

United States District Court
For the Northern District of California

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UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA

In re MICHAEL H. CLEMENT CORP.,
a California corporation,

Debtor.

FRANK C. ALEGRE, FRANK C. ALEGRE, SR.
AND HELEN C. ALEGRE, as Trustees of the
FRANK C. ALEGRE AND HELEN C. ALEGRE
REVOCABLE TRUST,

Appellants and Cross-Appellees,

No. C 10-1028 PJH/10-1030 PJH
Bankr. Case No. 09-43502 LT

v.

**ORDER RE: CONSOLIDATED
APPEALS**

MICHAEL H. CLEMENT CORP.,

Appellee and Cross-Appellant.

Both parties, the Alegres and debtor Michael H. Clement Corporation (“MHCC” and/or “debtor”), appeal the bankruptcy court’s order denying the Alegres’ motion for an order deeming a lease rejected, and the bankruptcy court’s subsequent orders denying both parties’ motions for reconsideration of that order. Because the appeals in essence constitute cross-appeals of the same orders and issues, the court ordered consolidated briefing.¹ For the reasons that follow, the court AFFIRMS the decisions of the bankruptcy

¹ Because the Alegres filed their notice of appeal first and therefore are the appellants in the earlier-filed case, the court noted that it would treat the Alegres as the appellants and debtor as the cross-appellant.

1 court.

2 **BACKGROUND**

3 **A. Procedural Background**

4 This appeal stems from the bankruptcy court's orders in the main bankruptcy case
5 regarding real property located at 3500 Wilbur Avenue in Antioch, California ("the Wilbur
6 property"). On April 28, 2009, debtor MHCC filed a Chapter 11 bankruptcy petition.
7 Subsequently, on September 4, 2009, the Alegres filed a motion for an order from the
8 bankruptcy court deeming the debtor, MHCC, to have rejected a lease of the Wilbur
9 property under Bankruptcy Code § 365(d)(4).

10 With their motion, the Alegres contended that MHCC was the lessee of the Wilbur
11 property, and that it was required to assume the lease no later than August 26, 2009, one
12 hundred twenty days after it filed its bankruptcy petition, and had not done so, nor had it
13 sought an extension of time to do so.² The Alegres thus asserted that MHCC was required
14 to immediately surrender the Wilbur property.

15 MHCC opposed the motion, and the bankruptcy court held a hearing on October 5,
16 2009, and in an October 14, 2009 memorandum decision, denied the Alegres' motion.³
17 The Alegres filed a motion for reconsideration, and MHCC filed its own countermotion for
18 reconsideration challenging certain findings and conclusions made by the bankruptcy court
19 in its memorandum decision. On January 13, 2010, the bankruptcy court denied both
20 motions for reconsideration.

21 The Alegres and MHCC appealed, and both parties elected to have this court hear
22 the appeal rather than the Ninth Circuit Bankruptcy Appellate Panel.

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24 _____
25 ²The assumption or rejection of a lease under § 365 is accomplished via a noticed
26 motion before the bankruptcy court, and is subject to court approval. See *Pacific Shores
27 Development LLC v. At Home Corp. (In re At Home Corp.)*, 392 F.3d 1064, 1065 (9th Cir.
28 2004).

³On November 5, 2009, the bankruptcy court signed the order denying the motion.

1 **B. Bankruptcy Court’s Factual Findings**

2 In its October 14, 2009 memorandum decision following the October 5, 2009 hearing
3 on the Alegres’ motion to deem the lease rejected, the bankruptcy court set forth its factual
4 findings as follows:

5 The Debtor [MHCC] purchased certain real property located at 3500
6 Wilbur Avenue, Antioch, California (the “Wilbur Avenue Property”) in 1985.
7 The Debtor is a licensed contractor and manufacturing company and
8 operates its business on the Wilbur Avenue Property. Michael H. Clement
9 (“Clement”), the president and sole shareholder of the Debtor, and his family
10 also reside on the Wilbur Avenue Property.

11 On January 12, 2001, the Debtor entered into an agreement to sell the
12 Wilbur Avenue Property to Alegre for \$1.3 million (the “Sale Agreement”).
13 Close of escrow was scheduled for October 31, 2001. As a pre-condition to
14 the close of escrow, Clement was required to obtain certain entitlements for
15 improvement of certain real property located on Holland Tract Road in
16 Knightsen, California (the “Holland Tract Property”). Clement appears to have
17 anticipated moving the Debtor’s business operations to the Holland Tract
18 Property when the improvements were completed. Clement failed to obtain
19 the entitlements, and escrow did not close within the scheduled time.

