In the United States Bankruptcy Court

for the Northern District of Iowa

Western Division

NICHOLAS G. COREY and
CAROL J. COREY
Debtor(s).

Bankruptcy No. X88-01902S

Chapter 11

MEMORANDUM OF DECISION AND ORDER RE: OBJECTION OF CLAIMS REPORT BY EQUITABLE LIFE ASSURANCE SOCIETY OF THE UNITED STATES

The matter before the court is the objection filed by Equitable Life Assurance Society of the United States (EQUITABLE) to the claims report filed by the debtors-in-possession. Trial was held on September 6, 1989 in Sioux City, Iowa. The court now issues this memorandum of decision which includes findings of fact and conclusions of law required by Bankr. R. 7052.

FINDINGS OF FACT

Debtors Nicholas G. and Carol J. Corey, husband and wife, filed their joint petition under chapter 11 of the Bankruptcy Code on December 12, 1988. An order was entered setting April 26, 1989 as the bar date for filing proofs of claim. A proof of claim was timely filed by Equitable in the amount of $19,647.26. Attached to the proof of claim was a copy of a shopping center lease for commercial space at Southern Hills Mall in Sioux City (MALL). Equitable owns the mall. General Growth Management Corporation (GENERAL GROWTH), Equitable's agent, manages it.

The lease in question was entered into by Nicholas G. Corey (COREY) and Equitable in 1985. It provided for the lease of approximately 745 square feet of mall space. The premises contain seventeen feet of frontage on a public interior hallway. A four screen theatre is located across the hallway. The subject space is also located close to a mall entrance.

The fixed minimum rent for the location was $15,648.00 per annum payable at the rate of $1,304.00 per month. The lease provided also for additional charges. These included among others a monthly sprinkler charge, a monthly water charge, and a monthly promotional charge. Including the additional charges and during the period in question in this contested matter proceeding, lease payments from tenant to landlord were to be $1,892.00 per month. The lease term began in 1985 and was to terminate January 31, 1989.

Paragraph 27 of the written lease governed assignment and subletting of the leased premises. Under its terms, the tenant could sublet the premises or assign the lease only with the prior written permission and consent of the landlord. Presuming such consent was given, the tenant and the

assignee or sublessee were to provide the landlord with a fully executed copy of the assignment or sublease.

Paragraph 43 of the lease governs default. Subsection (b) states that

> "[i]f by reason of the occurrence of any such Event of Default, Landlord at any time thereafter may relet the Demised Premises, or any part or parts thereof, either in the name of the Landlord or as agent for Tenant, for a term or terms which may, at Landlord's option, be less than or exceed the period of the remainder of the Lease Term hereof or which otherwise would have constituted the balance of the Lease Term. Landlord shall receive the rents from such reletting and shall apply the same first, to the payment of any indebtedness other than rent due hereunder from Tenant to Landlord; second, to the payment of such expenses as Landlord may have incurred in connection with reentering, ejecting, removing, dispossessing, reletting, altering, repairing, redecorating, subdividing, or otherwise preparing the Premises for reletting, including brokerage and reasonable attorneys' fees; and the balance, if any, Landlord shall apply to the fulfillment of the terms, covenants and conditions of Tenant hereunder and Tenant hereby waives all claims to the surplus, if any. Tenant shall be and hereby agrees to be liable for and to pay Landlord at Landlord's election any deficiency between the rent, additional rents and other charges reserved herein and the net rentals, as aforesaid, of reletting, if any, for each month of the period which otherwise would have constituted the balance of the Lease Term. Tenant hereby agrees to pay such deficiency in monthly installments on the rent day specified in this Lease, and any suit or proceeding brought to collect the deficiency for any month, either during the Lease Term or after any termination thereof, shall not prejudice or preclude in any way the rights of Landlord to collect the deficiency for any subsequent month by a similar suit or proceeding. Landlord shall in no event be liable in any way whatsoever for the failure to relet the Premises or in the event of such reletting, for failure to collect the rents reserved thereunder. Landlord is hereby authorized and empowered to make such repairs, alterations, decorations, subdivisions or other preparations for the reletting of the Premises as Landlord shall deem fit, advisable and necessary, without in any way releasing Tenant from any liability under this Lease.

