

# Be Careful What You Wish For: *Super Nova 330 LLC v. Gazes* and the Termination of Leases by Warrants of Eviction Under New York Law

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The Second Circuit Court of Appeals held, in *Super Nova 330 LLC v. Gazes* (*In re Association of Graphic Communications, Inc.*), 2012 WL 3125241 (2d Cir. Aug. 2, 2012), that a commercial real property lease is “unexpired” for purposes of § 365(d)(3) of the Bankruptcy Code when the tenant under the lease has the power to revive the lease pursuant to applicable state law. More specifically, the Second Circuit found that under New York law a tenant’s interest in a lease is extinguished only by the execution of a warrant of eviction and is not extinguished when the warrant is issued. Accordingly, even when a landlord obtains a warrant of eviction prior to a tenant’s bankruptcy filing, the debtor-tenant retains an interest in the leasehold until the warrant is executed.

On the one hand, this means that a landlord may be entitled to payment of post-petition rent obligations as administrative expenses under § 365(d)(3) of the Bankruptcy Code until a warrant of eviction is executed or the lease is rejected. On the other hand, this decision may result in landlords being stuck in their tenants’ bankruptcy cases even when a landlord has already contractually terminated the lease and obtained a judgment and warrant of eviction.

Somewhat surprisingly, the landlord was the appellant in *Super Nova 330*, arguing that the lease remained unexpired until the warrant of eviction was executed. Although in the short run there may have been a limited economic benefit from this outcome, in the long run the decision serves as a cautionary reminder: Be careful what you wish for. At least in New York, landlords will now be exposed to the delays, the uncertainties, the inability to mitigate and the costs associated with a bankruptcy of its tenant, notwithstanding a yeoman’s efforts pre-petition to regain control of the premises.

This article discusses the Second Circuit’s *Super Nova 330* decision and, along the way, summarizes the key provisions and mechanisms of bankruptcy law and New York property law relevant to the decision.

## Background

Section 365(d)(3) of the United States Bankruptcy Code requires a debtor that is a tenant under an unexpired lease of non-residential real property to timely perform its obligations under the lease until the lease is assumed or rejected in the debtor’s bankruptcy case. Courts hold that a lessor is entitled at least to administrative expense treatment for the amounts required to be paid under § 365(d)(3). The Bankruptcy Code does not define the term “unexpired,” nor is the meaning of the term made clear by the legislative history of the Bankruptcy Code. Rather, bankruptcy courts look to state law to determine whether a non-residential real property lease is “unexpired.”

The facts of *Super Nova 330* are as follows. A tenant under a non-residential lease of real property failed to make certain payments of rent. Its landlord demanded payment and, unsatisfied, began a non-payment proceeding in New York City Civil Court. The tenant did not defend the non-payment proceeding, and the court granted the landlord a default judgment of possession and issued a warrant of eviction. The day after the issuance of the warrant of eviction, and before the warrant was executed, the tenant filed a voluntary Chapter 7 bankruptcy petition.

Section 362 of the Bankruptcy Code provides for an automatic stay, protecting a debtor that files a petition under any chapter of the Bankruptcy Code. The automatic stay generally prohibits the commencement or continuation of litigation, lien enforcement and other actions that attempt to enforce or collect pre-petition claims. Section 362 also stays most actions that would affect or interfere with the property of the debtor or its estate. One notable exception to the automatic stay is the eviction of a debtor under a lease of non-residential real property that had terminated by the expiration of the stated term of the lease.

In *Super Nova 330*, the automatic stay prevented the landlord from executing its warrant of eviction once the tenant had filed for bankruptcy. Given the ultimate holding that the lease remained unexpired, the above-described exception to the stay did not apply. In order to execute the warrant, the landlord filed an unopposed motion before the bankruptcy court to lift the stay. The court granted the motion; the landlord executed the warrant almost three months after the warrant had been issued and the tenant had commenced its bankruptcy proceeding.

The landlord moved for payment of rent, attorney fees and pre-judgment interest pursuant to § 365(d)(3) for the period between the tenant’s bankruptcy petition filing and the eviction date. The trustee for the debtor’s bankruptcy estate opposed the motion. After discovery, the trustee moved for summary judgment, arguing that the lease had been terminated pre-petition when the warrant of eviction was issued and that, accordingly, the lease was not “unexpired” as required for relief under § 365(d)(3).

The bankruptcy court granted summary judgment for the trustee, concluding that the pre-petition issuance of the warrant of eviction terminated the landlord-tenant relationship such that there was no “unexpired” lease and therefore no right to payment under § 365(d)(3). On appeal, the district court agreed that the lease was not unexpired and affirmed the bankruptcy court’s decision. On subsequent appeal, the Second Circuit vacated the lower courts’ decisions.