20 The parties continued to negotiate and in 2003 entered into a second
21 agreement, entitled Rental and Development Agreement (the “RDA”). The
22 RDA recites that the Debtor and Clement will sell the Wilbur Avenue Property
23 to Alegre through a two-way Internal Revenue Code Section 1031 exchange.
24 (RDA, ¶ (2)) Thereafter, the Debtor will have the option to continue to occupy
25 the Wilbur Avenue Property rent free until thirty days after a certificate of
26 occupancy has been issued for the Holland Tract Property or an equivalent
27 facility. (RDA, ¶ (5)) Alegre agrees to provide the funds to acquire and build
28 out the Holland Tract Property up to \$1.3 million. (RDA, ¶ (8)(c)) Title to the
Wilbur Avenue Property is to be taken in Alegre’s name pending completion
of the Holland Tract Property project and 1031 exchange. (RDA, ¶ (10))

The RDA further provides that, in the event Alegre does not complete
the build out of the Holland Tract Property within two years, the Debtor will
have the option of buying back the Wilbur Avenue Property for \$1.3 million
less the commission paid by the Debtor. (RDA, ¶ (12)) Alegre agrees that,
over and above the \$1.3 million to be spent on the acquisition and build out of
the Holland Tract Property, he will provide the Debtor and Clement with
additional product and services with a value of \$104,000.

In the event the Holland Tract Property project has not been completed
within 15 months from the date of the RDA and the Debtor wishes to continue
to occupy the Wilbur Avenue Property, this \$104,000 obligation will be applied
as a credit against rent, to be calculated at \$5,000 per month for months 16
through 24 and at \$7,000 per month thereafter. When the credit is exhausted,
the Debtor may continue to occupy the space at a fair market value rent.
(RDA, ¶ (20))

The intended 1031 exchange was never accomplished. However, two

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days after the RDA was executed, the Debtor executed a deed transferring title to the Wilbur Avenue Property to Alegre, and the deed was recorded.⁴ Alegre paid \$1.3 million, less the commission, to or on behalf of the Debtor in connection with the transaction. At some point, the Debtor acquired title to the Holland Tract Property.⁵ After executing the deed transferring title to Alegre, the Debtor remained on the Wilbur Avenue Property, making no out-of-pocket payment of rent. The \$104,000 in rent credit was exhausted in or about May 2006. The Debtor has remained on the Wilbur Avenue Property since that time without paying rent.

In February 2006, the Debtor and Clement sued Alegre in state court, seeking, among other things, to rescind the sale of the Wilbur Avenue Property to Alegre. Trial was set for May 2009. The Debtor filed this bankruptcy case on April 28, 2009, presumably in the hope of delaying the trial. This effort was unsuccessful, the trial took place as scheduled, and judgment was rendered in July 2009 adversely to the Debtor. A copy of the Statement of Decision has been provided to the Court. In the Statement of Decision, the state court judge holds that the Debtor cannot rescind the sale because it is unable to repay Alegre for the approximately \$1.3 million sale price. In August 2009 the Debtor filed a notice of appeal from the judgment, and that appeal is pending.

The chapter 11 case has been pending for 163 days, and the Debtor has not filed a motion to assume the lease of the Wilbur Avenue Property or moved to extend the time for doing so.

C. Bankruptcy Court’s Decisions

1. Denial of the Alegres’ Motion to Deem Lease Rejected

In their motion, the Alegres contended that the RDA’s lease provisions gave rise to a nonresidential lease of the Wilbur property. They argued that, accordingly, MHCC was required to assume or reject the Wilbur lease within 120 days after its bankruptcy filing under Bankruptcy Code § 365(d)(4), which it had not done. As a result, the Alegres asserted that the lease should be deemed rejected, and that MHCC should be required to

⁴The bankruptcy court noted that MHCC “contend[ed] that the sale of the Wilbur Avenue Property was never consummated and that [MHCC] is still the owner of the property.” It found, though, that:

This contention is untenable. The Court has been provided with a copy of the recorded deed transferring title to Alegre. In addition, the complaint filed by the Debtor, seeking to rescind the RDA, affirmatively alleges that sale escrow closed and that Alegre is the owner of the Wilbur Avenue Property.

