

Fourth Supplement to Memorandum 81-24

Subject: Study D-300 - Enforcement of Judgments (AB 707) (Leasehold Interests Subject to Enforcement)

A question has been raised concerning the operation of Section 695.030(b)(1) of Assembly Bill 707 which provides that a leasehold subject to a provision precluding assignment or transfer is subject to enforcement of a money judgment. As this provision stands, it would seem to permit an execution sale of a leasehold interest regardless of the terms of the lease or the qualifications of the purchaser at the execution sale. The staff believes that this provision is inadequate. The Bankruptcy Code contains a very detailed provision governing the disposition of unexpired leases that is indicative of the problems involved. (See Exhibit 1.) It is also interesting to note that a bill is before the Legislature that would permit an assignee for the benefit of creditors to occupy leased business premises of a debtor for a period of up to 90 days upon payment of rent when due, notwithstanding a lease provision for termination upon assignment or insolvency. (Assembly Bill 1582, as amended May 18, 1981.)

The staff recommends that AB 707 be amended to provide that the lessee's interest may be applied to the satisfaction of a money judgment if the lease permits the lessee to sublet the property or assign the lease. If the right to sublet or assign is subject to reasonable standards and conditions, the execution purchaser or other assignee must agree to such standards or conditions. If the right to sublet or assign is subject to the consent of the lessor, the lessor's consent may not be unreasonably withheld. If any of the foregoing conditions are satisfied, a lease may be applied to the satisfaction of a money judgment notwithstanding a lease provision for a forfeiture upon involuntary assignment. If the lease does not permit the lessee to sublet or assign, the lessee's interest should be subject to enforcement if the lessor consents in writing. Amendments to accomplish the staff recommendation are attached hereto as Exhibit 2.

This scheme is consistent with Civil Code Section 1951.4 which under certain conditions permits a lessor to continue to collect rent after the lessee has breached the lease and abandoned the property.

Respectfully submitted,

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Staff Counsel

Exhibit 1

Bankruptcy Code 11 U.S.C. § 365

§ 365. Executory contracts and unexpired leases

(a) Except as provided in sections 765 and 766 of this title and in subsections (b), (c), and (d) of this section, the trustee, subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor.

(b) (1) If there has been a default in an executory contract or unexpired lease of the debtor, the trustee may not assume such contract or lease unless, at the time of assumption of such contract or lease, the trustee—

(A) cures, or provides adequate assurance that the trustee will promptly cure, such default;

(B) compensates, or provides adequate assurance that the trustee will promptly compensate, a party other than the debtor to such contract or lease, for any actual pecuniary loss to such party resulting from such default; and

(C) provides adequate assurance of future performance under such contract or lease.

(2) Paragraph (1) of this subsection does not apply to a default that is a breach of a provision relating to—

(A) the insolvency or financial condition of the debtor at any time before the closing of the case;

(B) the commencement of a case under this title; or

(C) the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement.

(3) For the purposes of paragraph (1) of this section, adequate assurance of future performance of a lease of real property in a shopping center includes adequate assurance—

(A) of the source of rent and other consideration due under such lease;

(B) that any percentage rent due under such lease will not decline substantially;

(C) that assumption or assignment of such lease will not breach substantially any provision, such as a radius, location, use, or exclusivity provision, in any other lease, financing agreement, or master agreement relating to such shopping center; and

(D) that assumption or assignment of such lease will not disrupt substantially any tenant mix or balance in such shopping center.

(4) Notwithstanding any other provision of this section, if there has been a default in an unexpired lease of the debtor, other than a default of a kind specified in paragraph (2) of this subsection, the trustee may not require a lessor to provide services or supplies incidental to such lease before assumption of such lease unless the lessor is compensated under the terms of such lease for any services and supplies provided under such lease before assumption of such lease.

(c) The trustee may not assume or assign an executory contract or unexpired lease of the debtor, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties, if—

(1) (A) applicable law excuses a party, other than the debtor, to such contract or lease from accepting performance from or rendering performance to the trustee or an assignee of such contract or lease, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties; and

(B) such party does not consent to such assumption or assignment; or

(2) such contract is a contract to make a loan, or extend other debt financing or financial accommodations, to or for the benefit of the debtor, or to issue a security of the debtor.

(d) (1) In a case under chapter 7 of this title, if the trustee does not assume or reject an executory contract or unexpired lease of the debtor within 60 days after the order for relief, or within such additional time as the court, for cause, within such 60-day period, fixes, then such contract or lease is deemed rejected.

(2) In a case under chapter 9, 11, or 13 of this title, the trustee may assume or reject an executory contract or unexpired lease of the debtor at any time before the confirmation of a plan, but the court, on request of any party to such contract or lease, may order the trustee to determine within a specified period of time whether to assume or reject such contract or lease.

(e) (1) Notwithstanding a provision in an executory contract or unexpired lease, or in applicable law, an executory contract or unexpired lease of the debtor may not be terminated or modified, and any right or obligation under such contract or lease may not be terminated or modified, at any time after the commencement of the case solely because of a provision in such contract or lease that is conditioned on—

(A) the insolvency or financial condition of the debtor at any time before the closing of the case;

(B) the commencement of a case under this title; or

(C) the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement.