## Analysis

The Second Circuit began by noting that, because property interests are created and defined by state law, bankruptcy courts should look to state law to determine a debtor's interests in property, including leasehold interests. On the subject of warrants of eviction, § 749(3), New York Real Property Acts Law provides:

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 relationship 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.

Interpreting this provision of New York property law, the Second Circuit found that, while the issuance of a warrant of eviction cancels any existing lease, the tenant retains a residual interest in the lease until execution of the warrant. The residual interest is apparent in the fact that, prior to execution of a warrant of eviction, the state court may vacate the warrant for good cause and thereby reinstate the lease.

The court went on to compare New York law regarding lease terminations with Vermont law, as applied in its prior decisions in *Brattleboro Hous. Auth. v. Stoltz (In re Stoltz)*, 197 F.3d 625 (2d Cir. 1999), and *Canney v. Merchants Bank (In re Canney)*, 284 F.3d 362 (2d Cir. 2002). Under Vermont law, a debtor may redeem and avoid ejection up until the issuance of a writ of possession in an ejection proceeding; but, once issued, the writ extinguishes the debtor's right to redeem. In contrast, New York law provides that a tenant may obtain *vacatur* of a warrant after it is issued and before its execution. The court noted that the automatic stay preserves a tenant's right to pursue its state court statutory remedy in the period between issuance and execution of a warrant of eviction: It effectively prevents a landlord from executing a warrant of eviction without bankruptcy court approval once a tenant files for bankruptcy.

Thus, the Second Circuit followed *Stoltz* and *Canney* in holding that a lease is "unexpired" for purposes of § 365(d)(3) when the tenant has the power to revive the lease under applicable state law. The court continued:

Because in New York it is the execution and not the issuance of the warrant of eviction that extinguishes the tenant's interest in the lease, the lease is "unexpired" as that term is used in § 365(d)(3), until the warrant is executed.

Having found that a lease is unexpired until a warrant of eviction is executed, the court went on to note that it does not necessarily follow that the landlord was entitled to the rental payments and other costs it sought. Section 365(d)(3) states:

The trustee shall timely perform all the obligations of the debtor . . . arising from and after the order for relief under any unexpired lease of non-residential real property, *until such lease is assumed or rejected*. (emphasis added)

Also, § 365(c) states that a lease cannot be assumed or assigned by the trustee if it is terminated under state law.

Accordingly, the Second Circuit raised the question of whether a "terminated" yet "unexpired" lease should be treated as presumptively rejected by the trustee or whether the court should require the trustee to affirmatively reject it in order to avoid liability for rent and other costs.

While noting that this issue was one of law and, therefore, could be decided by the Second Circuit as part of its resolution of the instant appeal, the Second Circuit instead remanded the issue for briefing and argument before the bankruptcy court, deferring to the bankruptcy court's specialized knowledge. Query, though, how a lease could possibly be treated as presumptively rejected and at the same time unexpired, as the Second Circuit held. The Second Circuit also vacated the bankruptcy court's finding that the tenant was not in possession of the space because both sides presented dramatically divergent accounts as to whether the landlord or tenant was in possession of the property in the months leading up to the eviction proceeding and bankruptcy filing. The Second Circuit noted that summary judgment was inappropriate where the two sides' accounts of the material facts were at odds.

## Conclusion

The *Super Nova 330* decision clarifies that, under New York law, a lease is unexpired and a tenant retains a residual interest in the lease up until a warrant of eviction is executed. This holding provides protection for tenants, who may file bankruptcy at any point prior to the execution of a warrant of eviction and be assured both that the automatic stay will prevent the landlord from taking further action to execute the warrant without court approval and that its leasehold may remain subject to assumption and assignment. Landlords, such as the landlord who won the appeal in the *Super Nova 330* decision, may also benefit, in that they can argue that they are entitled to administrative rent up until a warrant of eviction is actually executed or the lease is rejected. The better result for landlords, however, may have been a finding that the tenant's interest in the lease terminated upon issuance of the warrant of eviction. That outcome could be more beneficial going forward because it would give landlords control of their premises and the ability to re-let and mitigate damages. For many landlords, control of the premises is more beneficial than the ability to preserve a claim for post-bankruptcy rent. Under the *Super Nova 330* decision, however, landlords must now wait until execution of a warrant of eviction or rejection of a lease in bankruptcy before knowing they are free of a delinquent tenant.

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