⁵The bankruptcy court noted that MHCC “listed the Holland Tract Property as an asset on Schedule A of its Schedules of Assets and Liabilities.”

1 vacate the property. Alternatively, the Alegres contended that MHCC was not entitled to
2 remain on the property without paying rent.

3 MHCC, on the other hand, argued that the Wilbur lease was residential because
4 Clement and his family lived on the property. Because it was a residential lease, MHCC
5 argued that it was not required to assume or reject the lease within 120 days under §
6 365(d)(4). MHCC further contended that even if the lease of the Wilbur property was
7 nonresidential, because the lease provisions were so entangled with other provisions of the
8 RDA, it did not constitute a bona fide lease that MHCC was required to assume or reject
9 under § 365(d)(4).

10 The bankruptcy court found against MHCC, thus agreeing with the Alegres, that the
11 Wilbur property was nonresidential, finding that it could not be characterized as residential
12 for several reasons. The court noted that despite the fact that it was undisputed that
13 Clement and his family lived in trailers on the property in violation of the zoning laws and
14 had apparently done so for a long time, it was also undisputed that the property was
15 located in a heavy industrial zone and could not legally be used as a residence. It further
16 noted that the primary use of the property was commercial. The bankruptcy court
17 examined numerous relevant bankruptcy cases, and ultimately held that the Wilbur
18 property could not be characterized as residential simply because the Clement family lived
19 on it.

20 However, the bankruptcy court held in favor of MHCC and against the Alegres in
21 determining that the lease was not a bona fide lease, and therefore was not subject to §
22 365(d)(4)'s requirements. The bankruptcy court considered the key Ninth Circuit cases on
23 point, and first, contrary to MHCC's arguments, held that the Wilbur lease was not simply a
24 disguised financing lease, thus exempt from § 365(d)(4). In support, it found that "[t]he rent
25 to be paid [under the RDA] was not tied to the funds necessary [to] acquire or develop the
26 Wilbur Avenue Property." It further found that, "the RDA states that, after a specified period
27 of time, if the Debtor wishes to remain on the Wilbur Avenue Property, the parties must
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1 agree on a fair market rate rent.”

2 However, contrary to the Alegres’ contentions, the bankruptcy court found that the
3 Wilbur lease also was not a bona fide lease. In support, the court found that there was no
4 fixed term for the lease; MHCC had owned the property for many years before executing
5 the RDA; the RDA gave MHCC the right to reacquire the property provided the sale price
6 could be refunded; and MHCC had the right to remain on the property indefinitely assuming
7 it could pay the Alegres a fair rental rate.

8 In sum, because the bankruptcy court concluded that the RDA’s lease provisions did
9 not give rise to a bona fide lease, it held that MHCC was not required to assume or reject
10 the lease pursuant to § 365(d)(4). Nevertheless, the court agreed with the Alegres that
11 MHCC was not entitled to continue to occupy the Wilbur property rent-free, and directed
12 the parties to meet and confer regarding a fair rental rate.⁶

13 **2. Denial of Parties’ Motions for Reconsideration**

14 Following the bankruptcy court’s order denying the Alegres’ motion, both the Alegres
15 and MHCC filed motions for reconsideration. The Alegres argued that the bankruptcy court
16 erred in determining that that the RDA lease provisions did not create a bona fide lease. In
17 support, the Alegres noted that the bankruptcy court had rejected MHCC’s contention that it
18 owned the Wilbur property, and had also concluded that the RDA did not constitute a
19 disguised financing agreement.

20 The Alegres further challenged the bankruptcy court’s finding that the RDA appeared
21 to give MHCC the right to remain on the property indefinitely as long as it paid a fair market
22 rent. The Alegres argued that such a finding constituted manifest error under California law
23 because state law did not permit a lease of infinite duration. They thus argued that under
24 state law, MHCC possessed a month-to-month tenancy of nonresidential property that,

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26 ⁶The parties were unable to agree on the fair rental rate, and further motions and
27 hearings ensued. After a hearing, on March 12, 2010, the bankruptcy court held that the fair
28 rental rate was \$9,450 per month, and that MHCC owed the Alegres rent dating back to
December 1, 2009.

1 contrary to the court’s conclusion, constituted a bona fide lease subject to Bankruptcy Code
2 § 365(d)(4).