Corey operated a video cassette rental business at the leased premises. He operated the business as a sole proprietorship until August, 1986 when he formed Allied Limited Partnership. The general partner of Allied was ABC Associates, a corporation owned wholly by Corey. Allied took over the operation of the video rental store, occupying the premises until September, 1987. At that time, Allied filed a chapter 11 bankruptcy case in this court. When Allied Limited Partnership began operating the video rental business, Corey entered into a buy/sell agreement with regard to his assets. As part of the agreement, Allied agreed to assume the obligations under the lease. However, there was no assignment of the lease nor was there a subletting.

As part of the bankruptcy proceedings, Allied sold its assets to an unrelated company named Video Ventures (VIDEO). Video took possession of the premises in January, 1988 and began operating a video rental store. After Videos purchase of Allied's assets, it attempted to negotiate a new lease with General Growth. These negotiations were conducted between a Mr. Ealy (phonetic) for Video and William Haase, General Growth's local representative. During these negotiations, it was agreed that Video would continue to lease the premises on a month-to-month basis. During the period it occupied the premises, Video paid Equitable $4,245.00. This approximated the general rent which had previously been paid monthly by Allied/Corey.

Video offered to lease the premises for $1,000.00 per month but there is a lack of evidence as to any concrete discussions as to the term of the offer. The offer was rejected by Haase after consultation with the General Growth's home office.

Unable to negotiate a reduced payment lease, Video vacated the premises on approximately March 11, 1988. Haase was aware of the removal of Video from the premises. The premises remained vacant from March 11, 1988 to the expiration of Corey's lease term on January 31, 1989. In August, **1988,** General Growth served a notice on Corey in order to retake the premises.

The responsibility for re-leasing the premises after the removal of Video fell to Haase as mall manager. Haase wanted to find a tenant for a lease period longer than the remaining term of the Corey lease (January 31, 1989). His efforts to re-lease the premises included his normal efforts to lease any empty space located at the mall. Generally the lease period sought is one to three years, although General Growth on behalf of Equitable considers lease terms in excess of three years.

Haase testified that the area in question was small and was not the most desirable space for retail selling establishments such as clothing stores. He testified he believed that the location was a good one for video rental because of its proximity to a theatre, a business which would attract the same type of customers, and because of its proximity to an outside entrance to the mall.

In leasing space at the mall, General Growth relies more on direct contact with potential lessees than it does on advertising in local periodicals or shopping circulars. The majority of tenants for the mall have come from outside the general area and are national or regional business tenants. Often, tenants are located by General Growth's contacting tenants at other mall locations.

It was Haasels responsibility as property manager for the mall to maintain the occupancy for the approximately 135 shops located there. He has been able to maintain an occupancy rate of 96 to 99%. In searching out potential tenants at other mall locations, Haase maintains contacts with malls at Sioux Falls, Omaha, Des Moines and, to some extent, Denver, Kansas City and Minneapolis. Quarterly mailings were sent to prospective tenants including the advertisement of this space. Efforts were made to rent this location for use for food sales, shoe repair, H & R Block, gift stores and other specialty establishments. An availability sign was displayed at the premises. Haase testified that although he had made his best effort to relet the space, he was not successful. He described his efforts as reasonable.

It is undisputed that at the time the premises were vacated by Video there was a balance due of $3,943.63 on the lease obligation. Equitable seeks allowance of its claim in this amount plus monthly charges from February 1, 1988 through January 11, 1989. Its claim for this latter period is $19,613.77. Equitable claims, therefore, that the gross amount owed is $23,557.40 less the $4,245.00 received from Video Ventures for a net claim of $19,312.40.[(1)]

The period December 11, 1988 was used by Equitable as the end date for the lease payments claim as opposed to the January 31, 1989 termination date of the lease because the former was the day immediately preceding the bankruptcy filing.

Corey filed a claims report on July 5, 1989 and recommended disallowance of the Equitable claim on the ground that there had been "no showing of mitigation[,] claim unliquidated." Notice of the treatment of the claim was given to Equitable and Equitable thereafter timely filed an objection to the claims report.

DISCUSSION

Corey believes that the limit of Equitable's allowed unsecured claim should be $3,943.63, the amount of unpaid rent due and unpaid at the time Video Ventures vacated the premises. Corey argues that Equitable had an obligation to mitigate damages under state law and its failure to mitigate should bar it from any larger claim. As his strongest evidence supporting disallowance of any claim in excess of $3,943.63, Corey points to the failure of Equitable to accept Videos $1,000.00 per month lease offer.

