



BANKRUPTCY BLOG

Commercial Tenant Beware!

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The United States District Court for the Southern District of New York issued an opinion on October 18, 2022, finding that a security deposit for a commercial lease was nothing more than an unsecured loan to the landlord rather than a deposit held in trust.

The ruling holds that if the lease does not require the landlord to hold a security deposit in trust and/or if there is no state statute requiring landlords to hold the security deposit in trust, that deposit may not be recoverable if the landlord files bankruptcy.

In this case, a tenant leased commercial space and gave the landlord a \$270,000 security deposit. Shortly before the landlord filed bankruptcy, the secured lender swept the debtor's bank accounts, including the security deposit. When the tenant sought the security deposit back after the lease was rejected in bankruptcy, the debtor claimed there were no funds left to repay the security deposit. After finding that the federal court did have subject matter jurisdiction to decide the dispute, the district court found the amount of the deposit was nothing more than an unsecured claim in the bankruptcy case.

The court reasoned that Illinois only had a statute governing residential security deposits, requiring those deposits be held in trust. There was no such statute governing commercial leases. Nothing in the lease required the security deposit to be held in trust.

Furthermore, the tenant's claims for conversion were dismissed because New York law (where the bankruptcy case was pending), requires unauthorized exercise of control over property by someone who is not the owner. Because the tenant made an unsecured loan, the conversion claim and claims for negligence and unjust enrichment also failed. Since there was a governing lease, claims for wrongful retention also failed.

Lesson learned - A Security Deposit Is an Unsecured Loan, unless State Law or the Lease Says Otherwise. Case Citation: *10FN Inc. v. Cerberus Business Finance LLC*, 21-5996 (S.D.N.Y. Oct. 18, 2022)