3 The court denied the Alegres’ motion for reconsideration on the papers, concluding
4 that “the RDA appears to have created a hybrid contractual arrangement between [MHCC]
5 and Alegre, part lease and part property right.” The court further held:

6 It would be contrary to the expressed intent of the RDA to characterize the
7 Debtor's right to remain on the Property as a month-to-month tenancy. Such
8 a right would be subject to loss at any time at Alegre's discretion, even if the
9 Debtor were current on the rent. In any event, for purposes of this motion,
10 the Court makes no final ruling as to the nature of the rights created by the
11 RDA. The Court simply holds that the Debtor's failure to assume or reject the
12 lease-like provisions of the RDA does not result in the automatic rejection of
13 the Debtor's right to remain on the Property. However, as stated in the
14 Memorandum, the Debtor must pay the fair market rental rate for doing so.

15 The court then turned to MHCC’s motion for reconsideration, which it also decided
16 on the papers. MHCC requested the bankruptcy court to reconsider its determination that
17 the Wilbur property constituted nonresidential real property, and that the RDA was not a
18 disguised financing lease. The bankruptcy court rejected both requests, and denied
19 MHCC’s motion as well.

20 First, it rejected MHCC’s argument that the state court’s dismissal of a prior unlawful
21 detainer action filed by the Alegres against MHCC somehow demonstrated that the zoning
22 of the Wilbur property indeed permitted residential use. The court noted that there was
23 evidence that residential use of the property violated the Antioch Municipal Code, and that
24 it was not clear that the unlawful detainer action even involved the issue regarding the use
25 of the property for residential purposes. Finally, the court found that there was nothing in
26 the RDA suggesting that the parties envisioned the continued residential use of the Wilbur
27 property.

28 The bankruptcy court also denied MHCC’s motion to the extent it suggested the
RDA was in fact a financing lease based on the interrelationship of the Wilbur property rent
and the Holland Tract project. In rejecting MHCC’s arguments on reconsideration, the
court found that

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More relevant was that, once rent began to accrue, the RDA set a rental rate of \$5,000 per month initially, increasing to \$7,000 thereafter, still later to be set at the fair market rental rate. These provisions appear to be linked to the value of the Debtor's use of the Property, not to any financing arrangement.

ISSUES ON APPEAL

The Alegres argue on appeal that the bankruptcy court erred when it held initially and on reconsideration that the RDA lease provisions did not give rise to a month-to-month tenancy under California law, and thus was not a bona fide lease subject to Bankruptcy Code § 365(d)(4).

MHCC argues on appeal that the bankruptcy court erred when: (1) it found that the Wilbur property was nonresidential property; (2) it found that there were no disputed material factual issues requiring a hearing pursuant to Federal Rules of Bankruptcy Procedure (“FBRP”) 9014 in conjunction with its motion for reconsideration; and (3) it found that MHCC must pay the fair rental rate of the Wilbur property to the Alegres to remain in possession of the property.

DISCUSSION

A. Standard of Review

This court reviews the bankruptcy court's findings of fact for clear error, and its conclusions of law *de novo*. See *Microsoft Corp. v. DAK Indus., Inc. (In re DAK Industries, Inc.)*, 66 F.3d 1091, 1094 (9th Cir. 1995). The court reviews the bankruptcy court’s denial of a motion for reconsideration for an abuse of discretion. *Balla v. Idaho State Bd. of Corr.*, 869 F.2d 461, 464 (9th Cir. 1989).

B. Legal Standards

Bankruptcy Code section 365(d) provides in pertinent part:

(d)(1)

(2) In a case under chapter 9, 11, 12, or 13 of this title, the trustee⁷ may assume or reject an executory contract or unexpired lease of residential real property or of personal property of the debtor at any time before the

⁷In Chapter 11 bankruptcy cases, such as MHCC’s, a debtor in possession has the right to exercise the powers afforded the “trustee” under § 365. See Bankruptcy Code § 1107(a).

1 confirmation of a plan but the court, on the request of any party to such
2 contract or lease, may order the trustee to determine within a specified period
of time whether to assume or reject such contract or lease.

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4 (4)(A) Subject to subparagraph (B), an unexpired lease of nonresidential real
5 property under which the debtor is the lessee shall be deemed rejected, and
6 the trustee shall immediately surrender that nonresidential real property to the
lessor, if the trustee does not assume or reject the unexpired lease by the
earlier of–

7 (i) the date that is 120 days after the date of the order for relief; or

8 (ii) the date of the entry of an order confirming a plan.

