

## Navigating a Residential Tenant's Bankruptcy Proceeding



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Inevitably, those who hold residential property as an investment vehicle come across the frustrating impact of a tenant who is being evicted filing bankruptcy. Before becoming acquainted with the bankruptcy process, most landlords would describe bankruptcy as a “status” rather than a proceeding. One goal of this article is to change that perception. Another goal is to impart a basic understanding as to common pitfalls and concerns related to a bankruptcy proceeding. This article will accordingly be in “two parts”. The first part will address the impact of a tenant filing bankruptcy, including the impact of the automatic stay. The second part will focus on when a landlord must seek relief from stay in the bankruptcy proceeding.

As with all fields of law, there are nuances and unique attributes to each bankruptcy proceeding – most of which stem from what one might call the tenant’s “motive” in filing bankruptcy. There is no substitute for competent counsel, skilled in both landlord-tenant and bankruptcy matters. This article will focus on tenants who file bankruptcy for the legitimate reason of seeking a financial “fresh start” – which is often considered the purpose of the bankruptcy code. <sup>i</sup>As a general rule, a residential landlord is likely to see only Chapter 7 or 13 bankruptcies filed by their tenants. <sup>ii</sup>

### The Automatic Stay

Regardless of whether a tenant files a Chapter 7 or 13 proceeding, the most important concept a landlord (creditor) must grasp once becoming aware of a bankruptcy proceeding is the effect of the automatic stay. <sup>iii</sup> The automatic stay operates to halt all enforcement proceedings against the tenant (debtor) or property of the estate (anything the tenant owned or had some kind of ownership interest in). <sup>iv</sup> For landlords, this will include any act to obtain possession of property of the estate, such as possession of property to which the debtor-tenant has an unexpired lease. <sup>v</sup> The stay as to “property of the tenant” is an additional layer of difficulty for the manufactured housing industry, where possession of the mobilehome space, and title of the mobilehome unit, are frequently distinct inquiries. Generally, both are issues that must be addressed in the bankruptcy proceeding.

The automatic stay is, to be clear, not to be trifled with or ignored. A willful violation of the automatic stay can give rise to liability to any individual injured as a result. <sup>vi</sup> The damages can include actual damages, costs and attorney’s fees, as well as punitive damages in appropriate circumstances. <sup>vii</sup> Similarly, a willful violation does not require “specific intent” <sup>viii</sup> to trigger liability – the landlord need only be aware of the automatic stay (which in most cases is to say that the landlord is aware a bankruptcy petition was filed) and that the landlord performed an intentional act – which act violated the stay. <sup>ix</sup>

The most common violations by a landlord in violation of the automatic stay are (1) demanding payment for past-due rent, (2) serving an eviction notice – especially one that demands payment, and (3) utilizing a security deposit from the tenant to pay down past-due rent. Any one of these actions will place the landlord in violation of the automatic stay. Thus, the first and most pertinent step to take as a landlord once

discovering a tenant has sought bankruptcy protection is to *immediately halt* anything being done “to” the tenant or “towards” the tenancy (or if past that point, towards the mobilehome unit *owned* by the tenant). Best practices call for a landlord to have a system in place once a bankruptcy is filed. Managers, attorneys, and anyone that has potential dealings with the tenant must be notified and instructed to stop pending further instruction.

One final note on the automatic stay – it remains in effect until lifted by a creditor’s motion for relief from the automatic stay, until the case is closed or dismissed, or until the tenant’s discharge is entered. <sup>x</sup>

### The “Next Step” – Ascertained Whether the Tenant Intends to Assume or Reject the Lease

After halting all enforcement actions, a landlord must step back and evaluate the “status” of the tenancy in question. Regardless of the type of bankruptcy filed, the tenant has the option to keep the lease in place (“assuming” the lease), or to abandon the lease and relinquish possession (“rejecting” the lease). In a Chapter 7 proceeding, the trustee (the “neutral” party that assists in the administration of the bankruptcy proceeding) has 60 days to accept or reject a lease. In almost all cases, trustees reject a lease. As a practical matter, a residential lease will be more or less “ignored” by the trustee, and the tenant wishing to remain in possession will continue to pay rent with post-petition income. In a Chapter 13 proceeding the time to assume or reject a lease continues up to and until confirmation of the Chapter 13 Plan. If a tenant rejects a lease but does not vacate, then the landlord will need to seek relief from the automatic stay to proceed to evict. If the tenant assumes the lease, then the tenant needs to cure the defaults and remain current moving forward.

For the manufactured housing industry, the tenant’s election to assume or reject the lease has another component inquiry – what is to become of the manufactured home when the tenant indicates they intend to reject the lease. Due to the reality that states have different laws for what happens in this instance, precisely how to handle this situation can vary dramatically. In the second part to this article, the inquiry will shift to when a landlord needs to seek relief from the automatic stay.

<sup>i</sup> *In re: Tippett*, (9<sup>th</sup> Cir. 2008) 542 F3d 684, 689

<sup>ii</sup> While it is possible that a residential tenant could file a Chapter 11 petition, Chapter 11 petitions are generally reserved for “high net worth” individuals and thus the author has purposefully placed them as beyond the scope of this article.

<sup>iii</sup> With very limited exceptions, all bankruptcy filings will cause the imposition of the automatic stay.

<sup>iv</sup> 11 U.S.C. § 362(a) (1), (2)

<sup>v</sup> 11 U.S.C. § 362(a) (3)

<sup>vi</sup> 11 U.S.C. § 362(k) (1)

<sup>vii</sup> 11 U.S.C. § 362(k) (1)

<sup>viii</sup> Specific intent in this setting is “legalese” for sitting down and thinking “my goal is to violate the automatic stay.”

<sup>ix</sup> *In re: Pace*, (9<sup>th</sup> Cir. 1995) 67 F3d 187, 191

<sup>x</sup> 11 U.S.C. §§ 362(a); (d)

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