In the United States Bankruptcy Court

for the Northern District of Iowa

TED TRUNNELLE Debtor.	Bankruptcy No. X92-00957F Chapter 7
DAVID A. SERGEANT, Trustee Plaintiff vs. TED TRUNNELLE; MILDRED TRUNNELLE and/or her Estate Representatives, Assigns Heirs or other Beneficiaries; TONY CINK; DENNIS CINK; ESTATE OF PATRICIA MEYER and her Heirs, Assigns, Executors Representatives and Beneficiaries; ROSALIE BONAVIA; MARY KAHLER; ESTATE OF CHARLES D. TRUNNELLE and his Heirs, Assigns, Executors, Representatives and Beneficiaries; DAVID TRUNNELLE; DONALD TRUNNELLE, GORDON TRUNNELLE; SUSAN FUDURICH; GLENN TRUNNELLE; and WEST VIEW NURSING CENTER, Britt, Iowa Defendants.	Adversary No. 92-3270XF

ORDER RE: MOTION FOR SUMMARY JUDGMENT FILED BY DEFENDANT TED TRUNNELLE; MOTION TO DISMISS FILED BY DEFENDANT ROSALIE TRUNNELLE; MOTION TO COMPEL ABANDONMENT FILED BY TED TRUNNELLE

Three matters have been presented to the court: (1) identical motions for summary judgment filed by defendant Ted Trunnelle (docket nos. 13 and 15, adversary proceeding); (2) a motion to dismiss this proceeding filed by defendant Rosalie E. Bonavia (docket no. 63, adversary proceeding); and (3) Ted Trunnelle's motion in the case to compel the trustee to abandon two real estate leases (docket no. 13, Trunnelle case file). David A. Sergeant, as trustee and plaintiff, resists all three motions. Hearings on these matters were substantially delayed by an unsuccessful effort to conclude the adversary

proceeding by agreement between Sergeant and Ted Trunnelle. Whether a settlement agreement was reached is now an issue in this adversary proceeding. Hearing on the motions was held on May 25, 1994, in Fort Dodge, Iowa. James H. Cossitt appeared for plaintiff and trustee David A. Sergeant; R. L. Morgan and David M. Nelsen appeared for debtor and defendant Ted Trunnelle; Robert Dotson appeared for defendants Tony and Dennis Cink; defendant Rosalie E. Bonavia appeared pro se.

Motions for Summary Judgment

Ted Trunnelle has filed identical motions for summary judgment. The motions were filed before the complaint was amended to add defendants and claims. Nonetheless, the court will consider Trunnelle's argument as to all of the plaintiff's claims. For the reasons stated hereafter, the motions will be denied.[(1)]

Ted Trunnelle filed his voluntary chapter 7 petition on May 14, 1992. He scheduled as an asset the following real estate: "SE 1/4, Sec 33 Buffalo Twnshp, Kossuth County, Iowa" and described his interest as "Fee Simple homestead included in." (Schedule A). In his schedule of executory contracts and unexpired leases, he stated: "lease of farmland from life tenant sublease to farming tenant" (Schedule G). Trunnelle's mother, Mildred, was the "life tenant" referred to in Schedule G; Tony Cink was the "farming tenant" who leased the land from Ted Trunnelle. Neither was identified in the schedules. At the meeting of creditors on June 20, 1992, Trunnelle testified about his leasing of farmland from his mother and his subleasing of the same land. On the day of the meeting, the trustee, by chance, found a copy of the Ted Trunnelle/Mildred Trunnelle lease that apparently had been inadvertently left in the building where the meeting was held. By no later than June 20, 1992, the trustee was aware of the existence of the two leases, although he may not have been aware of all their details. On July 9, 1992, Trunnelle's attorney mailed to Sergeant a copy of the lease with debtor's mother and a copy of the sublease with Tony Cink. The legal descriptions on the two leases were approximately the same as the description of Ted Trunnelle's real estate in Schedule A. Any 60-day period for the trustee to assume or reject unexpired leases would have expired on July 13, 1992. The trustee did not move to assume or reject either lease by that date. He did not seek an extension of time to do so.