9 (B)(i) The court may extend the period determined under subparagraph (A),
10 prior to the expiration of the 120-day period, for 90 days on the motion of the
trustee or lessor for cause.

11 (ii) If the court grants an extension under clause (i), the court may
12 grant a subsequent extension only upon prior written consent of the
lessor in each instance.

13 The purpose of § 365(d)(4), the provision primarily at issue in these appeals, is to
14 protect lessors from delay and uncertainty by forcing the trustee or debtor-in-possession to
15 act quickly to assume unexpired leases. *City of San Francisco v. Walsh (In re Moreggia)*,
16 852 F.2d 1179, 1185 (9th Cir. 1988). However, “[o]n the other side of the equation, to
17 ensure that the bankrupt estate is not unwittingly burdened with liabilities, an affirmative act
18 of assumption by the trustee is required to bring executory contracts and unexpired leases
19 into the estate.” *Id.*

20 **C. Analysis**

21 At the outset, the court notes that the parties’ arguments on the first two issues are
22 nearly identical to their arguments before the bankruptcy court.

23 **1. Whether the Lease was a Bona Fide Lease**

24 The Bankruptcy Code does not specify what constitutes a lease under § 365. *Baker*
25 *v. Harris Pine Mills (In re Harris Pine Mills)*, 862 F.2d 217, 220 (9th Cir. 1988); *In re*
26 *Moreggia*, 852 F.2d at 1182. However, it is clear that notwithstanding the label given a
27 particular contract, § 365 and its requirements apply only to “bona fide” or “true” leases. *In*
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1 *re Moreggia*, 852 F.2d at 1182; *In re Harris Pine*, 862 F.2d at 220 n.5.

2 Whether a 'lease' is [a] true or bona fide lease or, in the alternative, a
3 financing 'lease' or a lease intended as security, depends upon the
4 circumstances of each case. The distinction between a true lease and a
5 financing transaction is based upon the economic substance of the
6 transaction and not, for example, upon the locus of title, the form of the
7 transaction or the fact that the transaction is denominated as a 'lease.'

8 *In re Moreggia*, 852 F.2d at 1182 (citing S.Rep. No. 989, 95th Cong., 2d Sess. 64, reprinted
9 in 1978 U.S. Code Cong. & Admin. News 5787, 5850).

10 What constitutes a lease as a matter of "economic substance" is generally
11 determined by nonbankruptcy law, usually state law. *In re Harris Pine*, 862 F.2d at 220-21
12 & n. 5. However, an agreement that qualifies as a lease under state law is not necessarily
13 a true or bona fide lease subject to § 365. See *In re Moreggia*, 852 F.2d at 1182. The
14 bankruptcy court may independently determine whether the economic substance of the
15 agreement is of a type anticipated by § 365. See *id*; see also *In re Harris Pine*, 862 F.2d at
16 220 n. 6.

17 Courts may consider several factors to determine whether in economic substance an
18 agreement appears to be a bona fide lease contemplated by the Bankruptcy Code. See *In*
19 *re Moreggia*, 852 F.2d at 1182-84 (discussing *In re PCH Associates*, 804 F.2d 193, 199 (2d
20 Cir. 1986)). With regard to real property transactions, the court may consider, in particular,
21 the parties' intent to enter into a typical landlord/tenant relationship and/or whether the
22 lease was the product of "unique circumstances." *Id*.

23 The Alegres argue that the bankruptcy court's conclusion that the Wilbur lease did
24 not constitute a bona fide lease was wrong as a matter of law, and that certain underlying
25 factual findings were clearly erroneous. They contend that the lease was actually a
26 "standard fare" lease, and dispute the bankruptcy court's finding that there was no fixed
27 term for the lease, reiterating their argument that the lease constitutes a month-to-month
28 lease under California law. The Alegres argue that any rent due under the RDA was not a
"disguise" for anything but was compensation for the use of the land after the time the
parties contemplated that MHCC would have moved from the Wilbur property.