Equitable contends that sufficient efforts were made to mitigate damages and it is entitled to allowance of the entire amount of its claim. Equitable further argues that even if the court were to find a failure to mitigate because of its rejection of the Video Ventures' offer, the court's disallowance of the claim should result in the disallowance of $1,000.00 per month for the balance of the term and not a disallowance of the entire rental amount due.

Under Iowa law, "when a tenant wrongfully abandons leased premises, the landlord is under a duty to show reasonable diligence has been used to relet the property at the best obtainable rent and thereby obviate or reduce the resulting damage." Harmsen v. Dr. MacDonald's, Inc., 403 N.W.2d 48, 51 (Iowa App. 1987) quoting Vawter v. McKissick, 159 N.W.2d 538, 541 (Iowa 1968). However, paragraph 43 of the lease between Corey and Equitable waives this duty to mitigate:

> Landlord shall in no event be liable in any way whatsoever for the failure to relet the Premises or in the event of such reletting, for failure to collect the rents reserved thereunder.

Unfortunately, Corey does not address the effect, if any, that this clause had on Equitable's duty to mitigate.

It has long been recognized in Iowa that parties to a lease may agree that one of them is relieved from liability for its own negligence. See Sears, Roebuck & Co. v. Poling, 248 Iowa 582, 81 N.W.2d 462, 465 (Iowa 1957). Although Iowa courts do not enforce contracts which contravene public policy, "[w] henever a court considers invalidating a contract on public policy grounds, it must also weigh in the balance the parties' freedom to contract." Walker v. American Family Mut. Ins. Co., 340 N.W.2d 599, 601 (Iowa 1983). Invalidation of a contract on public policy grounds must be cautiously applied and exercised only in cases free from doubt. Id.

> It is not the court's function to curtail the liberty to contract by enabling parties to escape their valid contractual obligation on the grounds of public policy unless the preservation of the general public welfare imperatively so demands.

Walker v. American Family Mut. Ins. Co., 340 N.W.2d at 601, quoting Twin City Pipeline Co. v. Harding Glass Co., 283 U.S. 353, 51 S.Ct. 476, 75 L.Ed. 1112 (1931).

If the landlord may waive its own liability for future negligence without violating public policy, there is no reason to believe a commercial landlord cannot obtain a waiver of its duty to mitigate. Indeed, although the Iowa legislature has passed legislation requiring residential landlords to make reasonable efforts to relet abandoned property at a fair rental rate, Iowa Code § 562A.29(3), commercial landlords in Iowa have no statutory duty to mitigate. There is no indication that this lease was not an arm's length transaction. There are no allegations of fraud or duress with regards to the signing of the lease. In fact, Corey has made no argument whatsoever as to any public policy which might be

violated by this waiver. Therefore, this court finds that under the terms of the lease, Equitable was under no duty to mitigate damages by attempting to relet the property abandoned by Corey.

Even if this waiver were found to be ineffective or contrary to public policy, this court finds that Equitable has nonetheless acted diligently in its attempt to mitigate damages.

The debtors' claims report constituted an objection to Equitable's written proof of claim. The debtors must therefore produce evidence which tends to defeat the claim which is of equal force of the creditor's claim. In re Simmons, 765 F.2d 547, 552 (5th Cir. 1985).

If the objector is able to overcome the prima facie effect of the proof of claim, the ultimate burden of persuasion is on the claimant. In re Wells, 51 B.R. 563, 566-567 (D. Colo. 1985).

Debtors' evidence was sufficient to overcome the initial presumption. The question before the court is the enforceability of Equitable's claim under state law. 11 U.S.C. § 502(b)(1). Under state law, the burden of pleading and proving reasonable diligence in reletting the premises is on the landlord. Vawter v. McKissick, 159 N.W.2d 538, 542 (Iowa 1968).

A lessor is not required to adopt any specific method in endeavoring to relet the property. Harmsen v. Dr. MacDonald's, Inc., 403 N.W.2d at 51; Friedman v. colonial Oil Co., 236 Iowa 140, 18 N.W.2d 196, 198 (1945). In Friedman v. Colonial Oil Co., the Iowa Supreme Court rejected a lessee's argument that the exercise of reasonable diligence required the lessor to advertise the vacant premises in a newspaper or list the property for rent with a realtor. The court determined that evidence showing that the lessor contacted and corresponded with various parties in an unsuccessful attempt to relet the property was sufficient to create a fact question. Friedman v. colonial Oil Co., 18 N.W.2d at 198.

