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## Commercial Leases in Bankruptcy

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## I. INTRODUCTION

This outline emphasizes some of the recurring legal and practical issues that a landlord typically faces once one of its tenants files bankruptcy under the United States Bankruptcy Code.<sup>1</sup> On many of these issues, the Code looks to the terms of the lease and state law to determine the respective rights and remedies of a landlord and tenant under the Code. **Appendix I** selects common lease terms that influence the disposition of the parties' respective claims in a bankruptcy, and the accompanying annotations cite authorities that examine the interplay between such lease terms, state law, and the occasionally conflicting judicial interpretations of the Code.<sup>2</sup>

## II. AUTOMATIC STAY

A bankruptcy case commences when a debtor files a voluntary petition<sup>3</sup> or eligible creditors file an involuntary petition against the debtor.<sup>4</sup>

**A. Unexpired Leases.** Section 362 automatically and immediately stays any creditor-landlord from initiating or continuing any action to enforce its possessory remedies or to recover on its monetary claims against the tenant-debtor under an unexpired commercial lease.<sup>5</sup> Such a lease is part of the tenant-debtor's bankruptcy estate, and the stay precludes any landlord from exercising any possessory or monetary remedies against the defaulting tenant-debtor until the stay is lifted.<sup>6</sup> The automatic stay thus gives a tenant-debtor time to exercise its legal rights under the Code to assume or reject its lease or leases and, if feasible, to reorganize.<sup>7</sup> The stay also

<sup>1</sup> Unless otherwise noted, "Code" refers to the United States Bankruptcy Code and the section numbers cited in the text refer to specific sections of the Code.

<sup>2</sup> See **Appendix I**: TEXAS ANNOTATED OFFICE LEASE (Bankruptcy and Default Related Provisions).

<sup>3</sup> 11 USC § 109 (who may be a debtor) and § 301 (voluntary case is commenced by filing bankruptcy petition).

<sup>4</sup> 11 USC § 303.

<sup>5</sup> 11 USC § 362(a). The term debtor refers to both a Chapter 7 trustee, who is appointed to liquidate the debtor's assets and pay allowed claims, and to the "debtor in possession," who remains in control of the management of the debtor during a Chapter 11 reorganization, unless the court appoints a bankruptcy trustee to administer the bankrupt debtor's estate.

<sup>6</sup> Cf. *In re Imperial Beverage Group, LLC*, 457 B.R. at 496 (stating that, under Texas law, default judgment and unexecuted writ of possession did not terminate lease set to expire approximately 40 days after date of default judgment); *48th Street Steakhouse, Inc. v. Rockefeller Group, Inc.* (*In re 48th Street Steakhouse*), 835 F.2d 427, 430 (2d Cir.1987) (stating that "a mere possessory interest in real property, without any accompanying legal interest, is sufficient to trigger the protection of the automatic stay"). Compare *In re Truong*, 557 B.R. 326, 332 (Bankr. D.N.J. 2016) (holding that "the asserted (and wrongful) continuing possessory interest of a debtor in a terminated lease such as this one includes "any interest of the debtor" as a holdover tenant (which, by definition, occurs only

after a lease is terminated) but is insufficient to trigger automatic stay) *with In re Mad LO LO LLC*, 09-11911MG, 2009 WL 2902567, at \*3 (Bankr. S.D.N.Y. May 28, 2009) (unpublished opinion) (finding that, even though issuance of a warrant of eviction severs landlord-tenant relationship, tenant-debtor's possessory interest in the property *can support* sustaining the automatic stay and that, even though automatic stay may apply, "the debtor must return to the state court for relief if the debtor wants the landlord-tenant relationship reinstated; the bankruptcy court cannot reinstate the landlord-tenant relationship."). And see generally *In re Marciano*, 288 B.R. 324, 338 (Bankr.S.D.N.Y.2003) ("Notwithstanding the issuance of a warrant, the tenant still retains 'an equitable interest in the property, and the potential to reinstate the landlord-tenant relationship.' The...state court retains the ability to vacate the warrant and order a tenant reinstated at least until actual execution of the warrant. In appropriate cases, bankruptcy courts have continued the automatic stay of § 362 in order to give the tenant an opportunity to seek an order from the state court vacating a warrant of eviction.").

<sup>7</sup> Compare *Graber v. Fuqua*, 279 S.W.3d 608, 620 (Tex. 2009) (holding, in accordance with minority view, that debtor may pursue a Texas common law malicious prosecution claim in state court for harm allegedly caused by conduct during federal bankruptcy proceedings) *Metcalfe v. Fitzgerald*, 333 Conn. 1, 29, 214 A.3d 361, 379 (2019) (holding, in accordance with majority view, that state law

preserves the debtor's assets for orderly distribution to creditors.

