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## Bankruptcy law adopts a pro-landlord position

A new bankruptcy law takes a pro-landlord view of the commercial and residential real estate world.

Certain provisions related to real estate leases and contained in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 take effect on Oct. 17.

For the most part, the new law is viewed as creditor-friendly because it removes some of the discretion afforded to bankruptcy judges. Essentially, the law makes it harder to file for business or personal bankruptcy.

As a result, experts predicted that both business and personal bankruptcies would increase before the law's effective date.

In fact, personal bankruptcy filings have increased nationally by 12 percent during April, May and June compared with the same period last year, according to a USA Today report published this summer. This increase was driven in part by fear over the impact of the new law, according to the American Bankruptcy Institute.

Worthy to note, however, are the findings of a recent study conducted by two law professors and funded by the Ewing Marion Kaufman Foundation. That study showed the number of business bankruptcies had been consistently underreported since the 1980s.

The study concluded that court records and government statistics had not reflected entrepreneurs who file for personal bankruptcy when their businesses have failed.

The anticipated impacts of the new law on business bankruptcies are still being debated, particularly with respect to landlords. Nevertheless, when a business fails, the new law recognizes that a commercial real estate owner is often one of the larger unsecured creditors. Under the new law, owners leasing real estate are afforded new protections when a tenant files for bankruptcy.

For example, the new law eliminates



### VIEWPOINT

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some of the discretion afforded to courts to grant tenant-debtors multiple extensions to assume or reject leases. The old law gave the debtor 60 days after the filing of its bankruptcy petition to assume or reject a commercial lease, plus an opportunity, at the court's discretion, to seek multiple extensions.

Under the new law, a tenant-debtor will have 120 days after the filing of its petition to assume or reject a commercial lease; a lease not assumed or rejected within the 120-day period will be deemed rejected. A tenant-debtor may seek a one-time 90-day extension. Additional extensions may only be granted with a landlord's written consent and the new law carries no guarantee that extensions will be granted by a bankruptcy court.

Time will tell whether this provision produces a trend whereby debtors reject leases and surrender the leased premises if they cannot negotiate additional extensions with their landlords.

Once a lease is assumed, landlords are entitled to priority payment of all future rental obligations. If a debtor later rejects a previously assumed lease, the new law entitles the landlord to an administrative expense claim. The landlord is also entitled to payment of the remaining balance due under the now-rejected lease as an unsecured, capped claim. The landlord's claim will take priority over other unsecured creditors.

The new law also strengthens the enforceability of restrictive-use clauses. Most bankruptcy courts allowed lease assignments where a use differed from the use defined in the lease on the premise that restrictive-use clauses may not be enforceable. The new law provides that any assumption or assignment of a lease from the bankrupt tenant is subject to certain restrictions contained in the lease.

In leases requiring continuous operations by the tenant, the new law states operations must be resumed in order for the lease to be assumed or assigned. If the tenant breaches its covenant of continuous operation, the landlord has the right to recover monetary damages.

Finally, the new law gives residential property landlords certain exceptions from the automatic stay, which previously prevented them from taking action to remove a tenant. The automatic stay gives the debtor protection from creditors, subject to the oversight of a bankruptcy judge, and brings all of the debtor's assets and creditors into the same forum—the bankruptcy court—where the rights of all concerned can be balanced.

The first exception to the automatic stay allows a landlord who has already obtained a court order authorizing possession to continue to remove the tenant notwithstanding the bankruptcy. The second exception allows the landlord to evict a tenant based on endangerment of the property, or the illegal use of controlled substances, without the prior need of bankruptcy court approval.

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