

No. 18-1099

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UNITED STATES COURT OF APPEALS  
FOR THE FOURTH CIRCUIT

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In re: EDWARD RICHARDSON,  
*Debtor.*

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EDWARD RICHARDSON,  
*Appellant,*  
– v. –  
PRIDEROCK CAPITAL PARTNERS, LLC,  
*Appellee.*

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On Appeal from the United States District Court  
For the Eastern District of Virginia

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**BRIEF OF AMICI CURIAE NATIONAL CONSUMER BANKRUPTCY RIGHTS  
CENTER AND NATIONAL ASSOCIATION OF CONSUMER BANKRUPTCY  
ATTORNEYS IN SUPPORT OF NEITHER PARTY**

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March 26, 2018

**RULE 26.1 CORPORATE DISCLOSURE STATEMENT**

*Richardson v. Priderock Capital Partners, LLC*, No. 18-1099

Pursuant to FRAP 26.1 and Fourth Circuit Local Rule 26.1(b), Amicus Curiae, the National Consumer Bankruptcy Rights Center, makes the following disclosure:

- 1) Is party/amicus a publicly held corporation or other publicly held entity? **NO**
- 2) Does party/amicus have any parent corporations? **NO**
- 3) Is 10% or more of the stock of party/amicus owned by a publicly held corporation or other publicly held entity? **NO**
- 4) Is there any other publicly held corporation or other publicly held entity that has a direct financial interest in the outcome of the litigation? **NO**
- 5) Does this case arise out of a bankruptcy proceeding? **YES**. If yes, identify any trustee and the members of any creditors' committee. **Thomas P. Gorman, Chapter 13 Trustee**

This day of March 26, 2018.

*/s/ Tara Twomey*

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Tara Twomey, Esq.

Attorney for Amicus Curiae

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Pursuant to FRAP 26.1 and Fourth Circuit Local Rule 26.1(b), Amicus Curiae, the National Association of Consumer Bankruptcy Attorneys, makes the following disclosure:

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- 2) Does party/amicus have any parent corporations? **NO**
- 3) Is 10% or more of the stock of party/amicus owned by a publicly held corporation or other publicly held entity? **NO**
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This day of March 26, 2018.

*/s/ Tara Twomey*

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Tara Twomey, Esq.  
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### TABLE OF CONTENTS

CORPORATE DISCLOSURE STATEMENT ..... i

TABLE OF AUTHORITIES ..... iv

STATEMENT OF INTEREST OF *AMICI CURIAE* ..... 1

CERTIFICATION OF AUTHORSHIP ..... 2

CONSENT ..... 2

SUMMARY OF ARGUMENT ..... 3

STATUTORY FRAMEWORK..... 3

ARGUMENT..... 6

    I.    Rejection of a Residential Lease Constitutes a Breach, Not A  
    Termination of the Lease Agreement ..... 6

    II.   The Landlord Was Entitled to A General Unsecured Claim Against  
    the Estate and Had the Right to Evict the Debtor Based on  
    Nonpayment..... 8

    III.  Any Rent Obligations Under the Contract Including the Payment  
    of Post-Petition Rent Are Discharged..... 10

CONCLUSION..... 13

**TABLE OF AUTHORITIES****Cases**

<i>Alvarez v. HSBC Bank USA</i> , 733 F.3d 136 (4th Cir. 2013).....	11
<i>In re Arizona Appetito’s Stores, Inc.</i> , 893 F.2d 216 (9th Cir. 1990).....	4
<i>In re Bacon</i> , 212 B.R. 66 (Bankr. E.D. Pa. 1997).....	7
<i>Burlingham v. Crouse</i> , 228 U.S. 459 (1913).....	4
<i>In re Dabrowski</i> , 257 B.R. 394 (Bankr. S.D. N.Y. 2001).....	8
<i>In re Dornier Aviation (North America), Inc.</i> , 2002 WL 31999222 (Bankr. E.D. Va. 2002).....	7
<i>In re 48th Street Steakhouse, Inc.</i> , 835 F.2d 427 (2d Cir. 1987).....	4
<i>In re Hepburn</i> , 27 B.R. 135 (Bankr. E.D. N.Y. 1983).....	8
<i>Johnson v. Home State Bank</i> , 501 U.S. 78 (1991).....	11
<i>Local Loan Co. v. Hunt</i> , 292 U.S. 234 (1934).....	5
<i>In re Meadows</i> , 428 B.R. 894 (N.D. Ga. 2010).....	6
<i>In re Miller</i> , 282 F.3d 874 (6th Cir. 2002).....	10