**B. Expired or Terminated Leases.** The automatic stay, however, does not prevent a landlord from initiating or continuing any enforcement action against a tenant-debtor *if* the lease has expired by its terms or has been *irrevocably terminated* before a voluntary or involuntary bankruptcy filing. If, at the time a bankruptcy petition is filed, a tenant-debtor has no contractual, legal, or equitable right that is sufficient *under state law* to reinstate a lease,<sup>8</sup> the lease is not an asset of the bankruptcy estate and, as a result, a debtor-tenant cannot assume or assign it.<sup>9</sup> In addition, the expiration or irrevocable pre-petition termination of a lease dictates the nature, extent, and priority of the landlord's allowable monetary claims against the bankruptcy estate.

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abuse of process actions for vexatious litigation in bankruptcy court proceedings are preempted by federal bankruptcy law).

<sup>8</sup> See, e.g., *In re Imperial Beverage Group, LLC*, 457 B.R. 490, 496 (Bankr. N.D. Tex. 2011) (stating that, under Texas law, default judgment and unexecuted writ of possession did not terminate lease set to expire approximately 40 days after date of default judgment).

<sup>9</sup> See 11 U.S.C. § 541(b)(2) (property of bankruptcy estate "does not include...any interest of the debtor as a lessee under a lease of nonresidential real property that has terminated at the expiration of the stated term of such lease; 11 U.S.C. § 362(b)(10) (filing bankruptcy petition "does not operate as a stay...of any act by a lessor to the debtor under a lease of nonresidential real property that has terminated by the expiration of the stated term of the lease before the commencement of ... a case under this title to obtain possession of such property"); 11 U.S.C. § 365(c)(3) ("trustee may not assume or assign any... unexpired lease of the debtor ... if such lease is of nonresidential real property and has been terminated under applicable non-bankruptcy law prior to the order for relief"); see also *In re Truong*, 557 B.R. 326, 332 (Bankr. D.N.J. 2016) (stating that "predicate notice" issued by landlord cut off tenant-debtor's interest in leased premises under New York state law without the need for further judicial action and state court found that, under

**C. Automatic Stay in State Court Proceedings.** While the stay is in effect, any "action taken in violation of the automatic [in bankruptcy] stay is void, not merely voidable."<sup>10</sup> But any limitations the automatic stay may impose on a party's conduct "cannot simply be hypothesized" in state court proceedings.<sup>11</sup> In such cases, "[t]he parties should have had an opportunity to develop a record to support their positions and seek a ruling from the trial court [on the application of the stay], even if it should turn out that only the bankruptcy court can finally decide the issue."<sup>12</sup>

### III. POST-PETITION RIGHTS AND REMEDIES.

**A. Section 365(d)(3): Tenant must timely perform "all" lease obligations.** Section 365(d)(3) requires a tenant-debtor to perform timely "*all of the obligations*" under a lease of non-residential real property, except those obligations specified in

[11 USC §§ 541\(b\)\(2\)](#) and [362\(b\)\(10\)](#), tenant-debtor had no interest in leased premises "to qualify as property of the estate, and [tenant-debtor] was afforded no protection by the stay from entry of the judgment of possession and warrant of removal"); *In re Policy Realty Corp.*, 242 B.R. 121, 127–28 (S.D.N.Y.1999) (reversing the Bankruptcy Court), *aff'd*, 213 F.3d 626 (2d Cir.2000) (stating that lease may be terminated under New York law by operation of a conditional limitation and that default notice purporting to terminate lease on specified date due to tenant's default, effectively terminates lease when specified time expires without any further act by the landlord); *In re Scarsdale Tires Inc.*, 47 B.R. 478, 480 (S.D.N.Y.1985) ("It is settled law that a lease or license that was terminated before the filing of a bankruptcy petition is neither affected by the automatic stay under 11 U.S.C. § 362(a) nor may it be assumed by the debtor under 11 U.S.C. § 365").

<sup>10</sup> *York v. State*, 373 S.W.3d 32, 38 (Tex.2012) (quoting *Continental Casing Corp. v. Samedan Oil Corp.*, 751 S.W.2d 499, 501 (Tex.1988) (per curiam)).

<sup>11</sup> *Evans v. Unit 82 Joint Venture*, 377 S.W.3d 694, 695 (Tex. 2012).

<sup>12</sup> *Id.* See *supra* footnote 6 (citing cases in which state court determination of tenant-debtor's rights under lease under state law affect application of stay and other rights of tenant-debtor under Code).

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