct business support; and

WHEREAS, many Landlords charge late fees which can operate as an unfair penalty if a tenant is unable to pay rent due to reasons related to COVID-19; and

WHEREAS, some Landlords refuse to provide a W-9 form when required for a tenant to access rental assistance from a government or non-profit agency; and

WHEREAS, pursuant to Oakland Municipal Code Section 8.22.360F, the City Council may add limitations to a landlord's right to evict under the Just Cause for Eviction Ordinance; and

WHEREAS, during this state of emergency, and in the interests of protecting the public health and preventing transmission of the COVID-19, it is essential to avoid unnecessary displacement and homelessness; and

WHEREAS, an emergency ordinance restricting evictions during the COVID-19 crisis would help ensure that residents stay housed during the pandemic and would therefore reduce opportunities for transmission of the virus; and

WHEREAS, the City Council finds that the Just Cause for Eviction Ordinance, as amended herein, is consistent with Civil Code Section 1946.2 (as enacted by the Tenant Protection Act of 2019), is more protective than Civil Code Section 1946.2, and, in comparison to Civil Code Section 1946.2, further limits the reasons for termination of residential tenancy, provides additional tenant protections, and, in conjunction with other City ordinances, provides for higher relocation assistance payments; and

WHEREAS, on March 16, 2020, California Governor Gavin Newsom issued Executive Order N-28-20, which, among other things, suspended any provision of state law that would preempt or otherwise restrict a local government's exercise of its police power to impose substantive limitations on commercial evictions, if the basis for eviction was nonpayment of rent, or foreclosure, arising out of a substantial decrease in income or substantial out-of-pocket medical expenses caused by the COVID-19 pandemic, or a government agency's response to it, and is documented; and requests that financial institutions implement an immediate moratorium on foreclosures and related evictions that arise due to a substantial loss of household/business income, or substantial out-of-pocket medical expenses, sue to COVID-19; and

WHEREAS, on March 18, 2020, the Federal Housing Administration (FHA) enacted a 60-day moratorium on foreclosures and evictions for single family homes with FHA-insured mortgages, and the Federal Housing Finance Agency suspended foreclosures and evictions for single family homes with mortgages backed by either the Federal National Mortgage Association (Fannie Mae) or the Federal Home Loan Mortgage Corporation (Freddie Mac) for 60-days; and

WHEREAS, on March 19, 2020, California Governor Gavin Newsom issued Executive Order N-33-20, ordering, with limited exceptions, all individuals living in the state of California to stay at home or at their place of residence, until further notice; and

WHEREAS, on March 19, 2020, the United States Senate introduced a $1 trillion proposal for a coronavirus stimulus package, with support from the Trump Administration, which includes a direct payment to qualified individuals, small business loans, corporate tax cuts, and financial support for hard-hit industries such as airlines; and

WHEREAS, according to the 2018 City of Oakland Equity Indicators Report 74 percent of African American residents are renters, 69 percent of Latinx residents are renters, and 48 percent of Asian residents are renters; and 58 percent of African American and 53 percent of Latino residents are rent burdened in Oakland, and African American residents are twice as likely to receive an eviction notice than all residents; and

WHEREAS, this Ordinance will serve justice and promote racial equity for African American and Latinx renters; and

WHEREAS, pursuant to City Charter Section 213, the City Council may introduce and adopt an emergency ordinance at the same City Council meeting by six affirmative six votes; and

WHEREAS, the City Council finds that it is necessary to enact an emergency ordinance pursuant to the powers that City Charter Section 213 grants to the City Council to preserve the public health and safety which is threatened by COVID-19; and

NOW, THEREFORE, THE CITY COUNCIL OF THE CITY OF OAKLAND DOES ORDAIN AS FOLLOWS:

SECTION 1. Recitals. The City Council finds the foregoing recitals to be true and correct and hereby incorporates such findings into this ordinance.

