LANDLORD/TENANT ISSUES UNDER SECTION 365 OF THE BANKRUPTCY CODE: THE MODIFICATIONS OF "BAPCPA" AND RECENT DEVELOPMENTS AFFECTING LANDLORD/TENANT ISSUES IN BANKRUPTCY CASES

Presented by Mark Stromberg, Esq.

STROMBERG & ASSOCIATES, P. C.
Two Lincoln Centre
5420 LBJ Freeway, Suite 300
Dallas, Texas 75240
Telephone: (972) 458-5353
Facsimile: (972) 770-2156
E-mail: mark@stromberglawfirm.com

STROMBERG & ASSOCIATES, P. C.
ATTORNEYS AND COUNSELORS AT LAW
TWO LINCOLN CENTRE
5420 LBJ FREEWAY, SUITE 300
DALLAS, TEXAS 75240
TELEPHONE: (972) 458-5353
FACSIMILE: (972) 770-2156

LICENSED: **State Bar of Texas: May, 1987 to present. Admitted to Practice Before the U. S. Supreme Court, U. S. Court of Appeals for the Fifth Circuit, and the U. S. District and Bankruptcy Courts for the Northern, Southern, Eastern and Western Districts of Texas in good standing.**

EXPERIENCE: **Trial and appellate court experience, including first chair and solo jury and bench trials, heavy motion practice, and both evidentiary and non-evidentiary hearings in state,[1] federal and bankruptcy courts.[2] Conducted discovery, prepared motions, briefs, and pleadings in complex commercial cases, lender liability actions, collection cases, and bankruptcy cases representing creditors.**

EMPLOYMENT: ***Stromberg & Associates, P. C.*, (address above); e-mail: mark@stromberglawfirm.com (June 15, 2001 to present - - Owner).**

***Shields, Britton & Fraser, P. C.*, 14643 Dallas Parkway, Suite 920, Dallas, Texas 75240; phone: (972) 788-2040; fax: (972) 788-4332; e-mail: mstromberg@sbflegal.com (March, 1996 through June 15, 2001 - - Shareholder [non-equity]).**

***Hoge, Evans & Holmes, L. C.*, 13455 Noel Road, Two Galleria Tower, Suite 400, Dallas, Texas 75240 (April, 1992 to March, 1996 - - Founding partner).**

***Graham, Bright & Smith, P. C.*, 5420 LBJ Freeway, Suite 330, Dallas, Texas 75240; phone: (972) 788-5300 (September, 1984 [beginning of 2nd year of law school] through April, 1992).**

EDUCATION: **Juris Doctor, Southern Methodist University; 1986.**
Bachelor of Arts, Texas A & M University; 1983.

RECENT OPINIONS: ***Charlie Thomas Chev. v First Extended Serv. Corp.*, 1998 Tex. App. LEXIS (Tex. App. - Houston [14th Dist.] 1998, no writ); *Tomlins v. BRW Paper Co., Inc. (In re Tulsa Litho Company)*, 229 B.R. 806 (10th Cir. B.A.P. 1999); *W.H.V., Inc. v. Associates Housing Finance, LLC*, 43 S.W.3d 83 (Tex. App. - - Dallas 2001, writ denied); *Adriano v. FINOVA Capital Corp*, 2003 Tex. App. LEXIS (Tex. App. - - San Antonio 2003, writ denied).**

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[1] **Trial experience** in the following counties: Dallas, Tarrant, Collin, Denton, Rockwall, Johnson, Somervell, Bandera, Gregg, Potter, Ector, El Paso, Kaufman, Houston, Belton, Smith, Harris, Bexar, Wise and Travis, among others. **Appellate experience** in and before the El Paso, Houston [14th Dist.], San Antonio, and Dallas Courts of Appeals, and the Texas Supreme Court.

[2] **Trial and/or pre-trial experience** in the federal district courts in Dallas, Fort Worth, and Salt Lake City, Utah (one case), and heavy experience in the bankruptcy courts for the Northern, Eastern, Western and Southern Districts of Texas, as well as other bankruptcy courts, including, among others: District of Delaware; District of New Jersey; Southern District of New York; Central and Northern Districts of California; Western District of Pennsylvania; District of Colorado; District of New Mexico; Northern and Western Districts of Oklahoma; Northern District of Ohio, Northern District of Indiana, and the Central District of Illinois. **Appellate experience** before the Court of Appeals for the Fifth Circuit, the Bankruptcy Appellate Panel for the Tenth Circuit, and United States District Courts in Dallas and Fort Worth (appeals from bankruptcy trials).

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I. INTRODUCTION

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the "BAPCPA"), which became effective October 2005, made wide-ranging changes to the Bankruptcy Code (the "Code"). The product of at least a decade of legislative effort[3], the BAPCPA was designed to strengthen creditor's rights, resolve ambiguities in the prior law, and limit the discretion of judges, all with the intent to significantly alter the dynamics of the debtor-creditor relationship.[4] Landlord and tenant rights were among those that were affected by the BAPCPA revisions.

Within this general framework, this paper will discuss some of the rights, burdens and benefits imposed by the Code on landlords and tenants, and how courts have begun resolving some of the issues created by the BAPCPA revisions to the Code.

II. GENERAL PRINCIPLES APPLICABLE TO UNEXPIRED LEASES

A. Leases as an Asset & Effect of Termination

Once a bankruptcy petition is filed, a "bankruptcy estate" is born, and that estate consists generally of "all legal or equitable interests of the debtor in property as of the commencement of the case."[5] The legal rights of a debtor under an *unexpired* lease are included among those rights that make up a part of the estate.

While the language of Section 541 governing "property of the estate" is intentionally broad and expansive so as to cover virtually all conceivable rights of the estate in property,[6] the Code does not enlarge or enhance the rights of a debtor in property beyond that which existed when the case was filed.[7] Thus, a non-residential lease which expires by its terms before bankruptcy is not "property of the estate" just as a lease which expires during the case ceases to be "property of the

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3 Susan Jensen, A Legislative History of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, 79 Am. Bankr. L.J. 485, 485 (Summer, 2005).

4 George H. Singer, The Year in Review: Case Law Developments Under the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, 82 N. Dak. L. Rev. 297, 304 (2006).

5 11 U.S.C. §541(a). It is important to note, however, that the pre-bankruptcy "debtor" and the "bankruptcy estate" are two completely separate legal entities. *See In re Dow Corning Corp.*, 270 B.R. 393 (Bankr. E. D. Mich. 2001).

6 *In re Nasson College*, 80 B.R. 600 (Bankr. D. Me. 1989).

