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Bankruptcy Court Finds Tenant Cannot Assume Commercial Lease After Waiving Rights to Seek Relief From Forfeiture Under California Law

The US Bankruptcy Court for the Central District of California (the “Court”) recently upheld the validity of a commercial lease provision by which a debtor/tenant waived its rights to seek relief from forfeiture (i.e., termination) of the lease under California law. As a result, the debtor/tenant had no right in the bankruptcy case to assume the lease. *In re Art and Architecture Books of the 21st Century*, Case No. 2:13-bk-14135-RK (September 18, 2014). This decision addresses an issue left open by the US Court of Appeals for the Ninth Circuit’s decision in *In re Windmill Farms, Inc.*, 841 F.2d 1467 (9th Cir. 1988).

The *Windmill Farms* Decision

In *Windmill Farms*, the Ninth Circuit held that a debtor/tenant’s nonresidential real property lease which was terminated under California law prior to a bankruptcy filing could not be assumed in the tenant’s bankruptcy case. Left unanswered by the Ninth Circuit was the question of whether relief from forfeiture was even available to a party seeking to assume a lease in bankruptcy.

The *Art and Architecture Books of the 21st Century* Decision

In *In re Art and Architecture Books of the 21st Century*, the Court upheld the validity of the debtor’s waiver of its rights to seek relief from forfeiture. The factors that the Court considered included whether: (1) other California statutes prohibited waiver of forfeiture; (2) the primary purpose of the statutes—California Code of Civil Procedure § 1179 and California Civil Code § 3275 (the “Statutes”)—was to benefit the public; and (3) waiver would seriously compromise a public purpose. The Court found that: no other statute prohibited waiver of the right to seek relief from forfeiture; the primary purpose of the Statutes was to mitigate private harm from such forfeiture rather than to benefit the public; and waiver would not seriously compromise a public purpose. The Court weighed the policies in favor of freedom of contract in commercial real property leases against the policy that equity abhors forfeiture of a lease, and found on balance that the express contractual language waiving the right to seek relief from forfeiture favored the policy of freedom of contract.

The Court held that “parties to a commercial lease should generally be free to contract with each other upon such terms as they agree,” and determined that “if two contracting parties in a commercial lease desire to waive specific provisions of the [California] Civil Code, as is the case here, they generally should be free to do so.” As to whether the debtor/tenant’s waiver of the right to seek relief from the forfeiture was “knowing and voluntary,” the Court found that the landlord met its burden of proof by showing that the lease was heavily negotiated by the parties, with numerous

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drafts exchanged prior to execution, between experienced and sophisticated real estate counsel. Thus, because the lease was terminated pre-petition and the debtor/tenant knowingly and voluntarily waived its rights to seek relief from forfeiture, it could not assume the lease in the bankruptcy case. The waiver provision, therefore, allowed the landlord to recapture the premises without the need to address the issue of whether the debtor/tenant could demonstrate adequate assurance of future performance under the lease.

Practical Guidelines for Landlords

Landlords should consider the following when drafting, negotiating and executing a nonresidential real property lease:

- Carefully draft any provisions of a lease concerning the waiver of statutory rights, and especially the tenant's waiver of rights to seek relief from forfeiture to make sure that the waiver language is clear, unambiguous and as all-inclusive as possible.
- Exercise diligence in monitoring any defaults under the lease to maximize your ability to declare a default and terminate the lease prior to any bankruptcy filing.

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