

# What Happens to My Lease in Bankruptcy?

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## Suppose you own farmland or retail commercial space and you lease your property.

What happens to your lease if the lessee files bankruptcy? And what must be done if your lessee wants to continue to honor your lease despite the bankruptcy? In In re Collins, The United States Bankruptcy Court for the Eastern District of North Carolina recently stressed that a debtor cannot

informally assume an unexpired lease. The debtor must follow the strict procedures in the Bankruptcy Code or the lease will be automatically rejected.

The Morton Estate leased 222 acres of farmland in Onslow County to David Collins. The lease was year-to-year with the lease term beginning on December 1 of each year. On April 23, 2018, Collins filed bankruptcy under Chapter 11. In Chapter 11, a debtor seeks to reorganize its debts while it continues to operate. Since the lease term ran to November 30, 2018, the lease was an "unexpired lease of nonresidential real property" under the Bankruptcy Code.

Under the Bankruptcy Code, a Chapter 11 debtor can assume or reject an unexpired lease. There are conditions. First, assumption or rejection is subject to court approval. Second, the debtor must decide within 120 days of filing bankruptcy or the date of an order confirming a plan of reorganization - whichever is earlier. The debtor may get a 90-day extension from the court if he can show good cause to do so, but any further extensions are subject to court approval and the lessor's written consent. Third, to assume a lease, the debtor must cure all defaults. So if the lease is three months past due, the lessee must bring it current as a condition of assumption.

Collins, having filed bankruptcy on April 23, 2018, had until August 23, 2018, to assume or reject the lease. He filed a proposed plan of reorganization on August 6, 2018, and on August 14, 2018, asked the court for an extension of time. The Bankruptcy Court granted an extension to November 19, 2018 - roughly 90 extra days. When November 19, 2018, arrived, Collins asked for another extension of time. The Morton Estate objected, stating it had not - and would not - give written consent. Chastened, Collins withdrew his motion. But a month later, with his bankruptcy case still pending, Collins sent the Morton Estate a check for \$21,000, representing the amount owed under the lease for the 2018 crop year.

Could Collins assume the lease by sending the \$21,000 payment? Was the payment an implicit assumption of the lease? Or did Collins' failure to assume or reject the lease before November 19, 2018, deem it rejected?

Collins argued that he assumed the lease because he sent the check to the Morton Estate and because no

party gave a 30-day statutory notice to quit the lease. The Bankruptcy Court held that Section 365 of the Bankruptcy Code provides clearly that the court must approve assumption or rejection of an unexpired lease. That means that Collins had to move to assume the lease, schedule the motion for hearing before the court, and send notice to all the parties who might be affected. Collins did none of these things. 7

The Bankruptcy Court emphasized that lease assumption cannot be implicitly assumed, assumed by conduct, or based on oral assumption. The Bankruptcy Court gave two reasons: First, the Code says so. Second, the Court did not want to be "led into the morass of attempting to judge the meaning and import of the conduct and conversations of the parties." If the debtor does not follow these procedures, the lease is deemed rejected by law. Because the lease was deemed rejected, the Bankruptcy Code required Collins to immediately surrender the property to the Morton Estate, without the need for relief from the automatic stay and eviction proceedings under state law.

Lessors and lessees need to understand that if the lessee files bankruptcy, the clock starts ticking on assumption or rejection of the lease. A decision on the fate of the lease must be made in short order and, if the lease is to be assumed, that can only be accomplished with a hearing before, and approval by, the Bankruptcy Court. At that hearing, other parties can object to assumption if they contend the assumed lease is a bad deal for the debtor or the other creditors. Lessors should contact counsel to provide guidance and strategy.

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