7 *In re Tudor Motor Lodge Assoc., Ltd. P'ship*, 102 B.R. 936 (Bankr. D.N.J. 1989); *In re Lally*, 51 B.R. 204 (N. D. Iowa 1985).

estate.[8] Similarly, a lease that has been properly terminated under applicable state law prior to bankruptcy cannot be assumed and does not constitute "property of the estate".[9]

It is also important to recognize that, at the same time as the bankruptcy filing creates the "bankruptcy estate", those assets comprising the bankruptcy estate are subject to protection against creditor actions under the "order for relief", sometimes also referred to as the "automatic stay".[10] This would mean that a landlord may not terminate, or institute eviction proceedings, under an unexpired lease without seeking relief from the automatic stay.[11] But consistent with the axiom that when a non-residential lease terminates by its terms before or during the case it is not property of the estate, the automatic stay does not apply to an action by a landlord to recover possession of the real estate is not stayed.[12]

The U. S. Supreme Court has held that until the debtor-lessee assumes or rejects an unexpired lease, the non-debtor landlord may not enforce performance under the lease.[13] Thus, the landlord's remedy when its lessee is in bankruptcy is to insist upon compensation as required under 11 U.S.C. §365(d)(3). In the recent case of *In re Winn-Dixie Stores, Inc.*,[14] the Florida Bankruptcy Court enunciated a version of this rule, holding that if the landlord could prove that, by virtue of how far behind the debtor had fallen in its rents, it was "impossible" to cure its defaults, then the lease would terminate by default; otherwise, the landlord's recourse was limited to relief under §365 until debtor decides to reject or assume, though the landlord could file a motion to compel assumption or rejection.[15] In that regard, many (but not all) courts will indulge a presumption that the contract lease or rental rate is the reasonable value of the services or use of the property during the

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8 11 U.S.C. §541(b)(2). *See also Erickson v. Polk*, 921 F.2d 200 (8th Cir. 1990). However, one court recently held that where a lease expired by its terms before bankruptcy but that it permitted a holdover tenancy and the bankrupt was holding over, a month-to-month tenancy was established and that the debtor remained a tenant under 11 U.S.C. §365(d)(3). *See In re Van Vleet*, 383 B.R. 782 (D. Colo. 2008).

9 *See In re Gande Restaurants*, 162 B.R. 345 (Bankr. M. D. Fla. 1993); *In re Racing Wheels, Inc.*, 5 B.R. 309 (Bankr. M. D. Fla. 1980); *In re Trang*, 58 B.R. 183 (Bankr. S. D. Tex. 1985). *But see In re Dash*, 267 B.R. 915 (D.N.J. 2001), holding that where under state law the termination of the lessee's rights was not complete and final prior to bankruptcy, the lessee may retain rights which do in fact become property of the estate.

10 11 U.S.C. §362.

11 11 U.S.C. §362(a). *See also In re Borbridge*, 66 B.R. 998 (Bankr. E. D. Pa. 1986); and *In re Smith Corset Shops, Inc.*, 696 F.2d 971 (1st Cir. 1982).

12 11 U.S.C. §362(b)(10).

13 *NLRB v. Bildisco*, 465 U.S. 513, 532 (1984).

14 345 B.R. 402, 405-06 (Bankr. M.D. Fla. 2006).

15 *Id* at 405-06.

intervening period, but that presumption *is* rebuttable.[16]

B. Payment of Post-Petition Rents

As stated above, landlords whose tenants file bankruptcy are entitled to expect to be paid for rents arising after the bankruptcy is filed according to 11 U.S.C. §365(d)(3), which provides, in pertinent part:

> The trustee shall timely perform all the obligations of the debtor . . . arising from and after the order for relief under any unexpired lease of nonresidential real property, until such lease is assumed or rejected, notwithstanding section 503(b)(1) of this title. The court may extend, for cause, the time for performance of any such obligation that arises within 60 days after the date of the order for relief, but the time for performance shall not be extended beyond such 60-day period.

Courts have held that §365(d)(3) provides landlords with an administrative claim for rents arising post-petition and, in most cases, courts have held that these administrative claims are determined by the amounts due under the lease, such that the landlord is relieved of the duty of proving the value of the use of the property to the debtor's estate as would be required to calculate an administrative claim under §503(b)(1)(A).[17]

However, because the Bankruptcy Code does not define when obligations arise or when they are to be paid, controversies arise as to how to calculate the rents (and other associated lease expenses, such as CAM and taxes) constituting the administrative claim, and when any such administrative claim must be paid. As to calculation, there are two methods which have been adopted by various courts: a) the "billing method"; and b) the "accrual method."

Under the "billing method," the obligation to pay rent arises when a payment comes due under the terms of the lease. Thus, when the filing date is in the middle of a month, the duty to pay administrative rent first accrues when the next rent due is "billed," and thus, rents during the partial month are treated as entirely pre-petition obligations.[18] In contrast, under the "accrual method," in

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[16] *See Bethlehem Steel Corp. v. BP Energy Co.*, 291 B.R. 260, 264 (Bankr. S.D.N.Y. 2003); *In re Rich's Dept. Stores, Inc.*, 209 B.R. 810 (Bankr. D. Mass. 1997); *Norritech v. Geonex Corp.*, 204 B.R. 684 (D. Md. 1997).

[17] *See generally In re Amber's Stores, Inc.*, 193 B.R. 819 (Bankr. N. D. Tex. 1996);

[18] *See e.g., In re FFP Operating Partners, L. P.*, 2004 Bankr. LEXIS 884 (Bankr. N. D. Tex. 2004; Houser, J.); *Centerpoint Props. v. Montgomery Ward Holding Co. (In re Montgomery Ward Holding Co.)*, 268 F.3d 205, 209-10 (3d Cir. 2001); and *In re Montgomery Ward, LLC v. Western Land Props. (In re Montgomery Ward, LLC)*, 302 B.R. 478, 481-82 (D. Del. 2003); *see also Gwinnett Prado, LLP v. Rhodes, Inc. (In re Rhodes, Inc.)*, 321

the case of a mid-month filing, the rents are pro-rated such that the first portion of the month prior to the filing date is treated as pre-petition, and an administrative claim for "stub rents" arises for the remaining pro-rata portion of the month.[19] There is a split among the various circuit and bankruptcy courts as to which of these methods will be applied, and counsel for landlords are encouraged to check which method is applied in the jurisdiction in which their tenant has filed.

