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Expert Analysis

Lease May Be 'Terminated' but 'Unexpired', Circuit Says

BY BRENDAN PIERSON

THE TRUSTEE of a bankrupt business may have to pay administrative rent to its landlord even though the landlord obtained an eviction warrant before the bankruptcy began, the U.S. Court of Appeals for the Second Circuit ruled in vacating decisions by two lower courts.

Judge Guido Calabresi, joined by Judges Reena Raggi and Denny Chin, ruled on Aug. 2 in *Super Nova 330 LLC v. Gazes*, 11-1773-bk, that there were both legal and factual questions about whether the trustee owed the rent and it remanded the case for further proceedings.

The tenant, Association of Graphic Communications Inc., leased a commercial space in a building on Seventh Avenue owned by Super Nova 330 LLC. According to the decision, the tenant stopped paying rent in 2006, and Super Nova obtained a warrant of eviction. However, on Feb. 2, 2007, before Super Nova was able to execute the warrant, the tenant filed for Chapter 7 bankruptcy, triggering an automatic stay.

Attorney Ian Gazes was named Chapter 7 trustee of the estate.

Super Nova successfully moved to lift the stay and executed the eviction warrant in April 2007. Almost two years later, according to the opinion, it moved to recover post-petition rent for the period between the bankruptcy filing and the eviction.

However, both Southern District Bankruptcy Judge Burton Lifland and District Court Judge Robert Sweet ruled that Super Nova could not recover the rent because the lease expired when Super Nova obtained the warrant of eviction, granting summary judgment on the issue to the tenant. Super Nova, on appeal, argued that the lease continued to exist until the warrant was executed.

The two sides also have different factual accounts of what happened in 2006, according to the opinion. Gazes has maintained that, starting in November 2006, the tenant was locked out and the space was effectively turned over to Super Nova.

Super Nova maintains it did not get possession of the space until the warrant was executed, and that the tenant refused to surrender the keys until that time.

Judge Calebresi

Calabresi said in his recent order that both Lifland and Sweet had erred in concluding that the lease expired when the warrant of eviction was obtained.

Calabresi quoted New York Real Property Actions & Proceedings Law, which states: "The issuing of a warrant for the removal of a tenant cancels the agreement under which the person removed held the premises, and annuls the relation of landlord and tenant, but nothing contained herein shall deprive the court of the power to vacate such warrant for good cause shown prior to the execution thereof."

He continued, "Under New York law, therefore, while the issuance of a warrant of eviction cancels any existing lease and seemingly terminates the landlord-tenant relationship, the tenant, in fact, retains a residual interest in the lease until the execution of the warrant. Prior to such execution, the state court may vacate the warrant of eviction for good cause and thereby reinstate the lease."

Calabresi also pointed out that the tenant had acted to preserve its interest in the lease when it filed for bankruptcy, triggering the automatic stay.

"That the warrant itself nominally terminates the lease is irrelevant: the existence of a statutory right to reinstate the lease upon a showing of good cause means that the lease remains 'unexpired,'" the judge said. "And only when the warrant is executed and the tenant's residual right to reinstate the lease is extinguished does the lease cease being 'unexpired.'"

Nonetheless, the judge said, a legal question remained: whether a terminated, yet unexpired, lease should be automatically deemed rejected by a bankruptcy trustee.

A debtor may decide either to assume a lease as part of its estate, in which case it may be sold, or to reject it, in which case it is terminated. Calabresi said there was an argument in favor of deeming a terminated, but unexpired, lease rejected unless a trustee specifically acts to assume it: that in order to assume the lease, the trustee must undertake the "moderately complex" action of seeking to lift the automatic stay and asking a state court to vacate the eviction warrant.

On the other hand, Calabresi said, "to avoid allowing the trustee to 'have it either way' depending on how the value of the lease moves, there may be a good reason to place the burden on the Trustee to disclaim any future interest in the lease and affirmatively to reject it if he intends to surrender the property."

Calabresi said that while the Second Circuit had the legal authority to decide that question, it should be left to the bankruptcy court, with its greater expertise, in the first instance.

He also wrote that the lower courts had been wrong to grant summary judgment because the parties' differing accounts of what happened in 2006 raised a material question of fact.

Jay Itkowitz of Itkowitz & Harwood, who represents Super Nova, said he believed his client would prevail on remand.

"An injustice was effected on the part of the trustee, in my view, to the landlord," Itkowitz said. "The trustee continued to occupy the premises in that the tenant remained in possession."

He added, "If the trustee didn't want the space, he could have surrendered the space at the outset. The landlord lost two or three months' rent for no good reason. We took it up to the Second Circuit because we felt strongly about it."

Gazes could not be reached for comment.

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