*In re Rogers*,  
 494 B.R. 664 (Bankr. E.D. N.C. 2013)..... 10, 12

*In re Stewart Foods, Inc.*,  
 64 F.3d 141 (4th Cir. 1995)..... 6, 7, 10

**Statutes**

11 U.S.C. § 365..... 3, 5

11 U.S.C. § 365(a) ..... 5

11 U.S.C. § 365(d)(1) ..... 5, 6

11 U.S.C. § 365(d)(3) ..... 6

11 U.S.C. § 365(d)(4)(A)..... 6

11 U.S.C. § 365(g)..... 5, 6

11 U.S.C. § 502(b)(6) ..... 5, 8

11 U.S.C. § 502(g)..... 5, 7, 10

11 U.S.C. § 503..... 7

11 U.S.C. § 507(a) ..... 7

11 U.S.C. § 523..... 5

11 U.S.C. § 524(a) ..... 5

11 U.S.C. § 541(a) ..... 4

11 U.S.C. § 727..... 3, 6, 10

11 U.S.C. § 727(b)..... 5, 6, 10

**Other Authorities**

Michael T. Andrew, Executory Contract Revisited: A Reply to Professor  
Westbrook, 62 U. Colo. L. Rev. 1, 15 (1991) ..... 7

## STATEMENT OF INTEREST OF AMICI CURIAE

NCBRC is a nonprofit organization dedicated to preserving the bankruptcy rights of consumer debtors and protecting the bankruptcy system's integrity. The Bankruptcy Code grants financially distressed debtors rights that are critical to the bankruptcy system's operation. Yet consumer debtors with limited financial resources and minimal exposure to that system often are ill-equipped to protect their rights in the appellate process. NCBRC files *amicus curiae* briefs in systemically-important cases to ensure that courts have a full understanding of the applicable bankruptcy law, the case, and its implications for consumer debtors.

NACBA is also a nonprofit organization of approximately 3,000 consumer bankruptcy attorneys nationwide. NACBA advocates nationally on issues that cannot adequately be addressed by individual member attorneys. It is the only national association of attorneys organized for the specific purpose of protecting the rights of consumer bankruptcy debtors.

NCBRC, NACBA and its membership have a vital interest in the outcome of this case. It is not unusual for debtors to enter bankruptcy while subject to an ongoing residential lease obligation. The Bankruptcy Code provides for discharge of the debtor's *in personam* liability for pre- and post-petition rents without regard to whether the debtor remains on the property, but leaves intact the lessor's entitlement to assert its *in rem* right to institute eviction proceedings. Any post-discharge action

on the part of the lessor to collect past rents from the debtor personally deprives the debtor of the fresh start promised by the bankruptcy process and constitutes a violation of the discharge injunction. However, proceedings to obtain possession of the property (such as an eviction action) do not violate the injunction absent a demand for a monetary judgment against the debtor.

#### **AUTHORSHIP AND FUNDING OF AMICUS BRIEF**

Pursuant to Fed. R. App. P. 29(c)(5), no counsel for a party authored this brief in whole or in part, and no person or entity other than NACBA, its members, and its counsel made any monetary contribution toward the preparation or submission of this brief.

## SUMMARY OF ARGUMENT

The Bankruptcy Code, through the interaction of several sections, provides for situations in which a debtor enters bankruptcy while subject to a residential lease. Specifically, under section 365 of the Bankruptcy Code, the bankruptcy trustee has the option of either assuming the lease or rejecting it. Failure to take any action is deemed to be a rejection of the lease. Once rejected, the debtor is considered to have breached the lease agreement and the lessor may assert a claim against the bankruptcy estate for damages resulting from the breach. Upon conclusion of the case, the rent due on the pre-petition lease (whether those rents arise before or after the petition) are discharged under section 727. Any attempt by the creditor to collect those rents personally from the debtor is a violation of the discharge injunction. However, the lessor retains its *in rem* right to undertake eviction proceedings.

In this case, both courts correctly concluded that the eviction proceeding, to the extent it did not seek a monetary judgment against the debtor, did not violate the discharge injunction. However, both courts suggested that only the pre-petition rents were discharged in Mr. Richardson's chapter 7 bankruptcy. That determination is incorrect as a matter of law, but it is unclear whether the error affected the ultimate outcome of the case. The bankruptcy court did not appear to make any findings as to whether the lessor in this case sought to collect discharged rent personally from the debtor.