The decision as to which method to employ, and which Bankruptcy Code sections (§365(d)(3) versus §503(b)(1)(A)) are applied to determine how to calculate claims can be very critical when determining how to apportion *ad valorem* taxes for which a bankrupt tenant is liable under a lease. If, for instance, the tenant's bankruptcy is filed on November 10, and if the billing method is applied, then: a) if the prior year's taxes are billed by the landlord on December 1, the tenant would be responsible for 100% of the prior year's ad valorem taxes as an administrative expense; or b) if the prior year's taxes were billed on November 1, then none of the taxes for the prior year would be payable as an administrative expense, all of them having come due prior to filing. In contrast, under the accrual method, the date of billing would be irrelevant, and the administrative tax claim would be calculated by pro rating the taxes for the 51 days between November 10 and December 31. The responsibility for the taxes will hinge on these decisions, and also on the language of the lease.

Even assuming the claim for stub rents and/or later-billed taxes, CAM or insurance is characterized as an administrative claim, there is no guarantee that the landlord can compel the payment of these claims prior to confirmation of a plan of reorganization. Most courts interpreting these provisions have held that the bankruptcy court has discretion to order that such claims be paid at any time during the pendency of the case, but no later than confirmation.[20]

In the *Circuit City* bankruptcy, after applying the "accrual method" to calculate stub rents, the Bankruptcy Court for the Eastern District of Virginia declined to compel payment of the

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B.R. 80 (Bankr. N. D. Ga. 2005), holding that the obligation of the debtor arises at the time that the debtor's liability to the landlord becomes fixed in an amount unalterable by subsequent events.

[19] *See, e.g., In re Circuit City Stores, Inc.*, 2009 Bankr. LEXIS 672 (Bankr. E. D. Va. 2009), citing *In re Trak Auto Corp., 277 B.R. 655, 662 (Bankr. E.D. Va. 2002), rev'd on other grounds, 367 F.3d 237 (4th Cir. 2004)*; *In re Stone Barn Manhattan, LLC*, 398 B.R. 359 (Bankr. S.D.N.Y. 2008); *In re Handy Andy*, 144 F.3d 1125, 1127 (7th Cir. 1998).

[20] *See In re Global Home Products, LLC*, 2006 Bankr. LEXIS 3608, p. 10 (Bankr. D. Del. 2006), citing *In re Garden Ridge Corp.*, 323 B.R. 136 (Bankr. D. Del. 2005), *Varsity Carpet Servs. v. Richardson (In re Colortex Indus.)*, 19 F.3d 1371, 1384 (11th Cir. 1994), and *In re Continental Airlines, Inc.*, 146 B.R. 520, 531 (Bankr. D. Del. 1992); *In re Bookbinders' Restaurant, Inc.*, 2006 Bankr. LEXIS 3749, pp. 11-16 (Bankr. E. D. Pa. 2006); *In re Tubular Technologies, LLC*, 372 B.R. 820, 823, n. 4 (Bankr. D.S.C. 2007).

administrative rent claims based on the circumstances of the case.[21] The *Circuit City* court adopted the debtor's argument that, in ordering payment, the court would be converting the claims of the landlords to "superpriority" claims.

Some of the best counter-arguments for the assertion that ordering payment of administrative claims happen prior to confirmation include: a) the confirmation date is not a default payment date for administrative claims, but is rather the latest of four possible dates by which administrative claims will be paid;[22] b) waiting until confirmation foists upon the administrative claimant the entirety of the risk of an administrative insolvency; and c) making the administrative claimant wait until confirmation for payment sets up a *de facto* inferior class of administrative creditors who are not getting paid while other administrative creditors get discriminatorily paid in full.

C. *Ipso Facto* Provisions

In some cases, leases will contain clauses that either state that bankruptcy is an event of default, or even that the filing of bankruptcy affects an automatic, or *ispo facto*, termination of the lease. The Code specifically renders such clauses unenforceable in bankruptcy.[23] However, a recent bankruptcy court decision upheld a provision in a pre-petition forbearance agreement, negotiated with the assistance of experienced bankruptcy counsel for debtor, that prospectively waived the protections of the automatic stay if the debtor filed bankruptcy, in exchange for which the creditor rescheduled a foreclosure to give a debtor time to complete a refinancing.[24]

III. ASSUMPTION OR REJECTION OF A LEASE

Under Section 365, the debtor may assume, reject or assign an unexpired lease in its business judgment within a certain time, and under certain conditions, after filing a bankruptcy petition.[25] This is intended to allow the debtor or trustee to exercise discretion to maximize the value of the bankruptcy estate by assuming leases that benefit the estate and rejecting those that do not.[26]

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[21] *In re Circuit City Stores, Inc., supra*; citing *In re Trak Auto Corp.* for the proposition that bankruptcy judges have discretion to decide whether to pay administrative claims before confirmation of a plan, and *In re Va. Packing Supply Co.*, 122 B.R. 491, 495 (Bankr. E. D. Va. 2002) for the proposition that ordering payment of administrative claims prior to plan confirmation is tantamount to elevating those claims to "superpriority" claims.

[22] *In re Bookbinders' Restaurant, Inc.*, *supra* at p. 12.

[23] 11 U.S.C. §365(e)(1).

[24] *In re Bryan Road, LLC*, 382 B.R. 844 (Bankr. S. D. Fla. 2008).

[25] 11 U.S.C. §365(a) (2007). *See Richmond Leasing Co. v. Capital Bank, N. A.*, 762 F.2d 1303, 1309 (5th Cir. 1985), holding that as long as assumption or rejection of an agreement enhances the debtor's estate, the business judgment of the debtor on whether to assume or reject should be approved by the bankruptcy court, unless the debtor's decision would be clearly erroneous, too speculative, or contrary to other provisions of the Code.

[26] *Cinicola v. Scharffenberger*, 248 F.3d 110, 119 (3d Cir. 2001).

A. Effect of Rejection and Rejection Damages Claims

In general, rejection of a lease constitutes a breach, and allows the creditor a claim for damages[27], but once rejected, the estate is relieved of the burden of further performance under the lease. This can be a tremendous economic advantage for a debtor overburdened by lease obligations from non-performing or under-performing leased locations and the associated burden of rents, employee costs and unprofitable operations.