In his initial complaint, the trustee alleged that rent from the sublease became due after the filing of the petition and that his claim to the rent was superior to any claims of the debtor or of Mildred Trunnelle. It appears undisputed that the sublessee, Tony Cink, paid rent to someone other than the trustee after the bankruptcy was filed. Mildred Trunnelle died after the filing of the complaint. After her death, Sergeant filed his amended complaint naming additional defendants whom he claimed were liable for the rents arising from the sublease.

Trunnelle asks the court to dismiss Sergeant's complaint on the theory that the trustee's "deemed rejection" of the primary lease resulted in the rejection of the sublease as a matter of law, and that as a consequence of the two rejections, the leases were automatically terminated, and, therefore, the trustee has no rights in the post-petition rental payments from Cink.

Sergeant argues that in chapter 7, the Code provides for automatic rejection of non-residential leases only where the debtor is lessee but not where the debtor is lessor. He says that the sublease, therefore, was not rejected or terminated, and that it and the rents arising from it remain property of the estate. The trustee seems to suggest also that because of his difficulty in getting exact information from Trunnelle on the two leases, he should not be prejudiced by the 60-day period for assuming or rejecting the leases.

The latter contention is without merit. The trustee knew about the existences of the leases. If he thought that he lacked sufficient information about them to make a reasonable judgment on assumption or rejection, he should have sought an extension of the time to make his decision. He did not, and he is not now entitled to an extension.

Because the trustee did not move to assume or reject the sublease with Cink within 60 days of the order for relief, the sublease was deemed rejected. The court reaches this conclusion for a different reason than that argued by Trunnelle. He contends that rejection of a lease results in any subleases also being rejected.

As support for this proposition, he cites the rationales of Chatlos Systems, Inc. v. Kaplan, 147 B.R. 96, 100 (D. Del. 1992), aff'd without opinion 998 F.2d 1005 (3d Cir. 1993) ("the sublessee's rights in the property extinguish with those of the sublessor") and In re Dial-a-Tire, Inc., 78 B.R. 13, 16 (Bankr. W.D. N.Y. 1987) (the continuing effectiveness of the sublease depends on the "continuing viability" of the lease).

Both of these cases seem to rely on the belief that rejection constitutes termination of a lease. I disagree with that proposition. Instead, I conclude that the sublease was deemed rejected, because I construe the Code to include a "deemed rejection" provision in chapter 7 cases for nonresidential leases under which the debtor was lessor.

The Code does not now expressly so provide, but it formerly did so. Prior to the 1984 amendments to the Code, the time periods for assuming or rejecting executory contracts and unexpired leases were set out entirely in 11 U.S.C. § § 365(d)(1) and (2). Subsection (d)(1) provided a 60-day time period for trustees in chapter 7 cases to assume or reject any executory contract or unexpired lease. If the trustee did not assume or reject within the 60-day period, the leases or contracts were deemed rejected. This was so regardless of whether the debtor had been lessor or lessee or whether the lease was for residential or non-residential property. Subsection (d)(2) applied to cases under chapters 9, 11 and 13. The trustee could assume or reject the executory contracts or unexpired leases "at any time before the confirmation of a plan. . . ." Subsection (d)(2) applied to residential and non-residential leases alike and regardless of the status of the debtor as lessor or lessee.