1 The Alegres further argue that the bankruptcy court erroneously relied on the fact
2 that MHCC previously owned the Wilbur property, and suggest that this factor is only
3 relevant in determining whether a lease is actually a financing lease. Additionally, the
4 Alegres challenge the bankruptcy court’s finding that pursuant to the RDA, MHCC had the
5 right to reacquire the property, arguing that this is only partially true because two conditions
6 were required to occur before that happened: (1) the Alegres failed to complete the
7 development of the Holland Tract; and (2) MHCC was able to pay the Alegres the price to
8 reacquire the Wilbur property.

9 Reviewing the issue *de novo*, the court concludes that the bankruptcy court did not
10 err in concluding that the Wilbur lease did *not* constitute a bona fide lease. Even if the
11 lease could be considered a month-to-month lease under California law, as the Alegres
12 assert, the bankruptcy court was entitled to determine whether the economic substance of
13 the lease was of a type anticipated by the Bankruptcy Code. *See In re Moreggia*, 852 F.2d
14 at 1182; *In re Harris Pine*, 862 F.2d at 220 n.6. The court did not err when it concluded that
15 it was not. In so holding, the bankruptcy court considered key Ninth Circuit cases on point,
16 *In re Moreggia & Sons, Inc.*, 852 F.2d 1179 (9th Cir. 1988), and *In re George*, 177 F.3d 885
17 (9th Cir. 1999), and held that this case fell “somewhere in between. . . the facts” in *George*
18 and *Moreggia*.

19 This court’s review of the pertinent evidence and authority leads it to the same
20 conclusion. In *Moreggia*, the Ninth Circuit held that the “Lease Agreement” entered into by
21 the parties in that case did not constitute a true lease. 852 F.2d at 1184. The agreement in
22 *Moreggia* was a “peculiar” transaction between a displaced business and a non-profit
23 corporation, which was created to aid a municipality in relocating industries uprooted by a
24 redevelopment project. *Id.* The lessor sold bonds and used the proceeds to build a
25 terminal in which the lessee “rented” space. *Id.* The rent was not related to the value of
26 possessing the terminal space, and the lessee was not obligated to pay rent after the
27 bonds were satisfied. *Id.* Instead, the terminal was built mainly to allow the municipality to
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1 discharge a legal obligation to furnish space to displaced businesses. *Id.*

2 Although the Ninth Circuit agreed with the lessor that the lease qualified as a lease
3 under state law, it nevertheless concluded that not every lease was subject to the
4 automatic rejection provisions of § 365(d)(4). *Id.* at 1182-83. It quoted a passage from the
5 Senate Report to 11 U.S.C. § 506(b)(6), stating that references to leases of real property
6 applied only to bona fide leases and not to financing leases. *Id.* at 1182. Importantly, the
7 *Moreggia* court concluded that the lease in question was the product of “unique
8 circumstances” and that no true landlord/tenant relationship was ever intended or created.
9 *Id.*

10 In *George*, unlike *Moreggia*, the court found that the agreement between the debtors
11 and the City of Morro Bay possessed all the indicia of a landlord/tenant relationship. 177
12 F.3d at 888. The agreement in *George* concerned waterfront property that the debtors
13 were leasing from the city, and required the debtors to provide public access to the harbor
14 and the tidelands. *Id.* at 886-87. The Ninth Circuit concluded that the agreement
15 constituted a “true” lease subject to § 365, despite the debtors' contention that the
16 agreement was a “development agreement” under California Tidelands Trust Doctrine. *Id.*
17 at 888. In support, it noted that the debtors were required to pay rent, which was tied to the
18 Consumer Price Index (CPI) and the property's fair market value; that the debtors had no
19 fee title to the land; and that the agreement noted that lessor would take control of the land
20 if the lease were terminated and take title to improvements that were not removed within 60
21 days. *Id.*

22 This court's review of the evidence and the RDA leads it to the same findings of fact
23 and conclusions of law reached by the bankruptcy court, including that that there was no
24 fixed term for the lease here; that MHCC had owned the property for many years before
25 executing the RDA; that the RDA gave MHCC the right to reacquire the property provided
26 the sale price could be refunded; and that MHCC had the right to remain on the property
27 indefinitely assuming it could pay the Alegres a fair rental rate. Based on these supporting
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1 determinations, the court concludes, as did the bankruptcy court, that the RDA is more akin
2 to the unique agreement at issue in *Moreggia*, and therefore did not create a true or bona
3 fide lease subject to the requirements of § 365.