There is often disagreement over how to apply the limitations the Code places on the extent and elements of the landlord's claim arising from rejection of a lease.[28] In §502, the Code provides that a claim for lease rejection includes and is limited to accrued, matured rent, plus "the rent reserved by such lease, without acceleration, for the greater of one year, or 15 percent, not to exceed three years, of the remaining term of such lease following the earlier of" the bankruptcy filing date or the date the lessor did recover or could have recovered possession of the property.[29] This is in contrast to state law, which permits a landlord to prove up the "present value" of future rents over the remaining term of the lease and obtain and enforce a judgment thereon against a defaulting tenant.[30] Thus, if the lease of a bankrupt debtor, when rejected, has 5 remaining years of obligations, the landlord will only be able to make a claim for future rents for one year's worth of arrearage under §502.

Because this "rejection claim" is a general unsecured claim without priority, rather than a post-bankruptcy "administrative" claim, the rejected landlord will in most circumstances receive pennies on the dollar, along with all other unsecured creditors, for the pre-petition accrued rents, and for the future, "lease rejection" rents element of its claim. (As stated above, until rejection of the lease, the landlord may seek and recover post-petition rents as an administrative claim under 11 U.S.C. §§503(b)(1) and 507(a).)[31] Consequently, landlords seeking to maximize their recovery on their unsecured claims look to enhance their rejection damages claims to the fullest extent that the Code permits.

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[27] 11 U.S.C. § 365(g) (2007).

[28] *See* 11 U.S.C. §502(g) and §502(b)(6).

[29] *Id.*

[30] *See generally Speedee Mart v. Stovall*, 664 S.W.2d 174 (Tex. App.–Amarillo 1983, no writ), holding Texas landlords have four potential remedies for lease breach: (1) maintain the lease, suing for rents as they come due; (2) treat the breach as anticipatory repudiation, repossess the property, and sue for the present value of future rentals, reduced by the reasonable cash market value of the property for the remaining term; (3) treat the breach as anticipatory, repossess, re-lease the property, and sue for the difference between the contractual rent and rent received from the new tenant; or (4) declare the lease forfeited and relieve tenant of liability for future rents.

[31] *See* Footnote 14, and cases cited therein.

In the recent case of *In re Foamex Int'l, Inc.*,[32] the landlord sought to enforce its contractual claim for damages or repairs to the property in addition to accrued and future rents, and the tenants sought to limit the claim to a maximum of the one year's rejection damages permitted under §502(b)(6). The landlord argued that the rejection limits embodied in §502(b)(6) were only intended to apply to rents, and that because the repair claims were unrelated to the termination or rejection of the lease but were already accrued before hand, they should be separately allowed.[33] Holding for the debtor, the Delaware bankruptcy court held that the §502(b)(6) cap on damages for landlords applies to limit debtor/lessee's covenants to maintain and repair the leased premises as well as any future rents claims.[34] However, other courts have declined to strictly limit landlords claiming damages other than rents to the limits contained in §502(b)(6).

In *Saddleback Valley Community Church v. El Toro Materials Co. (In re El Toro Materials Co.)*,[35] the Ninth Circuit Court of Appeals declined to limit the landlord claiming damages to the leased property to a rejection claim measured only by rents. In *El Toro*, the debtor, a mining company, left behind for the landlord on the rented property approximately "one million tons of wet clay 'goo,' mining equipment, and other materials." The estimated costs for the damages and cleanup costs were estimated by the landlord to have exceeded $23 million. Reversing the Bankruptcy Appellate Panel decision in favor of the debtor, the Court of Appeals held that the limitations of §502(b)(6) did not operate to bar collateral damage to the property and was only intended to limit future lost rents resulting from the rejection of the lease.[36] A strange amalgam holding was announced in *In re Brown*,[37] in which the court held that refitting costs are typically non-rent costs, but were nevertheless denied under the §502(b)(6) cap because, under the language of the lease, such costs were only payable in the event of a default, and were thus related to rejection.[38]

Some courts have allowed debtors to further limit the §502(b)(6) rejection claim by arguing that the landlord was obliged to mitigate damages,[39] or that a credit for actual mitigation through the reletting of the property to a new tenant reduces the claim.[40] This question may turn on whether or

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[32] 368 B.R. 383 (Bankr. D. Del. 2007).

[33] *Id* at 390.

[34] *Id* at 392-94.

[35] 504 F.3d 978 (9th Cir. 2007), *cert. denied*, 128 S. Ct. 1875 (2008).

[36] Overruling *Kuske v. McSheridan (In re McSheridan)*, 184 B.R. 91 (B.A.P. 9th Cir. 1995).

[37] 398 B.R. 215 (Bankr. N. D. Ohio 2008).

[38] *Id.* at 219-20, citing *In re Bob's Sea Ray Boats, Inc.*, 143 B.R. 229 (Bankr. D.N.D. 1992).

[39] *See, e.g., In re Atlantic Container Corp.*, 133 B.R. 980 (Bankr. N. D. Ill. 1991)

[40] *In re Bob's Sea Ray Boats, Inc.*, 143 B.R. 229 (Bankr. D.N.D. 1992).

not, as in Texas, commercial landlords have any duty to mitigate. However, this author believes that the same strict construction of §502(b)(6) that is being used to hard-cap landlords' lease rejection damages claims at one year's rents should equally support the "rejection" of mitigation as a further reduction to the claim, since the Code makes no mention of any such obligation either in 365 or, more importantly, in §502(b)(6).

An interesting fact pattern was addressed by the Sixth Circuit Court of Appeals in *Giant Eagle, Inc. v. Phar Mor, Inc.*,[41] relating to the liability of a debtor whose rejection liability was mitigated by a subsequent lessee who later defaults and files bankruptcy before the rejection damages were fully mitigated by the subsequent lessee's payments. The Sixth Circuit reasoned that the debtor's liability was the result of the lease, and that debtor did not become any less liable by virtue of the landlord's mitigation effort.

B. General Requirements for Assumption and Assignment

To assume a lease, the debtor must "promptly cure" monetary defaults and provide "adequate assurance of future performance" under the lease.[42] There are frequently disputes over what constitutes a "prompt cure" and as to what a tenant must prove to provide "adequate assurances."

Judge Bill Parker in the Eastern District of Texas addressed the requirement of "prompt cure" in his decision in *In re PRK Enterprises, Inc.*[43] Judge Parker ruled that the requirement of prompt cure mandates that the debtor provide adequate assurances both to future performance and also to promptly curing the arrearage. The adequate assurances, in regards to cure of arrearages, requires both a firm commitment to make all payments, and a reasonably demonstrable ability to do so. However, he also held that §365(d)(3) allows a debtor/lessee to make the cure payments in installments in amounts to be determined by the court based on the facts of each case. Further, as relates to adequate assurances of future performance, Judge Parker held, "Assurance of future performance is adequate 'if performance is likely (i.e. more probable than not)' and the degree of assurance necessary to be deemed adequate 'falls considerably short of an absolute guaranty.'"[44]

Following *PKR Enters.*, in *In re Brown*,[45] the Bankruptcy Court for the Southern District of Mississippi discussed the requirements of the Code when it comes to the requirement of "adequate assurances of future performance". Applying 5th Circuit principles, the *Brown* court acknowledged that the Code does not define "prompt cure" or "adequate assurance". The court found that whether or not a repayment is "prompt" turns on the nature of leased property, the provisions of lease, the

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41 528 F.3d 455 (6th Cir. 2008).