SECTION 2. Purpose and Intent. The purpose and intent of this ordinance is to prevent displacement, reduce transmission of the novel Coronavirus (COVID-19), and promote the stability and the health and safety of the residents and businesses of Oakland during the Local Emergency declared by the City Administrator on March 9, 2020, and ratified by the Oakland City Council on March 12, 2020, in response to the COVID-19 pandemic (hereinafter, "Local Emergency").

SECTION 3. Residential Eviction Moratorium. Except when the tenant poses an imminent threat to the health or safety of other occupants of the property, and such threat is stated in the notice as the grounds for the eviction, it shall be an absolute defense to any unlawful detainer action filed under Oakland Municipal Code 8.22.360A subsections (1) – (10) that the notice was served or expired, or that the complaint was filed or served, during the Local Emergency. Any notice served pursuant to Oakland Municipal Code 8.22.360A (1) - (10) on a tenant during the Local Emergency shall include the following statement in bold underlined 12-point font: "**Except to protect the health and safety of other occupants of the property, you may not be evicted during the Local Emergency declared by the City of Oakland in response to the COVID-19 pandemic. This does not relieve you of the obligation to pay back rent in the future. You may contact the Rent Adjustment Program at (510) 238–3721 for additional information and referrals.**" This section shall remain in effect until May 31, 2020, unless extended.

SECTION 4. Rent Increase Moratorium. For rental units regulated by Oakland Municipal Code 8.22.010 et seq, any notice of rent increase in excess of the CPI Rent Adjustment, as defined in Oakland Municipal Code Section 8.22.020, shall be void and unenforceable if the notice is served or has an effective date during the Local Emergency, unless required to provide a fair return. Any notice of rent increase served during the Local Emergency shall include the following statement in bold underlined 12-point font: "**During the Local Emergency declared by the City of Oakland in response to the COVID-19 pandemic, your rent may not be increased in excess of the CPI Rent Adjustment (3.5% until June 30, 2020), unless required for the landlord to obtain a fair return. You may contact the Rent Adjustment Program at (510) 238–3721 for additional information and referrals.**"

SECTION 5. Late Fee Moratorium. Notwithstanding any lease provision to the contrary, for residential tenancies, no late fees may be imposed for rent that became due during the Local Emergency if the rent was late for reasons resulting from the COVID-19 pandemic. This includes, but is not limited to (1) the tenant was sick or incapacitated due to COVID-19, or was complying with a recommendation from a governmental agency to self-quarantine, (2) the tenant suffered a substantial reduction in household income because of a loss of employment or a reduction in hours, or because they were unable to work because they were caring for their child(ren) who were out of school or a household or family member who was sick with COVID-19, or because they were complying with a recommendation from a government agency to self-quarantine, and (3) the tenant incurred substantial out-of-pocket medical expenses caused by COVID-19. Any notice demanding late fees for rent that became due during the Local Emergency shall include the following statement in bold underlined 12-point font: "**You are not required to pay late fees for rent that became due during the Local Emergency declared by the City of Oakland in response to the COVID-19 pandemic if the rent was late for reasons**

related to the pandemic. You may contact the Rent Adjustment Program at (510) 238–3721 for additional information and referrals."

SECTION 6. Commercial Eviction Moratorium. In any action for unlawful detainer of a commercial unit based on non-payment of rent, it shall be an absolute defense if the failure to pay rent during the local emergency was the result of a substantial decrease in income (including but not limited to a decrease caused by a reduction in hours or consumer demand) and the decrease in income was caused by the COVID-19 pandemic or by any local, state, or federal government response to COVID-19, and is documented. This section shall only apply to small businesses as defined by Government Code Section 14837(d)(1)(A) and to nonprofit organizations. Any notice to a commercial tenant demanding rent shall include the following statement in bold underlined 12-point font: "**If you are a small business as defined by Government Code 14837(d)(1)(a) or a non-profit organization, you may not be evicted for failure to pay rent if the failure was due to a substantial decrease in income caused by the COVID-19 pandemic, or by any local, state, or federal government response to COVID-19, and is documented. This does not relieve you of the obligation to pay back rent in the future.**" This section shall remain in effect until May 31, 2020, unless extended. Nothing in this section shall relieve the tenant of liability for the unpaid rent.

