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# Commercial Leasing

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## In the Spotlight

### *New Bankruptcy Law Is Not All Good for Landlords*

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On April 20, 2005, President Bush signed into law the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, which significantly changed the U.S. Bankruptcy Code. While various aspects of the new law give landlords greater rights in tenant bankruptcies, the law is not all good for landlords. The benefits of the new law for commercial landlords have been written about extensively, including an analysis of the new provisions setting definitive

deadlines for a tenant to assume or reject a lease under the Bankruptcy Code. What has not been highlighted is that if a commercial tenant files a Chapter 7 bankruptcy case, a landlord's space could be tied up for 120 days or more, instead of 60 days or more under the old law. (This article does not address the special rules and protections for landlords of residential properties and is devoted to a discussion of the provisions regarding commercial properties.)

This situation may occur because many tenants file Chapter 7 bankruptcies, a trustee is appointed, and there is no effort to reorganize the business. For this reason, a landlord will need to be much more proactive in cases where the tenant files Chapter 7 bankruptcy and should not just idly sit by and allow the lengthened time period to run.

The filing of a tenant bankruptcy "stays," or prohibits, the landlord from taking any action against the tenant, such as eviction, without bankruptcy court approval and is designed to give the tenant or bankruptcy trustee breathing room

while it decides what to do with the premises. In a bankruptcy, the tenant, whether a Chapter 11 debtor or a Chapter 7 bankruptcy trustee, has essentially three options:

- 1) Reject the lease and surrender the premises to the landlord;
- 2) Assume the lease, curing all defaults and providing adequate assurance of future performance. Under this option, the landlord benefits by recovering everything owed and maintaining the tenant as a source of future cash flow; or
- 3) Assume the lease and assign it to a third party with approval of the bankruptcy court.

In most cases in which the tenant files Chapter 7 bankruptcy, the bankruptcy trustee will likely want to reject the lease and surrender the premises. He or she may, however, need time to remove property from the premises and/or determine if there is any value in the lease that could be realized for the estate. The prior law required the tenant/bankruptcy trustee to assume or reject the lease within 60 days after the case filing date (subject to

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being extended), or the lease was deemed rejected. Pending the determination, the tenant is required to keep current on rent and otherwise timely perform under the lease. The Bankruptcy Court could, and frequently did, extend this deadline in Chapter 11 cases. However, in Chapter 7 cases, where the tenant/bankruptcy trustee usually closes the business, the deadline was typically allowed to pass, and the lease was deemed rejected 60 days after the filing date. The landlord did not have to take any action and could rely on the fact that once the 60 days had passed, assuming it was not extended, the lease was deemed rejected. Although the space was tied up for 60 days with little expectation of receiving rent from the trustee because the business was not operating, 60 days was typically the longest period of time that the landlord's space was tied up and not available for re-leasing unless the time period was extended in an extraordinary case.

Oftentimes, the trustee would not do anything, and the 60 days would pass. Sometimes, the trustee would reject the lease sooner in order to avoid the accrual of administrative rent for which he or she had no funds to pay. In the rare Chapter 7 case, the trustee would seek to extend the deadline or assume the lease and assign it to a third party.

The new law gives the tenant/trustee 120 days to decide whether to assume or reject the lease and allows for only one 90-day extension for cause shown without the landlord's consent. The landlord must consent to any further

extensions, or the Bankruptcy Court may not grant the extension. While this is of great benefit to landlords in Chapter 11 cases because it provides more certainty as to when the landlord will recover the space, it also yields greater uncertainty for a landlord in a Chapter 7 case because the space could now be tied up for at least 120 days, and not just 60 days, unless the landlord acts to protect its interest. Therefore, a landlord with a tenant that has filed a Chapter 7 bankruptcy will have the following options:

1) The landlord can convince the bankruptcy trustee that he or she should immediately reject the lease and surrender the premises. The trustee will need to file a motion with the Bankruptcy Court seeking approval of his or her rejection of the lease. The trustee should want to do this in most cases since it will avoid incurring rent on behalf of the bankruptcy estate that the trustee usually cannot pay. However, it is sometimes difficult to get the trustee to take any action because many trustees are overloaded with cases. If a trustee will not promptly reject the lease, the space will be off the market for at least 120 days, as opposed to the 60 days under the old law, unless the landlord takes the actions described below.

2) Alternatively, the landlord could promptly file pleadings with the Bankruptcy Court seeking an order requiring the trustee to assume or reject the lease in a shorter period of time. For example, the landlord would ask that the court direct the trustee to seek either to assume or reject the lease within 15 days of

entry of the order of the court. The landlord may also want to seek relief from the automatic stay to allow it to enforce its state law remedies under the lease, such as eviction.

3) A landlord may also want to seek payment of an administrative claim for rent that the trustee has not paid and an order directing him or her to timely pay rent.

A landlord's filing of pleadings with the court should get the trustee's attention and put the trustee in the position of having to decide what he or she wants to do. The most aggressive landlords will promptly seek the remedies described above and will not just take a "wait and see" approach. Usually, the landlord is in a better position to mitigate its loss if it has control over the space.

The recent revisions to the bankruptcy laws makes it critical for a landlord to protect its rights vigilantly in the event its tenant files Chapter 7 bankruptcy; otherwise, the space could be tied up for 120 days. While on the whole the new law favors landlords, they should heed well the foregoing caution and act quickly in the event of a tenant bankruptcy.