## STATUTORY FRAMEWORK

This case involves the interaction between the discharge injunction and the treatment of leases under the Bankruptcy Code. So that the Court may better understand this interaction, a brief overview of the relevant statutory framework is provided below.

**Bankruptcy:** Bankruptcy law reflects a balancing act in which Congress has established the rules for adjusting debtor-creditor relationships. The two main purposes of bankruptcy are to provide a fresh start to the debtor and to facilitate the fair and orderly repayment of creditors to the extent possible. *See Burlingham v. Crouse*, 228 U.S. 459, 473 (1913). Individuals seeking bankruptcy relief generally seek liquidation under chapter 7 of the Bankruptcy Code or propose a plan for repayment of a portion of their debt under chapter 13.

**Property of the Estate:** Critical to effectuating the dual goals of the Bankruptcy Code is the concept of the bankruptcy estate. The bankruptcy estate consists of “all legal or equitable interests of the debtor in property as of the commencement of the case”—that is, debtor’s pre-petition assets. 11 U.S.C. § 541(a). It is well settled that a debtor’s interest as a lessee in an unexpired lease (i.e., a leasehold interest) is property of the estate. *See In re Arizona Appetito’s Stores, Inc.*, 893 F.2d 216 (9th Cir. 1990); *In re 48th Street Steakhouse, Inc.*, 835 F.2d 427 (2d Cir. 1987) (citing cases). In a chapter 7 case, such as this one, assets of the estate are

liquidated by the chapter 7 trustee and proceeds are distributed to creditors with claims against the estate. 11 U.S.C. § 704. In a typical consumer chapter 7 case, the estate has no assets to be liquidated and therefore no funds to be distributed to creditors with claims. *See* Lois Lupica, *The Consumer Bankruptcy Fee Study: Final Report*, 20 *Am. Bankr. Inst. L. Rev.* 17, table 10 (2012) (approximately 90% of chapter 7 consumer cases are “no-asset” cases).

**Discharge:** The principal goal of most consumer bankruptcy cases is the discharge. The discharge, among other things, operates as an injunction against creditor’s efforts to collect debt as a personal liability of the debtor. 11 U.S.C. § 524(a). It is this clean slate that normally gives debtors the fresh start that bankruptcy is meant to provide. *See Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934). The discharge applies to almost all debts that arose before the petition date and any liability on a claim deemed to have arisen before the commencement of the case—such as claims resulting from rejected leases. *See* 11 U.S.C. § 365(g), 502(g), 727(b). There are exceptions to the discharge, none of which are applicable in this case. 11 U.S.C. § 523.

**Treatment of Leases:** The Bankruptcy Code has a number of provisions designed to balance the interest of debtors, as lessees, and creditor-lessors. As applicable in this case, section 365 provides that in a chapter 7 case the trustee may

assume or reject any unexpired lease of the debtor. 11 U.S.C § 365(a). If the trustee does not assume or reject an unexpired residential real property lease within 60 days of the filing of the petition, the lease is deemed rejected. 11 U.S.C § 365(d)(1). The rejection of the lease is treated as a breach of the agreement immediately before the filing of the case. 11 U.S.C. § 365(g). The lessor gets a claim against the estate for damages resulting from the breach. 11 U.S.C. § 502(g). The claim can include both pre-petition and post-petition rent amounts, but it is capped based in part on the remaining term of the lease. 11 U.S.C. § 502(b)(6).<sup>1</sup> Because rejection of the lease is treated as if it occurred immediately pre-petition and the lessor is given a claim for damages resulting from breach of the lease, post-petition rents are discharged under section 727(b). 11 U.S.C. § 727 (discharge applies to claims deemed to have arisen prior to the commencement of the case).

## ARGUMENT

### **I. Rejection of a Residential Lease Constitutes a Breach, Not A Termination of the Lease Agreement.**

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<sup>1</sup> For *non-residential leases*, the Bankruptcy Code requires the trustee to “timely perform” all post-petition, pre-rejection obligations including the payment of rent. 11 U.S.C. § 365(d)(3). Further, for *non-residential leases* that are rejected the Code instructs the trustee to immediately surrender the property to the lessor. 11 U.S.C. § 365(d)(4)(A). These provisions do not apply to residential leases.

