

Bankruptcy Issues for Landlords, Contractors, and Real Estate Buyers – Part 1: The Automatic Stay

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As real estate lawyers, we run into questions involving bankruptcy of our landlord clients' tenants, of our contractor clients' customers, and of the owners of real estate our clients want to buy. In this series of articles, we will attempt to address some of the issues faced by those clients in each of those situations, and some of the peculiarities which come up when the state and federal laws involved don't mesh well.

While most laws involving real property are specific to the state in which the property is located, bankruptcy law is federal, applying in all states and handled through special federal Bankruptcy Courts. This means that the same federal bankruptcy law has to fit with the real property laws of each state, which vary. And as anyone who has owned real estate in other states as well as Pennsylvania knows, Pennsylvania real estate law is not even close to the uniform or standard laws adopted in many other states. This creates certain issues in bankruptcies in Pennsylvania which involve real estate, as many bankruptcies do.

First, before we get to those unusual situations, we need to cover some basic rules of bankruptcy, applicable to all types of cases. Foremost for creditors, the bankruptcy of someone who owes you money does not mean that you have to give up any hope of ever collecting from them, and let them walk away. It does mean you have to change where and how you pursue the debt, and follow a new set of rules to do so. Unfortunately for creditors, the extra rules and procedures make it more likely you will need a lawyer to help you to pursue the eviction, lien or debt owed.

One of the most important and least understood rules of bankruptcy is the automatic stay under Section 362 of the Bankruptcy Code. Simply, the filing of a petition for bankruptcy protection by a debtor stays or freezes all lawsuits against the debtor and any actions by creditors to execute on judgments, to take a debtor's property, dispossess a debtor from real estate, or otherwise improve the creditor's position against the debtor. The protection the automatic stay offers to a debtor is very strong. Further, pure exceptions to the stay are limited, and primarily include actions by

governmental entities, actions on complex financial instruments, criminal and family law matters.

If a creditor violates the automatic stay, even if the creditor doesn't have notice of the debtor's bankruptcy, the actions taken by the creditor will be treated as if never taken at all, or voided. If a creditor violates the stay intentionally, after knowing of the bankruptcy, the creditor can be liable under Section 362(k) of the Bankruptcy Code to sanctions by the Bankruptcy Court, which can include any actual damages suffered by the debtor as a result of the creditor's actions, attorneys' fees for the debtor's attorney, and punitive damages to punish the creditor for breaking the rules. These risks mean the creditor must be very careful when a debtor tells you they have filed or are filing for bankruptcy, because your continued collection efforts can be voided or cost you a lot of money. This is probably why so many creditors just stop trying to collect at all after hearing the word bankruptcy.

However, the protections of the automatic stay are not without limits. We are often surprised to find that many landlords come to us and say they are letting tenants live in their properties rent free because they are in bankruptcy, or that contractors say they gave up collecting thousands of dollars for work they completed because the property owner filed for bankruptcy. We also don't understand how real estate owners who owe money to lenders secured by mortgages on the real estate think that they can file bankruptcy, keep the property and wipe out the mortgage and the debt owed to the lender.

Creditors need to remember that an automatic stay is not permanent. If the debtor does not follow through with the rules and requirements to complete a bankruptcy, his or her case will be dismissed by the bankruptcy court and the stay will end when the case is dismissed. And many debtors say they are filing or have filed bankruptcy when they have not filed a petition for bankruptcy court protection.

Relief from the automatic stay is generally available to secured creditors and landlords in Chapter 7 liquidation bankruptcies, obtained by a motion to the judge handling the bankruptcy. This typically takes several weeks and a few hours of attorneys' time, and is a complicated task to complete on your own. Whenever a tenant in possession of your property, or an owner who owes you more than two thousand dollars for your work as a contractor, files for bankruptcy protection, you should consider filing a

motion for relief from stay, and have an attorney review the bankruptcy filings.

Once a motion for relief from stay is filed with the bankruptcy court, the court has thirty days to consider it, so it makes sense to file quickly when you know you have a chance of success. If the court does not act on the motion in 30 days, the stay is automatically lifted. This doesn't happen too often, however, and bankruptcy judges typically either grant or deny the motion within the thirty days, or else enter an order postponing the hearing to a later date and extending the stay until that hearing.

If your motion is granted or the court does not act in 30 days, the stay is lifted, and you can take the Order, or the verification from the clerk of the bankruptcy court that the stay is lifted, back to the state court where your action against the debtor was filed, and continue with your case, or with execution on your judgment for money or possession.

If the debtor is an individual tenant in your property and files under Chapter 13 of the Bankruptcy Code, a reorganization type of bankruptcy for a wage earner, or the debtor is a business entity and files a petition to reorganize under Chapter 11 of the Bankruptcy Code, you should be entitled under their plan of reorganization to receive ongoing payments of current rent to allow them to stay in the property during the bankruptcy, and some portion of the back rent due in monthly payments spread out over many months. If the plan isn't timely filed with the court, or if these payments do not get made on a regular basis, the creditor can force the debtor to convert the case to a liquidation Chapter 7 bankruptcy, or get relief from the court to continue with the eviction or collection action in state court.

In Chapter 11 and Chapter 13 reorganizations, getting relief is a little more complicated. The court will look at the plan of the debtor to keep possession of the property, determine whether you as a creditor are "adequately protected" under the payment plan the debtor proposes and with the equity in the property if the debtor owns it. The court will also look at whether the debtor's plan is realistic, or it was done simply to buy a little time and hinder, delay or defraud creditors. The last factor is especially considered if the debtor has filed multiple bankruptcies or tries to transfer assets to a third party.

There are some additional considerations when a residential tenant files for Chapter 13 bankruptcy in the middle of an eviction action, and rules which require many such tenants to pay the amount of the money judgment against them to stay in possession during the bankruptcy. That particular

issue is discussed in some depth in my previous articles on “Bankruptcy Law Meets Eviction Law”.

For a contractor another possible way to short circuit the automatic stay protections is through a mechanic’s lien. Bankruptcy courts in Pennsylvania have recognized that under state law, the lien relates back to the date the construction for which the debtor did not pay commenced. This means that even though the debtor filed for bankruptcy later, the mechanic’s lien is a “pre-petition act” under the bankruptcy code, and cannot easily be wiped out. The contractor should then be able to proceed with enforcement of the lien and request relief from the bankruptcy court to do so.

Likewise, since the date of lien of a mortgage against a property relates back to the date of the loan or the recording of the mortgage, the lender in many cases should be able to get relief from stay to proceed with a foreclosure action on the property, which is really an action against the property and not an action against the debtor individually. The debtor’s liability to the lender on the note can be wiped out by the bankruptcy, but the mortgage lien will usually remain intact if the mortgage was adequately secured.

There is an easy way to determine whether or not someone has filed for bankruptcy, and if so what Chapter they have filed under. We therefore recommend that anyone facing the potential bankruptcy of someone who owes them money get a PACER account. PACER stands for Public Access to Court Electronic Records, and allows anyone to open an account at pacer.gov, and have access to all of the public bankruptcy court records for every debtor who files for bankruptcy protection anywhere in the United States. It only costs eight cents to see if someone has filed a petition with the court, eight cents per page for every page you download to read or print, and nothing to watch the dockets showing whether a case is proceeding or dismissed. All filings by attorneys are electronic, and the docket is current to the same day of most filings, so you can know today whether someone filed for bankruptcy protection as recently as yesterday, or whether their case has been dismissed.

The above thoughts about complete our primer on the automatic stay in bankruptcy. Look for our next article in this series on “Claims in Bankruptcy”.

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