In response to pressure from lessors of commercial property, Congress, in 1984, amended section 365. Among the concerns with which Congress dealt was the lessors' objection to the extended period of time allowed for a tenant's rejection or assumption of a commercial lease in a reorganization case. See legislative history cited in Jeffrey S. Battershall, "Commercial Leases and Section 365 of the Bankruptcy Code," 64 Am.Bankr.L.J. 329, 331-336 (Vol. 64, Fall 1990). To limit the time, Congress added subsection (d)(4). It provided:

> Notwithstanding paragraphs (1) and (2), in a case under any chapter of this title, if the trustee does not assume or reject an unexpired lease of nonresidential real property under which the debtor is the lessee within 60 days after the date of the order for relief, or within such additional time as the court, for cause, within such 60-day period, fixes, then such lease is deemed rejected, and the trustee shall immediately surrender such nonresidential real property to the lessor.

11 U.S.C. § 365(d)(4). At the same time, Congress amended subsection (d)(1) by adding the phrase "of residential real property or of personal property" after the words "unexpired lease." The amended section read:

> In a case under chapter 7 of this title, if the trustee does not assume or reject an executory contract or unexpired lease of residential real property or of personal property of the debtor within 60 days after the order for relief, or within such additional time as the court, for cause, within such 60-day period, fixes, then such contract or lease is deemed rejected.

11 U.S.C. § 365(d)(1) (emphasis added to language by amendment).

As a result of these changes, there is no longer an express 60-day time limit for chapter 7 trustees to assume or reject nonresidential leases under which the debtor was lessor. The court considers the statute as amended to be ambiguous as it is now not clear from the statute what time period is imposed for assumption or rejection of such unexpired leases. There must be some deadline. If the case were to close without assumption or rejection, the lessee would not be able to prove its claim under 11 U.S.C. § 502(g). That section permits allowance of claims arising from rejection of executory contracts and unexpired leases. To conclude there is no deadline and that this one type of lease cannot be considered deemed rejected would not conform to the statutory scheme whereby all other unexpired leases must be acted upon within 60 days or by confirmation of a plan. Moreover, to consider that the closing of the case constitutes the time at which such leases are deemed rejected would lead to an absurd result--that the lessee's claim would arise at the closing of the case when the lessee could no longer participate in a distribution on account of a claim arising by rejection.

It is arguable that a time limit is not at all necessary because the lessee can seek by motion at any time to force assumption or rejection. But that is true also with all other types of leases, so it makes no sense that merely because of the motion provision one type of unexpired lease should not be covered by the Code.

It seems to the court that Congress inadvertently eliminated from the statute "deemed rejection" for this type of unexpired lease. The background to the 1984 changes indicates that Congress' goal was to limit the time period in reorganization cases for assuming or rejecting unexpired leases of a particular type--commercial leases where the debtor was lessee. It accomplished that goal by adding subsection (d)(4). However, by its terms, the new subsection applied the time limit to cases under any chapter. The new subsection accomplished Congress' goal and did not effect a change in the period for assuming or rejecting such leases under chapter 7. However, the new section, if no other amendments were made, would have duplicated the time limit which was provided for such leases in subsection (d)(1). Congress may have tried to eliminate this duplication by amending subsection (d)(1) to eliminate from it the types of lease it had covered in (d)(4). There is nothing in the legislative history of the change to indicate that Congress intended to eliminate the applicability of "deemed rejection" to unexpired nonresidential leases under which debtor was lessor, a type of lease not covered by subsection (d)(4). It just did not go far enough in amending (d)(1) after amending the statute to add (d)(4). Subsection (d)(1) should be construed to include unexpired leases of nonresidential real property under which the debtor is the lessor. Thus to the extent that a chapter 7 trustee fails to assume or reject such a lease within the 60-day time period, the lease would be deemed rejected.

Because the trustee in this case did not move to assume or reject the sublease with Cink within the 60-day period, the lease was deemed rejected. Similarly, because he failed to assume or reject debtor's lease with Mildred Trunnelle, it also was deemed rejected.

The fact that both leases were deemed to have been rejected by Sergeant does not lead the court to conclude that the leases were automatically thereby terminated. The rejections constituted pre-petition breaches of the leases. 11 U.S.C. § 365(g)(1). Whether and when the leases could be terminated by

Cink and Mildred Trunnelle as their remedies for the breaches depend on the lease agreements themselves, on Iowa law, and on the Bankruptcy Code.

