STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

In re: COUDERT BROTHERS LLP, Debtors.	
DEVELOPMENT SPECIALISTS, INC., in its capacity as Plan Administrator for Coudert Brothers LLP, Plaintiff-Appellant -v- 1114 6TH AVENUE CO. LLC, f/k/a, 1114 TRIZECHAHN-SWIG, L.L.C. Defendant-Appellee.	09 CIV. 5047 (DLC) OPINION & ORDER

Appearances:

For Appellant:
J. Joseph Bainton
John G. McCarthy
Smith, Gambrell & Russell
250 Park Ave., Suite 1900
New York, NY 10177

For Appellee:
Charles E. Boulbol
Law Office of Charles E. Boulbol
26 Broadway 17th Fl.
New York, NY 10004

DENISE COTE, District Judge:

This appeal from an order of the bankruptcy court raises the issue of when an amendment to a lease and the lease itself should be considered a single contract. Having assumed a lease while in bankruptcy, the debtor seeks to avoid the obligations

under the lease amendment by arguing that the lease amendment was a separate (and unassumed) contract. The bankruptcy court rejected its argument, and the bankruptcy court's dismissal of the avoidance action is affirmed.

BACKGROUND

The appellant is Development Specialists, plan administrator ("Appellant") for debtor Coudert Brothers LLP ("Coudert"), an international law firm. The appellee is 1114 6th Avenue Co. LLC f/k/a 1114 TrizecHahn-Swig LLC ("Landlord"), a company that owns the building at 1114 6th Avenue (the "Grace Building").

On February 26, 1992, Coudert entered into a lease agreement with the Landlord's predecessor-in-interest covering the entire fourth, thirty-seventh, and fortieth through forty-fifth floors of the Grace Building for a term expiring on May 30, 2013.[1] Coudert occupied portions of its space, and subleased the remainder to various tenants.

On September 23, 2005, the Landlord and Coudert executed an agreement entitled "Amendment of Lease" ("Lease Amendment"). Pursuant to the Lease Amendment, on October 1, 2005, the entire fourth, thirty-seventh, fortieth, forty-second, forty-third, and forty-fourth floors, as well as portions of the forty-first and forty-fifth floors were surrendered to the Landlord. On

[1] The Landlord bought the Grace Building in 1997.

December 31, 2006, the remainder of the forty-first floor was to be surrendered; and the expiration date on the remainder of the forty-fifth floor was amended to be June 30, 2008. As a condition of Coudert surrendering the forth, and forty-second through forty-fourth floors, the Landlord agreed to enter into a direct lease with Baker & McKenzie ("Baker") for those floors; Baker directly paid the Landlord $4.9 million and made "certain payments" to Coudert in connection with this provision. The Lease Amendment also provided for, inter alia, a reduction of Coudert's rent and the return of the $1 million letter of credit Coudert had given the Landlord as a security deposit. In addition, the space Coudert had been subleasing to tenants was assigned back to the Landlord. In exchange for entering this agreement, Coudert received $8.9 million.

On September 22, 2006, a year after executing the Lease Amendment, Coudert filed a voluntary petition for relief under chapter 11 of the Bankruptcy Code. On April 23, 2007, Coudert filed an application seeking authorization from the United States Bankruptcy Court for the Southern District of New York to assume and assign the remaining portions of the Lease. By an order of November 8, 2007 ("Assumption Order"), the bankruptcy court authorized Coudert to assume the remaining portion of the Lease (for the forty-fifth floor) and assign it to the law firm Teitler & Teitler ("Teitler"), which had been a subtenant of

Coudert's. The Assumption Order provides that the assumption and assignment of the Lease was

> Free and clear of (i) all liens . . ., (ii) all claims . . . demands, liabilities or restrictions of any kind, including without limitation, rights that purport to give any party a right or option to effect any forfeiture, modification or termination of the interest of any of the Debtor or Teitler, as the case may be, in the New York Lease,[2] and (iii) all taxes, claims or liabilities accruing during or relating to a period prior to April 30, 2007
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> . . . .
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> All defaults, claims or other obligations of the Debtor arising or accruing prior to April 30, 2007 under the New York Lease, if any, shall be deemed cured and satisfied by the Debtor, by the payment of the Cure Amount to Landlord.

On September 19, 2008, the Appellant filed a complaint in the bankruptcy court commencing an adversary proceeding against the Landlord. In its complaint, the Appellant sought to avoid and recover Coudert's transfers of space under the Lease Amendment. The Appellant asserted that Coudert had not received reasonably equivalent value or fair consideration for its transfers -- it claims Coudert should have received $10 million more than it did -- and that the Lease Amendment was made at a time when Coudert was insolvent.