The lessor appears to have acted with reasonable diligence in the case sub judice. Mall manager Haase made a number of efforts to relet the vacated premises. He showed prospects the location and quarterly mailings were sent to prospective tenants throughout the region informing them of this and other vacancies. Haase explained that advertising in local newspapers and periodicals was usually unsuccessful, adding that the number of people likely to see the "for sale" signs on the premises exceeded the number of people likely to notice an ad in the newspaper. The sum of his testimony indicates that the plaintiff acted in a reasonably diligent manner in attempting to relet the vacated premises.

However, the question remains as to whether lessor's diligence is negated by the fact that Video was willing to rent the location at a lower rate. Iowa requires a landlord to show reasonable diligence has been used to relet the property at the best obtainable rent. Harmson v. Dr. MacDonald's. Inc., 403 N.W.2d at 51.

The duty to relet vacated property at the best obtainable rent is not a duty to relet the property at any rate obtainable in order to minimize the damages. In Vawter v. McKissick, the landlord was questioned by a prospect as to the possibility of renting property vacated by the defendant. When informed of the rate, which was the same rate the defendant had been paying, the prospect replied that "that is a little too much for us to pay." Vawter v. McKisskick, 159 N.W.2d at 542. The landlord admitted that she did not discuss terms with the prospect nor pursue the prospect's interest in the property. Id. at 542. Although these facts were cited in the court's decision that the landlord had not been reasonably diligent, they alone were not dispositive. The court seems to base its opinion more on the fact that the only effort the landlord made to relet the premises was to put a "for rent" sign in the window. Furthermore, the Iowa Supreme Court has held that where a landlord had the opportunity to

relet a building at the same rent, but refused to do so because it considered the renter to be undesirable because of the business in which he was engaged, the question of whether the landlord had acted in a reasonably diligent manner was a question of fact for the jury. Benson v. Iowa Bake-Rite Co., 207 Iowa 410, 221 N.W. 464, 467 (1928).

Finally, the requirement that a landlord use reasonable diligence to relet the property at the best obtainable rent is a two-edged sword. It may be used to deny a landlord's recovery if he rejects a prospective offer to relet the premises at a lower, but still reasonable, rate. It might also be used to punish a landlord for accepting an unreasonably low rent. See Roberts v. Watson, 196 Iowa 816, 195 N.W. 211, 212-13 (1923) (the court rejects defendant's argument that the landlord failed to mitigate because he relet the property at a rate of $68.00 a month less than what the defendant had contracted to pay, finding nothing in the record to indicate the lessor's action was unreasonable). In other words, had Equitable accepted Video Venture's offer and permitted it to leave the vacated premises at a rental rate almost 50% below what the debtor had been paying the debtor could just as easily have come into this court and argued that Equitable, rather than diligently seeking out a new lessee at a higher rate, permitted Video Ventures to lease the property at an unreasonably low rate.

Consequently, even had the lease between Corey and Equitable contained no clause waiving Equitable's duty to mitigate, this court would conclude that Equitable's refusal to lease the property to Video Ventures was reasonable. The proffered rent was substantially below the level of rent Equitable had received for that location. Furthermore, Equitable believed that they could rent the property to another prospect at a more reasonable price; Mr. Haase testified that several other prospects had shown specific interest in the vacated property. Had Equitable disregarded these prospects and tied up the property for nearly a year at a significantly lower rate, it would have certainly opened itself to allegations that it had not made a reasonable effort to procure the best obtainable rent in reletting that location. It is clear today that reletting to Video would have minimized defendant's damages. It was by no means clear eighteen months ago. Therefore, this court finds that Equitable acted with reasonable diligence to relet the abandoned property at the best obtainable rent, and therefore its claim should be allowed.

ORDER

IT IS ORDERED that the debtors' objection to Equitable's claim is overruled. Equitable's unsecured claim in the amount of $19,312.40 is allowed.

SO ORDERED THIS 26th DAY OF OCTOBER, 1989.

William L. Edmonds
Chief Bankruptcy Judge

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1. This varies from the proof of claim filed January 9, 1989 in the amount of $19,647.26.