As to the debtor's lease with Mildred Trunnelle, it appears to permit termination in accordance with the notice provisions of Iowa law (Section II) except that it required written notice of termination on or before August 31, rather than September 1 as provided in the statute. Iowa Code § 562.7. If written notice were given, the lease would terminate under Iowa law on the following March 1. Iowa Code § 562.5. It would appear that Mildred Trunnelle could terminate the lease for any reason so long as she abided by the foregoing lease provision and the state statute. But there is nothing in the lease which appears to permit immediate forfeiture of the lease as a remedy for breach. If there were a breach by the tenant, the lease permits Mildred Trunnelle to seek the appointment of a receiver to take control of the property until "settlement is made," (Trunnelle-Trunnelle lease, section VIII).

A lease may be terminated by express agreement of the parties. There is no evidence of any termination agreement between Mildred Trunnelle and the lessee. The court believes that the lease, despite its rejection, remained property of the estate. Therefore, any agreement to terminate would have had to have been made with Sergeant as trustee of the estate. There is no allegation or proof that he expressly agreed to termination of the lease.

Termination may be accomplished by a surrender of the lessee's term and an acceptance by the landlord. Such a surrender may be implied from the actions of the parties, but nonetheless it is accomplished by mutual agreement. Ballenger v. Kahl, 247 Iowa 721, 76 N.W.2d 196, 198 (1956). The surrender of a primary lease under Iowa law would not effect the termination of a sublease. It would remain in force. Parris-West Maytag Hotel Corp. v. Continental Amusement Co., 168 N.W.2d 735, 738 (Iowa 1969).

Federal courts have held that termination takes place upon rejection because of the Bankruptcy Code's requirement that the trustee immediately surrender the real property to the landlord upon rejection of the nonresidential lease. 11 U.S.C. § 365(d)(4). Sea Harvest Corp. v. Riviera Land Co., 868 F.2d 1077, 1080-81 (9th Cir. 1989); In re 6177 Realty Associates, Inc., 142 B.R. 1017, 1019 (Bankr. S.D. Fla. 1992); In re Giles Associates, Ltd., 92 B.R. 695, 696 (Bankr. W.D. Tex. 1988); In re Bernard, 69 B.R. 13, 15 (Bankr. D. Haw. 1986); Southwest Aircraft Services v. City of Long Beach (In re Southwest Aircraft Services, Inc.), 53 B.R. 805, 810 (Bankr. C.D. Cal. 1985) aff'd 660 B.R. 121 (9th Cir. BAP 1986) reversed on other grounds 831 F.2d 848 (9th Cir. 1987).

I do not agree that because of the surrender requirement of § 365(d)(4) it is clear that Congress intended that rejection of a lease terminates the lease as a matter of federal law. State and federal law are not necessarily in conflict on this issue, and reference to state law may still be made to determine if and when a lease is terminated. I do not think that the surrender required by § 365(d)(4) is equivalent to a surrender of the term under state law.

The Iowa Supreme Court has recognized that surrender of the term, which accomplishes termination of the tenancy, must be distinguished from surrender of possession. Ballenger v. Kahl, 76 N.W.2d at 198. In a bankruptcy context, the distinction makes sense. Surrender of a tenancy's term under Iowa law is by agreement. The Bankruptcy Code, by mandating surrender of the real property, ignores the concept of agreement. Termination of a tenancy by surrender of the term operates to relieve the tenant of post-termination liabilities, but the tenant remains liable for pre-termination obligations. 49 Am.Jur.2d, Landlord and Tenant § 1111 (1970). The Bankruptcy Code recognizes post-surrender liability and provides the method of calculating the landlord's claim. 11 U.S.C. § 502(b)(6). Section 365(d)(4) refers to surrender of possession, not termination of the tenancy.