(2) Paragraph (1) of this subsection does not apply to an executory contract or unexpired lease of the debtor, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties, if—

(A) (i) applicable law excuses a party, other than the debtor, to such contract or lease from accepting performance from or rendering performance to the trustee or to an assignee of such contract or lease, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties; and

(ii) such party does not consent to such assumption or assignment; or

(B) such contract is a contract to make a loan, or extend other debt financing or financial accommodations, to or for the benefit of the debtor, or to issue a security of the debtor.

(f) (1) Except as provided in subsection (c) of this section, notwithstanding a provision in an executory contract or unexpired lease of the debtor, or in applicable law, that prohibits, restricts, or conditions the assignment of such contract or lease, the trustee may assign such contract or lease under paragraph (2) of this subsection.

(2) The trustee may assign an executory contract or unexpired lease of the debtor only if—

(A) the trustee assumes such contract or lease in accordance with the provisions of this section; and

(B) 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.

(3) Notwithstanding a provision in an executory contract or unexpired lease of the debtor, or in applicable law that terminates or modifies, or permits a party other than the debtor to terminate or modify, such contract or lease or a right or obligation under such contract or lease on account of an assignment of such contract or lease, such contract, lease, right, or obligation may not be terminated or modified under such provision because of the assumption or assignment of such contract or lease by the trustee.

(g) Except as provided in subsections (h) (2) and (i) (2) of this section, the rejection of an executory contract or unexpired lease of the debtor constitutes a breach of such contract or lease—

(1) if such contract or lease has not been assumed under this section or under a plan confirmed under chapter 9, 11, or 13 of this title, immediately before the date of the filing of the petition; or

(2) if such contract or lease has been assumed under this section or under a plan confirmed under chapter 9, 11, or 13 of this title—

(A) if before such rejection the case has not been converted under section 1112 or 1307 of this title, at the time of such rejection; or

(B) if before such rejection the case has been converted under section 1112 or 1307 of this title—

(i) immediately before the date of such conversion, if such contract or lease was assumed before such conversion; or

(ii) at the time of such rejection, if such contract or lease was assumed after such conversion.

(h)(1) If the trustee rejects an unexpired lease of real property of the debtor under which the debtor is the lessor, the lessee under such lease may treat the lease as terminated by such rejection, or, in the alternative, may remain in possession for the balance of the term of such lease and any renewal or extension of such term that is enforceable by such lessee under applicable nonbankruptcy law.

(2) If such lessee remains in possession, such lessee may offset against the rent reserved under such lease for the balance of the term after the date of the rejection of such lease, and any such renewal or extension, any damages occurring after such date caused by the nonperformance of any obligation of the debtor after such date, but such lessee does not have any rights against the estate on account of any damages arising after such date from such rejection, other than such offset.

(i)(1) If the trustee rejects an executory contract of the debtor for the sale of real property under which the purchaser is in possession, such purchaser may treat such contract as terminated, or, in the alternative, may remain in possession of such real property.

(2) If such purchaser remains in possession—

(A) such purchaser shall continue to make all payments due under such contract, but may, offset against such payments any damages occurring after the date of the rejection of such contract caused by the nonperformance of any obligation of the debtor after such date, but such purchaser does not have any rights against the estate on account of any damages arising after such date from such rejection, other than such offset; and

(B) the trustee shall deliver title to such purchaser in accordance with the provisions of such contract, but is relieved of all other obligations to perform under such contract.

(j) A purchaser that treats an executory contract as terminated under subsection (i) of this section, or a party whose executory contract to purchase real property from the debtor is rejected and under which such party is not in possession, has a lien on the interest of the debtor in such property for the recovery of any portion of the purchase price that such purchaser or party has paid.

(k) Assignment by the trustee to an entity of a contract or lease assumed under this section relieves the trustee and the estate from any liability for any breach of such contract or lease occurring after such assignment.

Exhibit 2

PROPOSED AMENDMENTS RELATING TO ENFORCEMENT OF
MONEY JUDGMENT AGAINST LEASEHOLD

Amendment 1

On page 33, line 31, strike out "Property" and insert:
Except as otherwise provided by statute, property

Amendment 2

On page 33, line 34, strike out "Notwithstanding subdivision
(a), the" and insert:
The

Amendment 3

On page 33, strike out lines 36 and 37

Amendment 4

On page 33, line 38, strike out "(2)" and insert:
(1)

Amendment 5

On page 33, line 40, strike out "(3)" and insert:
(2)

Amendment 6

On page 34, between lines 1 and 2, insert:
695.035. (a) A lessee's interest in real property may be
applied to the satisfaction of a money judgment in any of the following
circumstances:

(1) If the lessee has the right voluntarily to sublet the property or assign the interest in the lease.

(2) If the lease permits the lessee to sublet the property or assign the interest in the lease subject to standards or conditions, provided that the purchaser at an execution sale or other assignee agrees to comply such standards or conditions to the extent they are reasonable.

(3) If the lease permits the lessee to sublet the property or assign the interest in the lease with the consent of the lessor, provided that the lessor may not unreasonably withhold consent.

(4) In any other case, if the lessor consents in writing.

(b) A provision in a lease for the termination or modification of the lease upon an involuntary transfer or assignment of the lessee's interest is ineffective if the lessee's interest may be applied to the satisfaction of the money judgment pursuant to subdivision (a).