42 11 U.S.C. § 365(b)(1) (2007).

43 235 B.R. 597 (Bankr. E. D. Tex. 1999).

44 *Id.* at 603.

45 No. 05-55925-NPO, 2006 Bankr. LEXIS 2180 (Bankr. S.D. Miss. 2006).

amount of the arrearages, the remaining term of the lease, and the debtor's proposed plan for repayment.[46] And applying standards later affirmed by the 5th Circuit Court of Appeals in *Texas Health Enters., Inc. v. Lytle Nursing Home (In re Texas Health Enters., Inc.)*,[47] the *Brown* court held future ability to generate income stream, general outlook of debtor's industry, and the presence of a meaningful guarantee of payment are the criteria which were generally to be considered when deciding whether "adequate assurances" were provided. Ultimately, in *Brown*, the court ultimately held that cure was "prompt" because the arrearages would be paid within 13 months, with 5 years remaining on the lease, and debtor made a deposit of funds to guarantee monthly payments. It also found that "adequate assurances" were provided because profits were projected to increase over 6 months, the debtor had streamlined business operations, and testimony about a new hotel being built next to lease premises strongly suggested a positive business outlook.[48] These questions typically are decided on their facts, and courts are urged to consider what constitutes adequate assurances on a case-by-case basis.[49]

Standing of a party to request assumption or rejection of a lease is sometimes in issue.[50] In the recent decision in *In re Three A's Holdings, L.L.C.*,[51] the Delaware Bankruptcy Court considered the issue of who would have standing to object to assignment of lease. In *Three A's*, the lease in question was a shopping center lease as to which there were use restrictions, and the proposed assignment of that lease was contended (and later, held) to violate those restrictions. The parties who objected to the assignment of the lease included the municipality and the "Brea Downtown Owners' Association. The assignee argued that only a landlord has standing to object to an assumption and assignment under §365(b)(3), but reading the definition of "parties in interest" and the right "to appear and be heard on any issue in a case under [Chapter 11]" broadly, and distinguishing cases in which non-bankrupt tenants seek to enforce lease provisions against bankrupt tenants, the Delaware court disagreed and denied approval of the assumption.[52]

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46 *Id* at pp. 10-11, citing *In re PRK Enters., supra*, and *In re Reed*, 226 B.R. 1 (Bankr. W. D. Ky. 1998).

47 72 Fed. Appx. 122, 126 (5th Cir. 2003); *PRK Enters., supra* at 206.

48 In contrast, *see In re America the Beautiful Dreamer, Inc.*, Bankr. Ct. Dec. 174 (Bankr. W.D. Wash. 2006), in which the court held that cure was *not* prompt because only $50K of $180K debt was to paid in eight installments, with remainder as balloon payment at end of eight months. The court found that under this proposal, the creditor would bear most of risk of non-payment. *See also In re Fleming Companies, Inc.*, No. 05-2365 2007 U.S. App. LEXIS 19927, p. 12 (3d Cir. 2007), reminding that the text of 11 U.S.C. §365(f)(2)(B) regarding "adequate assurances" mirrors similar language from the Uniform Commercial Code §2-609(1).

49 *In re Texas Health Enters.*, 246 B.R. 832 (Bankr. E. D. Tex. 2000).

50 *See, e.g., In re Brewer*, 233 B.R. 825 (Bankr. E. D. Ark. 1999) (holding that a Chapter 13 debtor had standing to assume a rental agreement); *In re Lil' Things, Inc.*, 220 B.R. 583 (Bankr. N. D. Tex. 1998) (holding that a Chapter 11 debtor-in-possession did have standing to assume and assign a lease over the objections of the landlord's agent).

51 364 B.R. 550 (Bankr. D. Del. 2007).

52 *Id* at 560-61.

Upon assuming an unexpired lease, the debtor or trustee is authorized to assign it to another party, subject to the same requirement of adequate assurance of future performance to the assignee[53] and other restrictions related to assignment of specific types of leases, such as shopping center leases.[54]

C. Time for the Debtor to Assume or Reject

Balancing the tremendous benefit the Code gives debtors to assume, or to reject and be relieved of the responsibility of performing under, leases in their discretion, the Code imposes a strict time-limit on the debtor to decide whether to assume or reject its unexpired leases.[55] During the time prior to the decision to assume or reject, the debtor has the obligation of continued performance under the lease.[56] Leases not assumed within the time-limit are deemed rejected by operation of law.[57]

Prior to BAPCPA, there was a split of authority on whether the deadline to assume a lease could be extended by a timely motion filed prior to the 60 day deadline where relief came after the 60-day period stated in §365(d)(4) had elapsed,[58] though the majority of jurisdictions recognized that a motion prior to the 60th day preserved the right. Some courts interpreted the language of the statute to allow an extension if the "cause" to extend merely existed during the first 60 days of the case. Other courts would grant a motion to extend so long as filed within the 60-day period.[59]

In pre-BAPCPA days, the decision on whether or not to extend the deadline was committed to the sound discretion of the Bankruptcy Court, though this discretion was not without criteria. In the case of *In re Burger Boys, Inc.*,[60] the Court of Appeals identified several, non-exclusive factors to be considered in the decision on whether or not to extend the 60 day deadline. These included:

> ". . . (1) whether the debtor was 'paying for the use of the property'; (2) whether 'the debtor's continued occupation . . . could damage the lessor[] beyond the compensation available under the Bankruptcy Code'; (3) whether the lease is the

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53 11 U.S.C. §365(f)(1) (2007).

54 *See, e.g.* 11 U.S.C. §365(h)(1)(C).

55 11 U.S.C. §365(d) (2007).

56 *See, e.g.*, 11 U.S.C. §365(d)(3) (2007).

57 11 U.S.C. §§365(d)(1), (4) (2007).

58 *In re Tubular Techs. LLC*, 348 B.R. 699, 707 (Bankr. D.S.C. 2006).

59 *Id.*

60 94 F.3d 755 (2d Cir. 1996).