Although I recognize courts disagree on the issue, I conclude that neither breach nor breach and surrender effects a termination of the lease as a matter of law. Eastover Bank for Savings v. Sowashee Venture (In the Matter of Austin Development Co.), 19 F.3d 1077, 1080-84 (5th Cir. 1994), petition for cert. filed, 63 U.S.L.W. 3093 (July 29, 1994); In re Storage Technology Corp., 53 B.R. 471, 475 (Bankr. D. Colo. 1985); cf. Kopolow v. P.M. Holding Corp. (In re Modern Textile, Inc.), 900 F.2d 1184, 1191 (8th Cir. 1990) (rejection operates as breach of continuing obligation of debtor, not as discharge or extinction of obligation).

Trunnelle also contends that once a lease is rejected, it is as though the lease never became part of the bankruptcy estate. For this proposition, he cites In re Lovitt, 757 F.2d 1035, 1041 (9th Cir. 1985) as amended on denial of rehearing. Lovitt states that "executory contracts and leases--unlike all other assets--do not vest in the trustee as of the date of the filing of the bankruptcy petition. They vest only upon the trustee's timely and affirmative act of assumption." Id. at 1041. Lovitt, however, is a case under the Bankruptcy Act, not the Code. Under § 70a of the Act, the trustee of a bankrupt's estate was vested with title to the bankrupt's property. However, executory contracts, including unexpired leases, were treated differently. As stated in one treatise:

> [T]here was one feature of the law as applied to executory contracts that distinguished them from all other property that might or might not be burdensome. It was said that contrary to the usual rule, the title to the bankrupt's executory contracts or leases (which were included in that category) did not vest in the trustee as of the time prescribed in § 70a, but rather vested only upon the affirmative act of adoption, though with retroactive effect so that such adoption related back to the time specified in § 70a.

4A Collier on Bankruptcy, 70.43[1] at 520 (14th ed. 1978).

That statement has been republished verbatim in Collier's treatise on the Code in its discussion of pre-Code law on executory contracts and unexpired leases. 2 Collier on Bankruptcy, 365.01[1] (15th ed. 1992). However, it has also recognized the continued vitality of the earlier principle in discussing the Code's treatment of executory contracts and unexpired leases. Id. at 365.03[4]. This is so even though the treatise recognizes that the Code no longer makes provision for "vesting" when the bankruptcy estate is created. Id. 541.02[2] at 541-13, and that leases are property of the estate. Id. at 541.07[4].

The principle stated in Lovitt finds some support in cases construing the Code. In re Moreggia & Sons, Inc., 852 F.2d 1179, 1185 (9th Cir. 1988); Matter of Tonry, 724 F.2d 467, 469 (5th Cir. 1984); In re Attorneys Office Management, Inc., 29 B.R. 96, 98 (Bankr. C.D. Cal. 1983).

On this point, I respectfully disagree with these cases. The range of property interests which become property of the estate upon the commencement of a case is broad. With some exceptions, it includes "all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541(a)(1). The leases are property of the estate from the outset of filing. The only statutory exclusion from the estate for a debtor's interest in a lease is provided for in 11 U.S.C. § 541(b)(2):

> "[p]roperty of the estate does not include . . . (2) any interest of the debtor as a lessee under a lease of nonresidential real property that has terminated at the expiration of the stated term of such lease before the commencement of the case under this title, and ceases to include any interest of the debtor as a lessee under a lease of nonresidential real property that has terminated at the expiration of the stated term of such lease during the case. . . ."

The court can find no provisions of the Code which exclude a debtor's interest in a lease from property of the estate until the unexpired lease is assumed by the trustee or which includes it until it is rejected.