4 **2. Whether the Lease was Residential or Nonresidential**

5 Having affirmed the bankruptcy court's decision on the above issue, the court need
6 not reach this issue on appeal to conclude that the Wilbur lease is not governed by §
7 365(d)(4). Nevertheless, the court has addressed the issue, and contrary to the bankruptcy
8 court, concludes that the Wilbur lease was "residential," thus providing an additional reason
9 that the lease was not subject to the requirements of § 365(d)(4).

10 Like the term "lease" discussed above, the Bankruptcy Code also does not define
11 either the terms "residential" or nonresidential" as contemplated by § 365. 3 Collier on
12 Bankruptcy § 365.05[3][a] (16th ed. 2010).⁸ Nor has this court located any circuit court
13 cases on point.

14 The majority of the bankruptcy courts that have considered the definition of
15 "residential," have narrowly construed it, focusing on the nature and use of the leased
16 property. Dunaway, 3 Law of Distressed Real Estate § 35:7, Distinction between
17 Residential Leases and Nonresidential Leases (Dec. 2010) (citing cases). In construing §
18 365(d), those courts generally hold that if people are living on the real property, it is
19 residential in nature, despite the fact there may be a commercial purpose underlying the
20 use. See *In re Bonita Glen II*, 152 B.R. 751, 753 (Bankr. S.D. Cal. 1993) (ground lease of
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22 ⁸The terms "residential" and "nonresidential" as used by § 365 were introduced into the
23 Code in 1984. In 1984, Congress revised § 365 to strengthen the Code's protection of
24 shopping centers. 130 Cong. Rec. S8894-95 (daily ed. June 29, 1984) (statement of Sen.
25 Hatch) reprinted in 1984 U.S. Code Cong. & Admin. News 590, 598-99. The 1984
26 Amendments to § 365 have been dubbed the "shopping center amendments" because they
27 were proposed to "prevent tenant space in shopping centers from remaining vacant for long
28 periods of time while a bankrupt tenant neither assumed nor rejected a lease." *Id.* It was
Congress' concern about the uncertainty and delay for lessors in shopping centers that led to
§ 365 being amended to require a debtor to assume or reject a nonresidential lease within sixty
days after the date of the order for relief. *Id.*

1 real property on which debtor later constructed apartment building was residential, and §
2 365(d)(4) did not apply to a lease for residential real property, even when the debtor used it
3 for a commercial purpose.); *In re Lippman*, 122 B.R. 206, 210 (Bankr. S.D.N.Y. 1990)
4 (leases of residential apartments located in a residential cooperative building were
5 residential leases not subject to the 60-day automatic termination provisions of § 365(d)(4),
6 even if some of the leases served a commercial purpose because it is the nature of the
7 property, not the nature of the lease, which governs whether a lease is nonresidential); *In*
8 *re Care Givers, Inc.*, 113 B.R. 263, 266 (Bankr. N.D. Tex. 1989) (since people were living at
9 the nursing home on the real property, the lease was residential); *In re Independence*
10 *Village*, 52 B.R. 715, 722 (Bankr. E.D. Mich. 1985) (even if an agreement regarding a life
11 care facility for the elderly were considered a lease, the agreement would not qualify as
12 nonresidential property because the facility housed several residents, notwithstanding the
13 fact that the corporate debtor, as lessee, did not personally reside on the premises); *Matter*
14 *of Terrace Apartments, Ltd.*, 107 B.R. 382 (Bankr. N.D. Ga. 1989) (where a long-term
15 ground lease was operated as an apartment complex, the court found the lease residential
16 in nature and that § 365(d)(4) was inapplicable).

17 However, a minority of courts have held that although land is used for dwellings, it
18 could be classified as nonresidential due to the commercial purpose of the lease. *See In re*
19 *Sonora Convalescent Hosp., Inc.*, 69 B.R. 134 (Bankr. E.D. Cal. 1986)). In *Sonora*, the
20 court held that the use of real and personal property for a nursing home was nonresidential
21 in nature due to the commercial purpose of the lease, especially the nature of the lease as
22 income-producing. *Id.*; *but see In re Bonita Glen II*, 152 B.R. at 753 (criticizing the
23 bankruptcy court's decision in *Sonora*). Additionally, another bankruptcy court held that a
24 lease of a mobile home park to the debtor was a nonresidential lease notwithstanding that
25 the debtor sublet the property by renting spaces to individual tenants, who took up
26 residence in the park. *Matter of Condominium Administrative Services, Inc.*, 55 B.R. 792
27 (Bankr. M.D. Fla. 1985). The court reasoned that "there [was] no question that . . . the
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1 individual tenants who reside in the park never had a lease with the [landlord], and the only
2 lease involved in this controversy is the lease between the [landlord] and the Debtor, a
3 lease which is clearly a commercial lease.” *Id.* at 795.

