

# THE BANKRUPT TENANT AND YOU PART 1- THE DAWN OF THE BANKRUPTCY

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The recent financial trouble of some well known retailers, and the high-profile bankruptcies of Quiznos, Sbarro, and Brookstone – just to name a few – calls to mind the need to stay on the right side of the law when you, as a property manager or owner, encounter a tenant bankruptcy. In this first installation of my multi-part bankruptcy series, I will discuss some typical issues that arise just before and after a tenant files for bankruptcy.

First, let's set some parameters and define some terms. In many cases the tenants may continue to control their assets (we call this a "debtor-in-possession" Chapter 11 reorganization), but sometimes they file for a liquidation (typically a Chapter 7 bankruptcy). A trustee may be appointed in a Chapter 11 case if there is a need for an outside person to run a business and a trustee will always be appointed in a Chapter 7 case. There is also a chapter 13 case (a "wage earner plan"), which we will specifically discuss in later installments of this series. Also, the landscape and tactics may change depending on whether the case involves a big multiple location tenant or a smaller local tenant.

Many times the bankruptcy is filed right in the middle of a landlord's effort to collect rent, evict, or lock the tenant out of the space. So, what do you do when you hear that a tenant has filed for bankruptcy? STOP whatever you are doing to/with this tenant and verify what you have heard. If you are talking to a tenant representative, try to get a case number and the location of the bankruptcy court. Most attorneys have access to nationwide, online subscription search engine called "PACER" ("Public Access to Court Electronic Records"), and they can look up the case for you. Make sure you have the correct business name. Your tenant may have a corporate name that differs from the trade name.

Occasionally you will find that what you heard is simply a rumor. If you cannot verify the filing, continue your actions to exercise your rights and remedies. More often than not, however, the rumor will be true. In that case, stop all actions. Regardless of the "chapter" under which a case is filed, the initiation of the case institutes the "automatic stay", which prohibits, among other things, all actions directed at the debtor/tenant – in other words, once the tenant files bankruptcy, you must immediately cease any lawsuit, eviction, lockout, drawing on a security deposit, or other collection efforts!

If you have locked out a tenant prior to the bankruptcy filing, in all likelihood you will have to let the tenant back in to continue operating the business if it is a "debtor-in-possession" Chapter 11 reorganization case. While technically the automatic stay freezes everyone in their tracks, the tenant's business operations are "property of the estate" and you have no right to interfere with them even if you have a legal right under your lease or state law to lock out the tenant. If it is a Chapter 7 liquidation, the trustee will likely want access to the space to inventory what is there. There is little downside to cooperating with the trustee. Also, be careful about trying to terminate the lease prior to the bankruptcy filing. The bankruptcy court cases are not at all settled as to what constitutes an effective termination of the lease or the tenant's right to possession. Consultation with your legal counsel may help in this instance.

Rent payments during a bankruptcy can be a little tricky. First, you are entitled under the Bankruptcy Code to your contractual rent until a decision is made on whether the tenant will assume or reject your lease (to be discussed in another installment). However, don't be surprised if you do not get your rent during the month that the bankruptcy is filed. For instance, if rent is due on May 1 and the tenant files bankruptcy on May 15, the courts consider that month's rent as owed prior to the filing of the case and it just becomes another unsecured claim in the bankruptcy. In this example your right to receive "post-petition rent" starts on June 1. Occasionally a tenant of high moral character will pay you rent from May 15-31 (or may have already paid rent on May 1), but that is unusual. If you do not get your first full month's rent, you or your attorney will need to contact the attorney for the tenant and if you get no satisfaction from that, you will need to file a motion in the court to compel payment of rent.

In a Chapter 7 liquidation case the trustee will usually seek to reject your lease and turn the premises back to you as soon as possible, but you may want to contact the trustee to make sure this will happen quickly.

Any rent payments you receive within 90 days prior to the filing of a case will be scrutinized carefully and you may be subject to returning that money to the trustee because you may have received what is called "a preference payment". There are several defenses to a preference which may make a trustee believe that it is not worth pursuing you. If you receive a demand for payment from the trustee, you should consider hiring an experienced bankruptcy attorney to deal with the trustee. However, do not be shy about accepting rent in the ordinary course of business from a financially distressed tenant who you think might file bankruptcy. Take the money and worry about the bankruptcy implications after the case is filed.