SECTION 7. No Residential Eviction for Nonpayment of Rent that Became Due During the Local Emergency. In any action for unlawful detainer filed under Oakland Municipal Code 8.22.360.A.1, it shall be a defense that the unpaid rent became due during the Local Emergency and was unpaid because of a substantial reduction in household income or substantial increase in expenses resulting from the Coronavirus pandemic. This includes, but is not limited to, where, as a result of the Coronavirus pandemic, the tenant suffered a loss of employment or a reduction in hours, or was unable to work because their children were out of school, or was unable to work because they were sick with COVID-19 or caring for a household or family member who was sick with COVID-19, or they were complying with a recommendation from a government agency to self-quarantine, or they incurred substantial out of pocket medical expenses due to COVID-19. Any notice served on a residential tenant demanding rent that became due during the Local Emergency shall include the following statement in bold underlined 12-point type: "**You may not be evicted for rent that became due during the Local Emergency if the rent was unpaid because of a substantial reduction in household income or a substantial increase in expenses related to the Coronavirus pandemic. This does not relieve you of the obligation to pay back rent in the future. You may contact the Rent Adjustment Program at (510) 238–3721 for additional information and referrals.**" Nothing in this subsection shall relieve the tenant of liability for the unpaid rent.

SECTION 8. No Eviction if Landlord Impeded Payment of Rent. Subsection D of Section 8.22.360 of the Oakland Municipal Code (Just Cause for Eviction Ordinance)] is hereby repealed and reenacted with amendments, as set forth below (additions are shown as double underline).

D. Substantive limitations on landlord's right to evict.

1. In any action to recover possession of a rental unit pursuant to Section 6 [8.22.360], a landlord must allege and prove the following:
   a. the basis for eviction, as set forth in Subsection 6(A)(1) through 6(A)(11) [8.22.360 A.1 through 8.22.360 A.11] above, was set forth in the notice of termination of tenancy or notice to quit;
   b. that the landlord seeks to recover possession of the unit with good faith, honest intent and with no ulterior motive;

2. If landlord claims the unit is exempt from this ordinance, landlord must allege and prove that the unit is covered by one of the exceptions enumerated in Section 5 [8.22.350] of this chapter. Such allegations must appear both in the notice of termination of tenancy or notice to quit, and in the complaint to recover possession. Failure to make such allegations in the notice shall be a defense to any unlawful detainer action.

3. This subsection (D) [8.22.360 D] is intended as both a substantive and procedural limitation on a landlord's right to evict. A landlord's failure to comply with the obligations described in Subsections 7(D)(1) or (2) [*sic*] [8.22.360 D.1 or 8.22.360 D.2] shall be a defense to any action for possession of a rental unit.

4. In any action to recover possession of a rental unit filed under 8.22.360A1, it shall be a defense if the landlord impeded the tenant's effort to pay rent by refusing to accept rent paid on behalf of the tenant from a third party, or refusing to provide a W-9 form or other necessary documentation for the tenant to receive rental assistance from a government agency, non-profit organization, or other third party. Acceptance of rental payments made on behalf of the tenant by a third party shall not create a tenancy between the landlord and the third party as long as either the landlord or the tenant provide written notice that no new tenancy is intended.

SECTION 9. No Relief from Liability for Rent. Nothing in this Ordinance shall relieve any tenant of liability for unpaid rent that became due during the Local Emergency. Landlords are encouraged to work with local agencies that will be making rental assistance available for qualifying tenants.

SECTION 10. Notice Requirements. Obligatory notice statements required by this ordinance shall be written in the language that the landlord and/or the landlord's agents normally use for verbal communications with the tenant.

SECTION 11. Good Samaritan Temporary Rent Decreases – A landlord and tenant may agree in writing to a temporary rent reduction without reducing the base rent used for calculating rent increases under the Rent Adjustment Ordinance. For Good Samaritan Status to exist, the written agreement must include a statement that the

reduction is temporary and is unrelated to market conditions, habitability, or a reduction in housing services.