4 MHCC argues on appeal that the bankruptcy court erred as a matter of law and with
5 respect to its related factual findings on the issue. It contends that the parties always
6 contemplated that the Clements would continue living on the Wilbur property, as they had
7 done for many years. MHCC further argues that the bankruptcy court erred in finding that
8 the Clements’ residential use of the property violated the zoning laws, and also disputes the
9 bankruptcy court’s characterization of the property as “heavily industrial.” MHCC argues
10 that the zoning is unsettled, and because it is disputed, the bankruptcy court should have
11 held an evidentiary hearing on the issue pursuant to FRBP 9014(d).

12 Given the dearth of controlling authority on the issue, and the Bankruptcy Code’s
13 failure to define the terms, the court notes that this issue is a close call. Under what
14 appears to be the majority approach, the fact that Clement and his family lived on the
15 property and would likely continue to live on the property, would be sufficient to render the
16 lease “residential” in nature. The evidence is undisputed that the Clements have been
17 living on the Wilbur property for more than twenty years, and that the Alegres were aware
18 of this fact at the time the RDA was executed.

19 The bankruptcy court, however, took a broader approach by examining the local
20 zoning laws in concluding that the lease was non-residential. While the bankruptcy court’s
21 approach was not unreasonable, reviewing the issue *de novo*, this court would conclude
22 that the lease was “residential” for purposes of § 365, given the Clement family’s long
23 history of residential use of the property, the Alegres’ awareness of this fact, and the fact
24 that Michael Clement himself was a party to the RDA.

25 Accordingly, because the Wilbur lease was “residential,” it was not subject to §
26 365(d)(4) for this additional reason. Because the court decides this issue in favor of
27 MHCC, it declines to reach the issue regarding whether the bankruptcy court erred when it
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1 failed to hold an evidentiary hearing on the issue.

2 **3. Bankruptcy Court’s Order re: Rent**

3 In what appears to be a procedurally improper argument, MHCC contends that the
4 bankruptcy court erred in determining that it was not entitled to continue to occupy the
5 Wilbur property rent-free, and that it would need to commence paying rent to the Alegres.
6 MHCC’s argument is not entirely comprehensible, but it appears that it is arguing that the
7 bankruptcy court lacks jurisdiction over a Chapter 11 debtor’s [MHCC’s] real property
8 obligations where the debtor is simultaneously seeking relief related to the same real
9 property before a state court.

10 The court rejects this claim for several reasons. First, it notes that MHCC’s
11 challenge appears to constitute an appeal of the bankruptcy court’s March 12, 2010 order
12 regarding rent, an order that MHCC failed to appeal. For this reason, it is not a proper
13 appeal. Second, even if the court were to reach the issue, it finds MHCC’s argument
14 preposterous and unsupported, especially given the fact that the state trial court found
15 against MHCC on the related issue. Finally, there is no question that the bankruptcy court
16 possessed jurisdiction to oversee the administration of the Chapter 11 bankruptcy estate,
17 including MHCC’s obligations with respect to the Wilbur property, given that MHCC
18 voluntarily filed a Chapter 11 bankruptcy petition subjecting itself to the bankruptcy court’s
19 jurisdiction.

20 For all of these reasons, this claim fails.

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CONCLUSION

For the reasons set forth above, the court AFFIRMS the bankruptcy court's October 14, 2009 order denying the Alegres' motion for an order deeming the lease rejected, and its January 13, 2010 order denying both parties' motions for reconsideration.⁹

This order fully adjudicates the consolidated appeals and terminates all pending motions in both cases. The clerk shall close the files.

IT IS SO ORDERED.

Dated: February 25, 2011



PHYLLIS J. HAMILTON
United States District Judge

⁹Even though this court disagrees with the bankruptcy court's determination regarding the nature of the Wilbur lease as nonresidential, that issue does not impact the ultimate result, and the court affirms the bankruptcy court's denial of all of the challenged motions.