> debtor's primary asset; and (4) whether the debtor has had sufficient time to formulate a plan of reorganization."[61]

The discretionary decision by bankruptcy courts to extend the 60 day deadline was very infrequently challenged, and almost never successfully so. This could become critical for a given landlord, since such extensions were often granted for the full duration of the debtor's bankruptcy case.[62]

This has all changed with BAPCPA's revisions to §365. The revised Code provides that the debtor has 120, rather than the old 60, days in which to assume or reject.[63] However, in other changes, the Code has removed the bankruptcy court's discretion to grant extensions. In particular, BAPCPA has limited the first extension of the deadline to 90 days "on motion for cause."[64] Then, any further extensions may only be granted with "the prior written consent of the lessor."[65]

This provision was recently judicially interpreted in *In re Tubular Techs. LLC*.[66] In *Tubular Techs*, the court noted that the amended §365(d)(4) now plainly provides that to extend the period to assume a lease, a debtor must obtain an order entered within 120 days of the date of the order for relief.[67] While this provision gives the debtor additional time to make a decision with regard to its leases over the previous statute, it also establishes a "firm, bright line deadline" to assume or reject an unexpired lease of nonresidential real property. The court noted that this comported with the legislative intent to remove the bankruptcy judge's discretion to grant extensions of time.[68]

Timing of the date of rejection of a lease is important since rents accruing prior to rejection constitute an administrative claim, and unlike the unsecured, non-priority rejection damages, are entitled to be paid in full. This issue was recently considered in *Adelphia Bus. Solutions, Inc. v.*

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[61] *Id* at 761, citing *Theatre Holding Corp. v. Mauro*, 681 F.2d 102, 105-06 (2d Cir. 1982). Other courts have established lengthier lists of considerations for making the decision as to whether "cause" exists to extend time (*see, e.g., In re S & M Food Services, Inc.*, 117 B.R. 497 (Bankr. E. D. Mo. 1990), establishing a 10 factor test). While "cause" is not defined in the new §365(d)(4)(B)(I), it is fairly assumed that the old case law regarding cause will be equally applicable to the BAPCPA changes in this area.

[62] Richard Lucas, The Intersection of Chapter 11 and Real Estate Law, 25-9 Am. Bankr. Inst. J. 28, 28 (2006).

[63] 11 U.S.C. §365(d)(4)(A) and (B).

[64] 11 U.S.C. §365(d)(4)(B)(i).

[65] 11 U.S.C. §365(d)(4)(B)(ii).

[66] *See* Footnote 23.

[67] *Tubular Techs*, 348 B.R. at 708.

[68] *Id*.

Abnos.[69] In this case, the bankruptcy court made its approval of the debtor's rejection of the lease *retroactive* to the date of the debtor's motion–a full two years before date of the order for approval. Sitting in review, the Court of Appeals for the Second Circuit assumed, without deciding, that the bankruptcy court had the equitable authority to make its approval retroactive, passing on deciding the issue because the creditor did not raise the argument at the district court level.[70]

If, in fact, a bankruptcy court has this authority, then - - as the landlord argued, too late - - the debtor could continue tying up the landlord's property, accruing what otherwise should be considered an administrative claim for rents, and then seek to impose a "retroactive rejection" on the lease, eliminating the obligation to pay for the now-past use of the property. This is a dangerous precedent for landlords, should it become accepted law.

Finally, in the case of personal property and residential leases only (since rejection is not "automatic" as with non-residential leases under §365(d)(4)), it used to be possible for a tenant to keep the lease current up to and through the filing of the bankruptcy case, not treat the lease in its plan, and allow the lease to "ride through" the bankruptcy. Under the "ride through doctrine", because the relations of the parties are essentially unaltered by bankruptcy, the lease emerges from bankruptcy subject to the rights and obligations conferred by state law.[71] This has been pulled back somewhat in regards to personal property leases under BAPCPA's §365(p)(3),[72] but still exists concerning residential real property leases.

D. Line-Item Assumption or Rejection?

The ability to assume or reject contracts based on one's relatively unfettered business judgment is a very powerful financial tool for a troubled business, permitting the shedding of only those unprofitable contracts and keeping the jewels. Imagine how powerful it would be if a debtor could select *portions* of the obligations of a particular agreement to assume and reject. Unfortunately for debtors (and fortunately for creditors), that power does not exist. Assumption or rejection is a decision that must be applied to the entire contract in question.[73] For instance, in the recent decision in *In re Buffets Holdings, Inc.*,[74] the Delaware Bankruptcy Court held that a debtor was required to either assume or reject master leases covering multiple properties in their entirety,

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[69] 482 F.3d 602 (2d Cir. 2007).

[70] *Id* at 607.

[71] *Stumpf v. McGee (In re O'Connor)*, 258 F.3d 392 (5th Cir. 2001).

[72] Section 365(p)(3) states that any personal property lease not assumed by confirmation is deemed rejected at the conclusion of the confirmation hearing.

[73] *In re Audra-John Corp.*, 140 B.R. 752 (Bankr. D. Minn. 1992); *Century Indemn. Co. v. NGC Settlement Trust (In re National Gypsum Co.)*, 208 F.3d 498 (5th Cir. 2000); *City of Covington v. Covington Landing, L. P.*, 71 F.3d 1221 (6th Cir. 1995).

[74] 387 B.R. 115 (Bankr. D. Del. 2008).

and that the debtor was prohibited from "picking and choosing" specific properties even though the master lease provided for rent allocations among the various properties (although the obligation to pay rent was joint and several). If there exists a narrow exception to this rule, it exists only where "an agreement" is really comprised of multiple, severable agreements.[75]

E. Damages After a Lease is Assumed

Prior to BAPCPA, the decision to assume a lease, whether before plan confirmation or during, was accompanied by significant risk, since all liabilities under that lease (including cure obligations and future rents through the entire lease term) were transformed into administrative expenses.[76] BAPCPA has reduced the estate's exposure to damages for leases once assume that are later rejected, by modifying §503(b)(7) to limit monetary rejection claims in that context to

> ". . . a sum equal to all monetary obligations due, excluding those arising from or relating to a failure to operate or a penalty provision, for the period of 2 years following the later of the rejection date or the date of actual turnover of the premises, without reduction or setoff for any reason whatsoever except for sums actually received or to be received from an entity other than the debtor, and the claims for the remaining sums due for the balance of the term of the lease shall be a claim under section 502(b)(6)."

This provision not only places a two year cap on the post-assumption rejection claim, it allows for the estate to benefit from a credit for any mitigation of damages by the creditor.