SECTION 12. No Waiver of Rights. Any agreement by a tenant to waive any rights under this ordinance shall be void as contrary to public policy.

SECTION 13. City Council Request for Additional State and Federal Action. The Oakland City Council hereby requests and urges Governor Newsom, California State legislators and U.S. Senators and Representatives to enact comprehensive legislation to further protect residents, tenants, homeowners and small businesses from the adverse health, safety and economic impacts of this crisis. This includes, but is not limited to, the following:

- A moratorium on mortgage foreclosures;
- A moratorium on commercial rent increases;
- Creation of emergency direct assistance programs for rent and mortgage payments, and other housing-related expenses such as utilities, property taxes, and insurance;
- Urging banks and financial institutions to suspend rents and mortgages;
- Creation of emergency grant programs to small businesses and nonprofits;
- Creation of emergency programs that provide homes and expanded services for people experiencing homelessness; and
- A moratorium on evictions, including those residential units newly covered by the enactment of AB 1482, which added Civil Code Section 1946.2.

SECTION 14. City Council Requests Action by Financial Institutions. The Oakland City Council hereby requests and urges banks and financial institutions to suspend mortgage payments, foreclosures, and late fees for low-income homeowners and landlords, with immediate forgiveness, and encourages financial institutions to provide zero-interest emergency unsecured loans and grants to small businesses and non-profits within Oakland that are unable to meet rent, mortgage, or other fixed operating costs.

SECTION 15. This ordinance is exempt from the California Environmental Quality Act (CEQA) under CEQA Guidelines Sections 15060(c)(2) (no direct or reasonably foreseeable indirect physical change in the environment),15061(b)(3) (no environmental impact),15269(c) (specific actions necessary to mitigate an emergency), and 15378 (regulatory actions). In response to the COVID-19 crisis, which has been declared a national, state, and local emergency, this ordinance implements rent stabilization measures and an eviction moratorium for existing residential units in the City with tenants who have been negatively impacted by the emergency.

The ordinance is necessary to mitigate an emergency and contains no provisions modifying the physical design, development, or construction of residential or

nonresidential structures. Accordingly, it can be seen with certainty that there is no possibility that the ordinance may have a significant effect on the environment and result in no physical changes to the environment.

SECTION 16. Severability. If any section, subsection, sentence, clause or phrase of this Ordinance is for any reason held to be invalid or unconstitutional by decision of any court of competent jurisdiction, such decision shall not affect the validity of the remaining portions of the Chapter. The City Council hereby declares that it would have passed this Ordinance and each section, subsection, clause or phrase thereof irrespective of the fact that one or more other sections, subsections, clauses or phrases may be declared invalid or unconstitutional.

SECTION 17. Direction to City Administrator. The City Council hereby directs the City Administrator to transmit a copy of this Ordinance to all banks, financial institutions, and public utilities operating in Oakland, Governor Gavin Newsom, State Senator Nancy Skinner, Assembly Member Buffy Wicks, Assembly Member Rob Bonta, U.S. Senator Kamala Harris, U.S. Senator Dianne Feinstein, and U.S. Representative Barbara Lee.

SECTION 18. Regulations. The City Administrator may issue regulations, guidance, and forms as needed to implement this Ordinance, including but not limited to guidelines for repayment of back rent.

SECTION 19. Effective Date. This ordinance shall become effective immediately if it receives six or more affirmative votes.

IN COUNCIL, OAKLAND, CALIFORNIA,

Introduction Date

PASSED BY THE FOLLOWING VOTE: MAR 27 2020

AYES - FORTUNATO BAS, GALLO, GIBSON MCELHANEY, KALB, REID, TAYLOR, THAO AND PRESIDENT KAPLAN — 8

NOES – Ø
ABSENT – Ø
ABSTENTION – Ø

ATTEST: LaTonda Simmons
LATONDA SIMMONS
City Clerk and Clerk of the Council of the City of Oakland, California