In virtually every consumer chapter 7 case filed by a tenant, the residential lease provides no benefit to the estate. As a result, in almost all chapter 7 cases, the chapter 7 trustee does nothing with respect to the lease, and it is deemed rejected sixty days after the petition date. 11 U.S.C. § 365(d)(1). In turn, the rejection of the lease is considered a breach of tenant's lease obligation, but it does not terminate the lease. 11 U.S.C. § 365(g); see *In re Stewart Foods, Inc.*, 64 F.3d 141, 144-145 (4th Cir. 1995) (rejection of executory contract constitutes breach of the contract); *In re Meadows*, 428 B.R. 894, 902 (N.D. Ga. 2010) (rejection of residential lease constitutes breach, not termination of lease).

Rejection's effect is to give rise to a remedy in the non-debtor party for breach of the rejected contract, typically a right to money damages assertable as a general unsecured claim in the bankruptcy case. Rejection has absolutely no effect upon the contract's existence; the contract is not cancelled, repudiated, rescinded, or in any fashion terminated.

*In re Bacon*, 212 B.R. 66 (Bankr. E.D. Pa. 1997), citing Michael T. Andrew, Executory Contract Revisited: A Reply to Professor Westbrook, 62 U. Colo. L. Rev. 1, 15 (1991).

Here, in this case, the chapter 7 trustee took no action to assume the debtor's residential lease within the prescribed time period, and consequently the lease was considered breached, but not terminated. The question is then what remedies are provided to the landlord for the breach resulting from rejection of the lease.

## **II. The Landlord Was Entitled to A General Unsecured Claim Against the Estate and Had the Right to Evict the Debtor Based on Nonpayment.**

The Bankruptcy Code provides that upon rejection of the lease, the landlord is entitled to a general unsecured claim against the estate for damages resulting from the breach.<sup>2</sup> 11 U.S.C. § 502(g); *In re Stewart Foods, Inc.*, 64 F.3d at 144 (“a party’s damages resulting from that rejection are treated as a pre-petition claim and receive the priority provided to general unsecured creditors); *In re Dornier Aviation (North America), Inc.*, 2002 WL 31999222, at \*2 (Bankr. E.D. Va. 2002) (“The claim of the creditor arising under a prepetition contract is simply a general unsecured claim in a bankruptcy case even if the time for performance—and hence, the breach—occurs post-petition”). This claim includes both pre-petition and post-petition rents up to certain limits. 11 U.S.C. § 502(b)(6).

In addition to its damages claim against the estate, the Landlord may terminate the lease and seek possession of the property based on the rejection and breach of the contract. That is, the landlord may seek to enforce its *in rem* rights to possession of the property. *See In re Hepburn*, 27 B.R. 135, 136 (Bankr. E.D. N.Y. 1983) (landlord may avail itself of its statutory remedy to recover possession of

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<sup>2</sup> Under certain circumstances, not applicable in this case, the lessor may be entitled to an administrative claim against the estate in the bankruptcy. *See* 11 U.S.C. § 503. Administrative claims have a higher priority and are paid before general unsecured claims. *See* 11 U.S.C. § 507(a).

premises for non-payment of rent.); *see also In re Dabrowski*, 257 B.R. 394, 411 (Bankr. S.D. N.Y 2001), and cases cited.

Here, the District Court correctly ruled that the post-petition, post-discharge unlawful detainer action did not violate the discharge injunction assuming that Mr. Richardson continued to occupy the residential premises without paying rent. D.C. Op. at 4, *citing In re Dabrowski*, 257 B.R. at 413-15. However, the District Court's reasoning is flawed. The District Court adopted the lessor's position that post-petition rents are not dischargeable, and therefore the eviction action did not violate the discharge injunction. Specifically, the District Court stated that "[a]s a matter of law, Appellant's post-petition rent obligations incurred in connection with a pre-petition residential lease were not dischargeable (a) where the Appellant continued to occupy the lease premises post-petition..." D.C. Op. at 3. This is an incorrect statement of the law; all rent due under a pre-petition lease is discharged.

Similarly, the Bankruptcy Court correctly stated that "the landlord can't sue for an in personam judgment, in other words a judgment against you for money on the pre-petition debt, but if you're in default on your pre-petition rent, the landlord can sue for possession of the property because you continue to be in breach of the lease on a post-petition basis." Transcript at p.67. However, the Bankruptcy Court confusingly goes on to distinguish pre-petition rents from post-petition rent under the lease suggesting at times that the post-petition rent was not discharged.

