

Addressing Lease Defaults in Bankruptcy

*Survey of Common Issues Affecting Commercial Leases in
Bankruptcy Proceedings*

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*This presentation does not express the views of the Honorable Marvin Isgur,
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It's an all too common scenario these days—another retail chain has entered bankruptcy and is closing a host of stores, including the brick and mortar in your local shopping center. Or, your client reaches out to you, worried that it may have expanded a bit too fast, and wanting to reevaluate certain of its commercial lease locations. Alternatively, you may represent a shopping center or lease office space, but are finding that tenants in distress are availing themselves of the bankruptcy process, to your detriment, more and more often.

Bankruptcy is designed to be an advantageous tool for businesses in need of operational restructuring, and provides distressed companies with, among other things, the unique opportunity to reevaluate its leases. In fact, the commercial real estate industry and bankruptcy law intersect in such an economically significant manner for the parties involved and the economy as a whole, that Congress, through the Bankruptcy Code, saw fit to include several provisions that significantly rebalance power between landlords and tenants within the bankruptcy framework.

Here, we provide a brief primer of the bankruptcy process from a landlord's perspective. While far from exhaustive, we aim to summarize the concepts of greatest importance to commercial real estate professionals, but caution that bankruptcy law is a highly specialized field and it's best practice to secure counsel if one finds himself or herself involved in a bankruptcy proceeding.

A. Full Stop: The Automatic Stay.

Immediately upon the filing of a bankruptcy petition, the bankrupt entity or “**Debtor**” enjoys a “breathing spell” known as the automatic stay under Bankruptcy Code section 362(a) (the “**Automatic Stay**”).¹ The Automatic Stay prevents all creditors from attempting to assess, collect,

¹ 11 U.S.C. § 362(a).

or recover from a Debtor any debt that arose before the filing of the bankruptcy.² With the Automatic Stay in effect, no party is permitted to exercise self-help or take judicial action outside of the bankruptcy court to attempt to recover past due rent (including setting-off a security deposit against amounts due), evict (even if the tenant is in default), or terminate a lease with a Debtor. Although the Automatic Stay has certain narrow exceptions and limits, it has been interpreted broadly and is generally sacrosanct in bankruptcy. Ironically, for example, a simple phone call or notice to a Debtor to request prepetition (pre-filing) rent after a bankruptcy filing may violate the Automatic Stay, while demands for the payment of overdue postpetition (post-filing) rent generally do not.³

Indeed, once a tenant files for bankruptcy, and the Automatic Stay has instantly sprung into effect, a landlord must obtain relief from the Automatic Stay in the Bankruptcy Court before exercising any remedies against a Debtor. To obtain relief from the Automatic Stay, a landlord must file a motion explaining the relief sought and why it is appropriate, request a hearing before the Bankruptcy Court, and provide notice to all creditors and parties-in-interest in the bankruptcy case of the landlord's request for relief. If, however, a commercial lease has expired according to its own terms (not due to default) before the filing of the bankruptcy case, the Automatic Stay does not apply and a landlord need not seek relief to recover possession of the premises.⁴ Landlords should not, however, read this exception to the Automatic Stay to extend to exercising rights in

² See 11 U.S.C. § 362(a)(1)-(8).

³ For this reason, among many, landlords should proceed with caution, or obtain bankruptcy counsel to guide them through the intricacies of the bankruptcy process.

⁴ See 11 U.S.C. § 362(b)(10).

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