

“So...Your Tenant Filed Bankruptcy”

By Robert L. Cain

The most common form of bankruptcy proceeding is filed under the federal code's Chapter 7, designed to allow individuals to keep certain belongings while selling off other property to repay creditors

About a third as many are filed under the code's Chapter 13, where debtors repay creditors in installments, in full or in part, over a period of years.

A tenant filing bankruptcy is not a pretty sight. The debtor is supposed to get a “fresh start” in the case of Chapter 7 filings, wiping out all their debts so they can begin anew. That means that several people whom the debtor owes money may not get paid, and if they do, it may mean pennies on the dollar. If the tenant owes back rent, that can mean the landlord.

Different Types of Bankruptcies

The bankruptcy code, a complex Byzantine statute that has been tweaked, fiddled with and interpreted by thousands of court cases, allows for four types, called chapters, of bankruptcies. As a landlord, chances are, you will only have to deal with two of them: Chapter 7 and Chapter 13.

In a Chapter 7 filing, the debtor has to liquidate (sell off) personal property to pay, at least partially, debtors. When the bankruptcy is discharged, meaning all the debtor's allowable assets have been used up, many creditors receive only pennies on the dollar.

A Chapter 13, called a “wage-earner's bankruptcy” filing means the debtor and the bankruptcy court create a payment plan and arrange with creditors to pay off debts in smaller installments over a longer period of time.

The vast majority of filings are Chapter 7, leaving many creditors high and dry, with no chance of seeing anything but a small percentage of the debt owed them.

In every kind of bankruptcy, the court appoints a trustee to handle the disposition of the debtor's assets.

Creditors get paid in a specific order. At the top of the list are “secured” creditors. These are people who have a secured interest in some personal property the debtor is buying, such as a car. Any money left goes next to certain priority creditors such as taxing authorities. **Finally, bringing up the rear are “unsecured” creditors – those would include landlords.**

Several types of debts are not and cannot be discharged by a bankruptcy. For example, most taxes, spousal maintenance, child support and, most important to landlords, debts owed to creditors who did not receive notice of the bankruptcy remain in force, bankruptcy or not. The last exception means that if the tenant does not list you as a creditor for the back rent he owes, he has to pay it. Debtors can specifically exclude some creditors, as well, simply by leaving that debt off the bankruptcy filing. Some tenants might do that. A medical bankruptcy would be one example where someone might do that. These are not a special legal class of bankruptcy, but bankruptcies that are brought on by onerous medical bills that a debtor simply has no hope of ever paying. In these cases, sometimes the debtor, or in this case the tenant, want to rid himself of the medical bills, but has the strength of character to not want to stiff other people he owes money to, such as the landlord, of what they have coming. So, he simply does not list them in the bankruptcy filing.

If your tenant warns you that he is thinking about filing bankruptcy and says he really doesn't want to have you lose any rent, tell him to speak to his bankruptcy attorney about excluding your bank rent from the list of creditors. It is important you do not speak to your tenant about this option **after** he has filed bankruptcy.

Automatic Stay

When a tenant files bankruptcy, all legal actions that had already been filed, or could have been filed, for debts incurred before the date of the bankruptcy are stopped. That means that if your tenant is two months in arrears for rent and you have filed an eviction, it is automatically stopped. You cannot go ahead with the eviction and you cannot attempt to collect the back rent from the

tenant. Moreover, the tenant gets to stay in the property. At this point, you cannot evict a tenant who owes you rent incurred before the bankruptcy while the bankruptcy is in progress, unless you obtain something called “relief.”

Within 30 to 40 days, the bankruptcy court will hold a creditors’ meeting to inform creditors of the financial situation of the estate of the debtor and to try to work out details of the liquidation or a payment schedule. You can attend that meeting to try to protect what you have coming. In any case, the creditors’ meeting will give you a pretty good idea of how likely you are to see any money. In the meantime, your non-paying tenant is still in the property.

Relief

You can go to the bankruptcy court and request that you be granted relief from the automatic stay if the automatic stay results in “lack of adequate protection of an interest in [the] property” of the landlord. You would have to show that your interest in the property would be in peril if you don’t get some rent. Don’t count on that happening; the courts are usually on the side of the debtor.

Special Rules for Landlords

The Bankruptcy Code gives landlords unique rights in dealing with tenant debtors. The debtor tenant or the trustee has the right to assume or reject “executory” contracts – that includes leases. And...leases are further defined as including rental agreements. The trustee is allowed 60 days to decide if he will assume the lease. If you, as the landlord, have a good reason for wanting a quicker decision, such as having a tenant ready to occupy, you can ask the trustee to decide sooner or file a motion in court requesting an earlier deadline.

If the trustee does decide to assume the lease and the tenant is behind in the rent, the trustee must either pay the back rent or provide adequate assurance that he will, and provide adequate insurance that the rent will continue to be paid.

Most Chapter 7 cases have leases rejected as a matter of course operation of law. Once the lease is rejected, your attorney needs to negotiate with the trustee for a deadline for the tenant to vacate the premises. The landlord is entitled to possession of the property as soon as the trustee rejects the lease. Plus, you may be entitled to “administrative rent” from the trustee for the period of time between the bankruptcy filing and the trustee’s vacating the property.

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