Date of Attestation: April 15, 2020

2916782v6

NOTICE AND DIGEST

EMERGENCY ORDINANCE (1) IMPOSING A MORATORIUM ON RESIDENTIAL EVICTIONS, RENT INCREASES, AND LATE FEES DURING THE LOCAL EMERGENCY PROCLAIMED IN RESPONSE TO THE NOVEL CORONAVIRUS (COVID-19) PANDEMIC; (2) PROHIBITING RESIDENTIAL AND COMMERCIAL EVICTIONS BASED ON NONPAYMENT OF RENT THAT BECAME DUE DURING THE LOCAL EMERGENCY WHEN TENANT SUFFERED A SUBSTANTIAL LOSS OF INCOME DUE TO COVID-19; (3) PROHIBITING RESIDENTIAL EVICTIONS FOR NON-PAYMENT OF RENT WHERE THE LANDLORD IMPEDED THE PAYMENT OF RENT; AND (4) CALLING ON STATE AND FEDERAL LEGISLATORS AND ON FINANCIAL INSTITUTIONS TO PROVIDE RELIEF TO LOW-INCOME HOMEOWNERS AND LANDLORDS

This ordinance imposes a temporary moratorium on residential evictions and rent increases in excess of CPI during the Local Emergency. It also prohibits residential evictions and the imposition of late fees for rent that became due during the Local Emergency if the tenant's failure to pay rent was a result of a substantial decrease in income or a substantial increase in expenses related to COVID-19; and prohibits evictions when the landlord has impeded the tenant's efforts to pay rent. The ordinance imposes a temporary moratorium on evictions of small businesses for non-payment of rent when the tenant suffered a substantial loss of business income related to COVID-19.

At the Oakland City Council's March 27, 2020 special meeting, the Council unanimously adopted the Emergency Ordinance by a vote of 8 ayes. Councilmember Fortunato-Bas made the motion to adopt the ordinance and President Pro Tempore Kalb seconded the motion.

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Gregg leads Coblentz's Bankruptcy and Creditors' Rights Practice Group. He has a nationwide bankruptcy and insolvency practice focused on representing landlords, real estate developers, aircraft lessors, asset purchasers, suppliers, and various other creditors both inside and outside of bankruptcy court.

Gregg's non-bankruptcy practice includes landlord-tenant litigation, fraudulent transfer, lien priority, and other debtor-creditor litigation, and representing hotels, commercial property owners, and other business in defending Americans with Disabilities Act litigation.

Gregg previously was Chair of the Bar Association of San Francisco Commercial Law and Bankruptcy Section, Chair of the Bench-Bar Liaison Committee for the United States Bankruptcy Court, Northern District of California, and Chair of the Alameda County Bar Association Bankruptcy and Commercial Law Section. He is a former Director of the Bay Area Bankruptcy Forum. Gregg is a graduate of UC Davis King Hall School of Law, and was Judicial Law Clerk to United States Bankruptcy Judge Edward D. Jellen (Ret.) (N.D. Cal.) from 1990-1992.

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Mr. Keller is a real estate lawyer with expertise in land use entitlements, litigation, and insolvency proceedings. His insolvency practice focuses on representing landlords in tenant bankruptcy cases all over the country. Recent engagements include representing three different clients with nine properties involved in the Sears case, as well as the lessors of the headquarters offices in the Sanchez Energy and Wave Computing cases.

Mr. Keller has served as the Chair of the San Francisco Bar Association's Commercial Law and Bankruptcy Section, a member of the Bay Area Bankruptcy Forum Board of Directors, and the President of the California Receivers Forum Bay Area Chapter. He is a graduate of UC Berkeley and UC Hastings College of the Law.

Michael St. James
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Mr. St. James is the principal of St. James Law, P.C. in San Francisco, California. He has been nationally designated "Board Certified – Business Bankruptcy" by the American Board of Bankruptcy Certification continuously since 1983; designated "Legal Specialist – Bankruptcy" by the State Bar of California continuously since 2005; designated "Super Lawyer" continuously since 2006, and designated "Best Lawyer" continuously since 2008. Mr. St. James limits his practice to business bankruptcy and insolvency law matters, representing debtors, creditors and landlords.