IV. PUBLIC HOUSING CASES

The Code contains provisions that prevent discriminatory treatment by governmental units due to the fact that a debtor has filed bankruptcy.[77] Controversies have recently arisen with respect to the ability of governmental agencies to evict non-paying tenants from public housing. For instance, in *Biggs v. Hous. Auth. of Pittsburgh*,[78] the bankruptcy court held that the lease in question was not terminated, even though it was not assumed by Chapter 7 trustee, because under Pennsylvania state law, a lease is not "terminated" until actual eviction of tenant and possession by landlord. Applying the anti-discrimination provisions of §525(a), the court found that the eviction of the debtor was related to her non-payment of discharged or dischargeable rents and was therefore

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[75] *Stewart Title Guar. Co. v. Old Republic Nat's Title Ins. Co.*, 83 F.3d 735 (5th Cir. 1996); *see also In re Cafeteria Operators, L. P.*, 299 B.R. 384, 392 (Bankr. N. D. Tex. 2003), holding separate leases under Master Lease were each severable leases.

[76] *In re Monica Scott, Inc.*, 123 B.R. 990 (Bankr. D. Minn. 1991); *In re Frontier Properties, Inc.*, 979 F.2d 1358 (9th Cir. 1992); *Nostas Assoc. v. Costich (In re Klein Sleep Products)*, 78 F.3d 18 (2d Cir. 1996).

[77] 11 U.S.C. §525(a).

[78] No. 07cv0007, 2007 U.S. Dist. LEXIS 14232 (W.D. Pa. 2007).

prohibited, and further, that §525(a) prohibited the housing authority from seeking, and the bankruptcy court from granting, stay relief to allow eviction to go forward.

A similar result was reached in *In re Kelly*.[79] The Miami-Dade Housing Agency argued that BAPCPA created an exception to the automatic stay under §362(b)(22) to allow the completion of eviction proceedings against the lessee, since the Miami-Dade Housing Agency obtained a judgment of eviction prior to the filing of the bankruptcy petition. The court examined this new provision as it relates to a debtor in arrears for rent in public housing, whose tenancy rights are protected under §525(a). Analogizing to pre-BAPCPA cases interpreting the interplay between §365(b)(1) cure obligations with §525(a), the court concluded that a Chapter 7 debtor may stay in his or her public housing unit even though pre-petition rents are being discharged, despite the BAPCPA addition of §362(b)(22). The court ruled as follows:

> Nevertheless, the Court concludes that §525(a) eliminates the need for a public housing debtor to cure a prepetition default as a condition to rendering the stay exception in §362(b)(22) inapplicable. This result is consistent with the pre-BAPCPA cases analyzing the cure obligations in §365(b)(1) in light of §525(a). Those cases hold that §525(s) trumps §365(b)(1). That is, a public housing debtor's right to retain possession under §525(a) after discharging the prepetition debt controls over the cure obligations in §365(b)(1).[80]

It is not at all clear that §525(a), limited as it is to "governmental unit[s]" would also apply equally to a private landlord who is seeking to evict a tenant from publicly subsidized housing (perhaps on some sort of "agency" theory), but the way the cases appear to be heading, it should not be ruled out either.

V. ATTORNEY'S FEES

Frequently, when deciding what a defaulting tenant's cure obligation will consist of, bankruptcy courts are asked by landlords to include attorneys fees incurred by the landlord. This topic recently came up in *In re America the Beautiful Dreamer, Inc.*[81] Citing §365(b)(1)(B), the landlord argued that the assuming debtor is required to "compensate the landlord for any actual pecuniary loss resulting from a default under an unexpired lease, before assuming the lease", and that this includes attorneys fees. The court held that while §365(b)(1)(B) creates no independent right to attorney's fees, when terms of lease provide for them and they are permitted under state law (and the lease provision governing attorneys fees in the context of bankruptcy in this case was unusually specific), then §365(b)(1)(B) entitles the landlord to attorney's fees as condition for

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[79] 356 B.R. 899 (Bankr. S. D. Fla. 2006).

[80] *Id* at 900-901.

[81] 2006 Bankr. LEXIS 1371, 46 Bankr. Ct. Dec. 174 (Bankr. W. D. Wash. 2006).

assumption of lease.[82] Bolstering this position further was the recent decision of the United States Supreme Court in the *Travelers* case.

On March 20, 2007, the United States Supreme Court announced its opinion in *Travelers Casualty & Surety Co. of America v. Pacific Gas & Electric Co.*, 549 U.S. 443, 127 S. Ct. 1199, 167 L. Ed. 2d 178 (2007). In that case, Travelers, a creditor/surety had hired attorneys to undertake substantial legal work in the PG&E bankruptcy to prevent the call of $100 million in surety bonds in the event that the debtor defaulted on its obligations to pay state workers' compensation benefits; the underlying pre-bankruptcy transaction documents provided that PG&E would be responsible for any loss incurred by Travelers in connection with the bonds, "including any attorneys fees incurred in pursuing, protecting, or litigating Travelers' rights in connection with those bonds." *Id.* at 127 S. Ct. 1202. Though there was never any default by the debtor under the bonds, Travelers' legal effort to protect itself resulted in language in the debtor's plan to protect Travelers' indemnity and subrogation rights in the event of a default by PG&E. Subsequent wrangling over plan language resulted first in litigation, and then in a stipulation that resolved the dispute and permitted Travelers to file a general unsecured claim for its attorneys' fees incurred in those wranglings, subject to PG&E's right to object. *Id.* at 127 S. Ct. 1202-03.

When Travelers filed its amended claim for those attorneys fees, PG&E objected, arguing the previously untested maxim that one could not recover attorneys fees incurred while litigating issues of bankruptcy law. This well-accepted proposition, announced in the United States Court of Appeals for the Ninth Circuit in *Fobian v. Western Farm Credit Bank (In re Fobian)*, 951 F.2d 1149 (9th Cir. 1991), was the basis of the Travelers claim's successive denials by the bankruptcy court, district court and Ninth Circuit. The Supreme Court appeal followed

The Supreme Court held that "a rule of the court's own creation--the so-called *Fobian* rule--which dictates that attorney fees are not recoverable in bankruptcy for litigating issues 'peculiar to federal bankruptcy law'... finds no support in the Bankruptcy Code, either in §502 or elsewhere." *Travelers,* 127 S.Ct. at 1207. Thus, the *Travelers* Court held that the *Fobian* rule is inappropriate in the context of determining the allowability of attorney's-fee claims for unsecured creditors.