See Transcript at p.69 (“the five-day notice and unlawful detainer did not violate the discharge injunction because both of them involved post-petition rent and other charges...[it] didn’t sue him for any pre-petition amounts.) The Bankruptcy Court’s findings do not clearly indicate whether Priderock’s eviction suit sought a personal judgment against the debtor for post-petition rent.

Pre-petition and post-petition rent due under the lease, which existed at the time the bankruptcy petition was filed, are discharged. But, the landlord does retain its *in rem* rights to possession of the property in the event of non-payment of rent.

### **III. Any Rent Obligations Under the Contract Including the Payment of Post-Petition Rent Are Discharged.**

In the typical case involving rejection of a residential lease, such as this case, there is no distinction between the dischargeability of pre-petition and post-petition rent. Both are discharged. 11 U.S.C §§ 502(g), 727(b).

This Court has already acknowledged that if the debtor has an obligation under the contract to pay money to a non-debtor party, and the contract is rejected, then that obligation is handled as a prepetition claim in bankruptcy. *See In re Stewart Foods, Inc.*, 64 F.3d at 145. The claim, which includes prepetition and postpetition damages up to certain limits, is deemed to have arisen prior to the filing of the debtor’s bankruptcy petition and is therefore discharged. 11 U.S.C. §

727; see *In re Miller*, 282 F.3d 874 (6th Cir. 2002) (the language of the Bankruptcy Code “plainly provides for the discharge of [lessor’s] claim, both pre-petition and post-petition.”). The discharge injunction prevents creditors from collecting discharged debts personally from debtors. *In re Rogers*, 494 B.R. 664, 669 (Bankr. E.D. N.C. 2013) (discharge extinguished personal liability with respect to any past, present, or future judgment arising from creditor’s claim).

In this case, the lessor, Priderock Capital, may not seek to collect prepetition or postpetition rent personally from Mr. Richardson. In essence, Mr. Richardson’s *in personam* liability for rent due under the contract has been eliminated.

However, the discharge does not extinguish the debt, and therefore landlords, such as Priderock, are permitted to exercise their *in rem* rights in order to obtain possession of the property. The difference between pursuing the debtor personally and seeking to reacquire the property is the critical distinction in determining whether a violation of the discharge injunction has occurred.

A helpful analogy exists in the context of post-petition mortgage debt. When homeowners file a Chapter 7 bankruptcy, their personal liability for the mortgage debt is eliminated or discharged. See *Johnson v. Home State Bank*, 501 U.S. 78, 80 (1991) (debtor’s personal liability to bank on mortgage was discharged in chapter 7). This applies equally to payments that came due *before* the filing of the petition, and any payments that came due *after* the filing of the petition. The key is that the

debtor is no longer personally responsible for payments under the contract. However, if the homeowner wants to keep their home, then they must keep making mortgage payments. If the payments are not kept current then the lender can foreclose. *See Alvarez v. HSBC Bank USA*, 733 F.3d 136, 137 (4th Cir. 2013) (“while a discharge in bankruptcy eliminates a lienholder’s *in personam* rights against the debtor, the lienholder’s *in rem* rights in the collateral property ordinarily remain intact despite the discharge.”). In the event of foreclosure, however, the lender cannot seek a deficiency judgment or otherwise seek to collect personally from the debtor. *See In re Rogers*, 494 B.R. at 669 (unsecured deficiency discharged).

The liability of tenants on pre-petition leases is similar to the liability of a mortgagor on a mortgage. Thus, to the extent that Priderock sought to collect pre-petition or post-petition amounts due under the lease personally from Mr. Richardson, such action would violate the discharge injunction.

## CONCLUSION

The Bankruptcy Court's findings of fact do not state whether the Priderock sought an *in personam* judgment against the debtor for post-petition rents during its eviction action. It is not clear that this Court has to reach the issue of whether the post-petition rent on the pre-petition lease was discharged, but if it does, it should hold that there is no *in personam* liability for that rent.

*/s/ Tara Twomey*

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**CERTIFICATE OF COMPLIANCE**

1. This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because this brief contains 2,620 words, excluding parts exempted by Fed. R. App. P. 32(a)(7)(B)(iii).
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3. This brief has been scanned for viruses pursuant to Rule 27(h)(2).

*/s/ Tara Twomey*

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**CERTIFICATE OF SERVICE**

I hereby certify that I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Fourth Circuit by using the appellate CM/ECF system on March 26, 2018 and that a true copy of same was also served by first class mail, postage prepaid, to:

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