As to the lease with Cink, the Code clearly does not contemplate automatic termination of the lease upon its rejection by the trustee. Section 365(h)(1) provides that if the trustee rejects a lease of real property under which debtor was lessor, the lessee may treat the lease as terminated by such rejection "where the disaffirmance by the trustee amounts to such a breach as would entitle the lessee . . . to treat such lease . . . as terminated by virtue of its own terms, applicable nonbankruptcy law, or other agreements the lessee . . . has made with other parties. . . ." 11 U.S.C. § 365(h)(1). Alternatively, instead of declaring the lease terminated under such circumstances, the lessee may remain in possession for the balance of the term and for enforceable renewal periods under nonbankruptcy law. Id. The lessee may offset rent owed for the remaining period of the lease against damages flowing from the rejection after the date of rejection. Id.

There is no evidence that either Mildred Trunnelle or her estate has taken any action to terminate the lease. Whether relief from the stay is necessary to terminate is not a question presently before the court. Also, there is no evidence that the trustee has terminated the lease with Cink, or that Cink has declared or legally could declare the lease as terminated. Cink has remained in possession, apparently paying rents to Trunnelle or her estate.

These rents are property of the bankruptcy estate. It may be that Cink may offset any post-petition damages he may have suffered from trustee's rejection. It may be that Trunnelle claims that by agreement or statute, the rents due from Cink are her collateral. None of these issues is before the court in this motion. Trunnelle's estate has contended that because of the rejections of the two leases by trustee, the trustee could have no legal right to the lease payments. For the foregoing reasons, I conclude to the contrary. The rights to the lease payments is the ultimate issue in this proceeding. It is expected that there are facts which are not yet apparent which are relevant to a determination of that issue. A determination of rights in the sublease payments is not possible on Mildred Trunnelle's motion. The motion will be overruled.

Bonavia's Motion to Dismiss

Ms. Bonavia's motion is considered under Fed.R.Bankr.P. 7012(b)(6). Sergeant's Counts III and VI are lodged against Ms. Bonavia and other heirs of Mildred Trunnelle. In Count III, Sergeant asks the court to determine the relative rights to the rents as between himself and the Mildred Trunnelle heirs. He asks also for turnover of any rents that might have been paid to the heirs since the filing of the bankruptcy petition. In Count VI, Sergeant alleges that any taking of rents by the heirs constitutes a violation of the stay for which he seeks damages.

The court treats the motion of Ms. Bonavia as a motion to dismiss for failure to state a claim and not as a motion for summary judgment. The court will, therefore, ignore her affidavit of facts. The court concludes that the trustee has stated a claim. The motion to dismiss will be denied.

Debtor's Motion to Compel [Abandonment]

Ted Trunnelle asks the court to compel the trustee to abandon the rejected leases. For this court to compel abandonment under 11 U.S.C. § 554(b), Trunnelle must show that the leases are burdensome

to the estate or are of inconsequential value. Trunnelle has failed to make this showing. The motion will be denied.

ORDER

IT IS ORDERED that the motions for summary judgment filed by Ted Trunnelle are OVERRULED.

IT IS FURTHER ORDERED that the motion to dismiss filed by Rosalie Bonavia is DENIED.

IT IS FURTHER ORDERED that the motion to compel abandonment filed by Ted Trunnelle is DENIED.

The clerk shall enter this order in both the case and adversary proceeding files.

SO ORDERED ON THIS 18th DAY OF AUGUST, 1994.

William L. Edmonds
Chief Bankruptcy Judge

I certify that on _____ I mailed a copy of this order by U. S. mail to: James Cossitt, David Nelsen, Robert Dotson, Todd Stowater, Monty Fisher, Rosalie Bonavia, Richard Allbee and U. S. Trustee.

1. [1] Trunnelle's motion for summary judgment does not address Sergeant's suit on the alleged settlement because the motion was filed before the settlement was allegedly entered into. As to the claim that Trunnelle agreed to settle, Trunnelle's motion could not be granted even if he were entitled to judgment on the merits of Sergeant's original claim.