> The absence of textual support is fatal for the *Fobian* rule. Consistent with our prior statements regarding creditors' entitlements in bankruptcy, we generally presume that claims enforceable under applicable state law will be allowed in bankruptcy unless they are expressly disallowed.

127 S.Ct. at 1206. However, the Supreme Court declined to address the underlying question of whether unsecured creditors may include postpetition attorneys' fees in their proofs of claim or whether recovery of such fees are precluded by the negative inference from 11 U.S.C. §506(b), which prohibits a secured creditor from recovering attorneys fees unless the secured creditor is "oversecured" (meaning that the collateral is worth more than the debt it secures or, stated another

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[82] *See also In re Legacy Health Care, LLC*, No. 05-11270 K, 2006 Bankr. LEXIS 2492 (Bankr. W.D.N.Y. 2006), citing *In re Best Prod. Co., Inc.*, 148 B.R. 413, 414 (Bankr. S.D.N.Y. 1992).

way, that the secured creditor does not have any under-secured or unsecured claim). The Supreme Court remanded the case to the Ninth Circuit, "express[ing] no opinion with regard to whether, following the demise of the *Fobian* rule, other principles of bankruptcy law might provide an independent basis for disallowing Travelers' claim for attorney's fees." *Travelers,* 127 S.Ct. at 1207 - 08.

It remains unclear, with the Court ducking the question of whether post-bankruptcy fees may be recoverable under the Bankruptcy Code generally, whether such fees can (or should) be allowed in all cases where the claim arises under contract and/or Texas statutes permitting of fee recoveries in contract and quasi-contract claims. However, this decision presents a potential opportunity for landlords who are "successful" in defending their rights post-filing contested matters relative to their leases, their claims, and/or in the plan confirmation process, to seek recovery of attorneys fees.

Recent decisions have sought to make some sense of the Supreme Court's *Travelers* decision, coming to opposite conclusions on the question. In *In re QMECT, Inc.*,[83] a California bankruptcy court held that a creditor's reasonable post-petition attorneys fees were in fact recoverable. The Bankruptcy Appellate Panel for the 9th Circuit came to the same conclusion in *Centre Ins. Co. v. SNTL Corp. (In re SNTL Corp.)*, 380 B.R. 204 (9th Cir. B.A.P. 2007); in addition to declining to follow the negative inference argument regarding §506(b), the B.A.P. also declined to adopt the debtor's argument that under §502(b), post-petition attorneys fees are categorically precluded by language stating that allowed claims are determined as of the petition date.

Consistent with the majority of courts prior to *Travelers*, in *In re Elec. Mach. Enters., Inc.*,[84] a Florida bankruptcy court disagreed and disallowed post-bankruptcy attorneys fees, reasoning that "[t]o find otherwise would impose unreasonable and potentially insurmountable burdens on the administration of bankruptcy cases." A similar result was reached in *J. P. Morgan Trust Co. v. A. P. Green Industries, Inc.*,[85] reasoning from the language of §506(b).

VI. BAD FAITH LITIGATION TACTICS BY COMMERCIAL TENANTS

Finally, a commercial tenant who sought to abuse the bankruptcy process to avoid eviction under what the court classified as "an obviously expired lease" was recently brought to heel. In. *Maryland Port Admin. v. Premier Auto. Svcs., Inc.*,[86] the Court of Appeals for the Fourth Circuit held that the tenant sought to tie up the landlord and the property "in endless, fruitless litigation", and that the debtor's use of Chapter 11 "demonstrated, unfortunately, how the good and useful ends of the bankruptcy process can be badly abused."

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83 368 B.R. 882 (Bankr. N. D. Cal. 2007).

84 371 B.R. 549 (Bankr. M. D. Fla. 2007).

85 No. 06-0885 (W. D. Pa. 2007).

86 492 F.3d 274 (4th Cir. 2007).

In this case, when negotiations to renew a lease on a marine terminal failed, the debtor remained as an at-will, month-to-month holdover. After 2 years saw no change in the situation, the landlord sought to terminate the debtor's month-to-month tenancy and had executed a lease with a new tenant for the terminal. On the last day before the tenancy was to end, the tenant invoked the automatic stay and filed bankruptcy. Separately, the debtor sued the landlord and others on various constitutional theories.

After several hearings in the bankruptcy court, the lawsuit was dismissed on the merits, the stay was lifted, and the bankruptcy was dismissed based on the bankruptcy court's finding that the bankruptcy was filed in bad faith inasmuch as it was solely intended to forestall eviction under an expired lease. Undaunted, the tenant - - over-clever by half - - appealed the dismissal of the bankruptcy, and filed another lawsuit, this one with the Federal Maritime Commission, but alleging the same facts as allegations of federal shipping laws. This suit was thereafter dismissed by an administrative law judge at the Federal Maritime Commission. Yet another suit, this time for injunction, was then filed, in federal district court. The district court then consolidated the bankruptcy appeal with the district court injunction suit and the Maritime Commission complaint. After the district court affirmed the dismissal of the lawsuits and the bankruptcy, the tenant appealed to the Fourth Circuit.

Citing the landmark decision of the Court of Appeals for the Fifth Circuit in *In re Little Creek Dev. Co.*,[87] the Court held that bankruptcy judges have the right to consider the "good faith" basis for a bankruptcy filing as a threshold inquiry, *sua sponte*, and to prevent cases intended to delay creditors, and not to in any way benefit them, from going forward. The Court found that the bankruptcy was both "objectively futile" (because the Court could not compel the landlord to give the tenant a "favorable" lease and that, by the time the issue had been raised, the tenant's - - and prospective estate's - - rights in the lease had expired by their terms) and that it was motivated by "subjective bad faith". Added to that, the Court found that the debtor "had no demonstrable need to reorganize when it filed its petition", and even that it was a solvent business with no record of financial distress when the bankruptcy was filed.

This case joins a growing line of cases in which courts have seen, and strongly disapproved, unreasonable litigation and bankruptcy tactics by bankrupt commercial tenants.[88] In particular, less-than-scrupulous tenants who have no financial need for bankruptcy have recently begun to file bankruptcies seeking to take advantage of lease rejection, and the caps on future claims for lease rejection, to oppress landlords.

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[87] 779 F.2d 1068 (5th Cir. 1986).

[88] *See, e.g., In re Integrated Telecom Express, Inc.*, 384 F.3d 108 (3d Cir. 2004); *In re Liberate Technologies, Inc.*, 314 B.R. 206 (Bankr. N. D. Cal. 2004).