

New Bankruptcy Law a Plus for Landlords **By Robert L. Cain**

On October 17th of last year, the new bankruptcy law went into effect. You may have seen the pictures on the news of last-minute filers waiting in long lines on October 16 to slide in ahead of the new law. The new law is far more landlord-friendly. It contains provisions that keep bad tenants from using the "automatic stay" provision thus allowing them to live in our properties for months without paying rent.

In this article, I will look at how the new law works and some of the issues yet to be resolved in the language of the law. While the changes are generally a plus for rental property owners, there are some provisions that we need to be careful of and some provisions that are unclear and will need to be clarified by the courts. Let's look at a hypothetical case to see how it works.

Look at the case of Joe Schlecter, your run-of-the-mill bad tenant. Joe doesn't pay much of anybody unless he has to. Landlords are no different. He had been remiss paying the rent for months, usually begging for more time and paying late. Finally, you had enough and sent him the three-day notice to pay up or move required in your state. After three days you had received no rent, so you filed the eviction in court.

Two weeks later you went to court; Joe Schlecter did not because he knew he would lose. You got judgment for possession. Two days after the judgment is filed, Schlecter files bankruptcy naming you as a creditor.

Schlecter had used a do-it-yourself bankruptcy kit he had copied out of a book he got at a bookstore (and then returned for cash) a year ago when he thought about filing bankruptcy and stiffing everyone he owed, before. You go ahead with the eviction process, sending him notice of the judgment and saying that the sheriff will be coming to remove him in the next few days.

He calls you and says that because he had filed bankruptcy there's "this automatic stay thing" and you can't evict him. He really thinks he has you there. He has been reading the instructions that came with the bankruptcy forms with glee. He thinks he has you and he will be able to live rent free for a while.

You begin laughing almost uncontrollably because as of October 17, 2005, the bankruptcy law changed and tenants with a current judgment for possession can no longer get an automatic stay that allows them to live rent free while the bankruptcy court decides what to do about the existing lease.

You tell Schlecter that the sheriff will be there in a couple of days and he will have his worldly possessions deposited on the curb. He can explain it to the sheriff when he arrives, but it won't do any good. He should have ripped off the new forms.

But, Joe Schlecter is not finished. He is determined that he is going to put one over on everybody. He finds a copy of the new bankruptcy law on the internet and reads it. In it he finds the provision that he can get an automatic stay after all, if the state's bankruptcy law provides for a cure of the default after judgment has been entered and the tenant has deposited with the clerk of the court the rent that will be due during the 30-day period. He thinks this one is worth a try. The only problem is that he will have to pay the current rent to the bankruptcy court. Well, if he absolutely has to pay the rent...

When he gets to the office of the bankruptcy court clerk, they look at him like he is crazy, which may not be too far off. There is no provision in state law that provides for a cure for a judgment such as an eviction once it has been entered, unless the landlord accepts rent and allows him to stay. The clerk's office will not accept the rent payment and will not put a 30-day hold on the automatic stay. Schlecter is about to become your ex-tenant.

There may be such a state law somewhere that permits a cure after an eviction judgment is entered, but no one I have spoken with knows of one and I have not been able to find one in any state law I have reviewed.

Those are the good parts of the new bankruptcy law. Now for the issues I can foresee. I spoke with Thomas Linde, a Seattle, Washington attorney to ask about some of the less clear aspects of the new law. Linde wrote the article from which I obtained the digest information about the new bankruptcy law. You can read his article at www.abanet.org/genpractice/newsletter/lawtrends/0509/realestate/autostay.html.

The new law has a number of pieces that are brand new and not only untested, but unclarified. The first one is how the bankruptcy court is going to act in 10 days as is required in several clauses of the new law. Courts are rarely in a hurry to do anything, so you have to wonder what will happen when the court is unable to hold a hearing in 10 days. Who will be the beneficiary of that inability, the tenant or the landlord?

For example, what if a tenant files a completely bogus claim saying he is entitled to an automatic stay in the eviction because "Applicable bankruptcy law provides for a cure of the [monetary] default after judgment has been entered." In fact, no such provision exists in the state law, but the tenant or the tenant's lawyer frivolously claims such a provision exists, citing a clause in state law that is no way applicable. The court is supposed to hold a hearing in 10 days to determine the truth of the tenant's claim. The court is unable to schedule a hearing within the time frame and the hearing is 15 days later instead of 10. Once the hearing is held, the court rules the automatic stay ineffective and the tenant is ordered to move out. The landlord has been held hostage by a frivolous claim for five days past the time of the hearing and 15 days past when the tenant should have been on the street.

Will there be a way for the landlord to be compensated for the obviously frivolous claim? Can the delay be added into the charges the tenant owes the landlord? There is no answer yet. Another question is the tenant depositing rent owned with the clerk of the bankruptcy court. Thomas Linde points out that the clerk's office has no such system set up now to accept such escrow money. All it can accept is filing fees. An entire new system will need to be established for holding money, much as a title company does now.

A drug-dealing tenant may have another opportunity to bollix up the works after he has filed bankruptcy if the landlord fails to file a certification on the tenant and with the court that the eviction was begun prior to the bankruptcy filing. A bad tenant can stall the eviction for at least 25 days in this case. The bad tenant has 15 days to file "an objection to the landlord's claim." After that, the court is supposed to hear the objection within 10 days. But, as pointed out earlier, the court may not be able to schedule a hearing that promptly. What are the landlord's options then? Both of these are issues that will be decided and clarified by the courts as the law acquires case law. Clarifications won't come from Congress in the foreseeable future, since it took them over a decade to get this modification passed.

When the New Law Doesn't Apply

You must have obtained a judgment for possession before the tenant files bankruptcy or the automatic stay will be in effect just as it was in the old law.

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 if Joe Schlecter was two months in arrears for rent and you filed an eviction but had not gotten to court, 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.

The mechanics of how this is handled vary slightly from state to state, but nowhere can you 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.

You can go to the bankruptcy court and request that you be granted relief from the automatic stay if the automatic stay results in a "lack of adequate protection of an interest in [the] property" of the landlord. You 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 will probably continue to be on the side of the debtor.

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 include leases. 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 assurance that the rent will continue to be paid.

Most Chapter 7 cases have leases rejected as a matter of course by 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 trustees vacating the property.

You Get Current Rent

As explained above, there is good news; the tenant has to stay current with all debts incurred *after* the bankruptcy filing. If he doesn't, you can go to the bankruptcy court and ask for an order that the tenant either pay the rent on time or leave the premises. In addition, any rent incurred after a bankruptcy filing enjoys a special place in bankruptcy law: it is an "administrative expense." It must be paid before all other unsecured creditors.

Automatic Stay Limits

There are two more provisions that will help landlords avoid the game playing that went on under the old law. Some California bankruptcy attorneys used to advertise "7 Months Free Rent" trying to chase debtors to the courthouse door. What they would do is file a bankruptcy for the bad tenant, who would then enjoy an automatic stay. They would string it out for five or six months with various motions. Then at the last moment would withdraw the bankruptcy filing. The landlord would have to start all over again with the eviction.

That abuse has been stopped with the new law. If someone has filed bankruptcy in the past year, no automatic stay of any kind will be in effect more than 15 days. If someone filed bankruptcy twice in the past year, no automatic stay of any kind is allowed.

The new bankruptcy law is an overall plus for landlords. Tenants will not be able to file bankruptcy and stay rent free, or at all, under the new law. Look for some technical questions

and issues to be ironed out in the courts, but this law is what we have been looking forward to for many years to protect ourselves against one aspect of the misuse of the courts.
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