On December 1, 2008, the Landlord moved to dismiss the complaint pursuant to Fed. R. Civ. P. 12(b)(6). United States Bankruptcy Judge for the Southern District of New York Robert

[2] This Opinion refers to the New York Lease as the Lease.

Drain heard oral argument on this motion on February 4, granted the Landlord's motion to dismiss in a March 5 ruling from the bench, and entered an Order granting the Landlord's motion to dismiss on April 20.

At the February 4 oral argument, Judge Drain heard, inter alia, parties' arguments about whether the Lease Amendment was a separate contract and therefore severable from the Lease that the Appellant admits it had assumed. Citing the provisions of the Lease Amendment that referred to Baker's rights and obligations, and the return of the security deposit, Judge Drain said "it seemed to me there was more going on in the document than just leaving those floors" that Coudert surrendered.

Before the March 5 conference, Judge Drain reviewed the Lease and Lease Amendment.[3] At the conference, he noted that the Lease Amendment provided for the partial surrender of Coudert's space, a modification of rent, the return or termination of Coudert's subleases, the return of part of Coudert's security deposit, and various payments. Judge Drain found the Lease Amendment to be a modification of the Lease, and not a separate agreement that could be severed. He found that the Appellant's

[3] Appellant contends that the Lease "was never made part of the record in the underlying Adversary Proceeding." Yet, Judge Drain referred at the March 5 hearing to "my review of the lease modification and the underlying lease (which again, I can consider and should consider in connection with the motion to dismiss. . .)."

effort to avoid the surrender of space prescribed in the Lease Amendment was barred because, pursuant to the Assumption Order, Coudert had previously assumed the Lease as it was modified by the Lease Amendment. Moreover, Judge Drain found that since Coudert's attempt to avoid the terms of the Lease Amendment was based upon a position that was contrary to Coudert's position when it applied for and obtained the Assumption Order, Coudert's avoidance action was also precluded under the doctrine of judicial estoppel.

The Appellant filed this timely appeal on April 29, 2009. The appeal became fully briefed on July 6, 2009.

DISCUSSION

District courts are vested with appellate jurisdiction over bankruptcy court rulings pursuant to 28 U.S.C. § 158(a), and may "affirm, modify, or reverse a bankruptcy judge's judgment, order or decree." Fed R. Bankr. P. 8013. On appeal, the legal conclusions of the bankruptcy court are reviewed de novo and the findings of fact are reversed only when they are "clearly erroneous." Id.; In re Tender Loving Care Health Svcs., Inc., 562 F.3d 158, 161 (2d Cir. 2009). While the bankruptcy court's findings of fact are not conclusive on appeal, "the party that seeks to overturn them bears a heavy burden." H & C Dev. Group, Inc. v. Miner (In re Miner), 229 B.R. 561, 565 (2d Cir. 1999). The reviewing court must be left with a "definite and firm

conviction" that a mistake has been made. Ortega v. Duncan, 333 F.3d 102, 107 (2d Cir. 2003) (citation omitted). Mixed questions of law and fact are reviewed "either de novo or under the clearly erroneous standard depending on whether the question is predominantly legal or factual." Italian Colors Rest. v. Am. Express Travel Related Servs. Co. (In re Am. Express Merchants' Litig.), 554 F.3d 300, 316 n.11 (2d Cir. 2009) (citation omitted).

The Bankruptcy Code allows a debtor to renege on a contractual obligation to transfer interests if the transfer was fraudulent. Section 548 provides that any obligation to transfer interests may be avoided "if the debtor . . . received less than a reasonably equivalent value in exchange for such transfer or obligation; and was insolvent on the date that such transfer was made or such obligation was incurred." 11 U.S.C. § 548; accord In re Red Dot Scenic, Inc., 351 F.3d 57, 58 (2d Cir. 2003) (per curiam).

But if a debtor in bankruptcy assumes a contract, it must honor its obligations under that contract. Section 365 of the Bankruptcy Code provides that "the trustee, subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor" and must "provide[] adequate assurance of future performance under such contract or lease." 11 U.S.C. § 365. See also 11 U.S.C. § 1107 (giving equivalent

powers and rights to debtors-in-possession). Accord In re Ionosphere Clubs, Inc., 85 F.3d 992, 998-99 (2d Cir. 1996). "[C]ontract assumption is an important re-organizational tool." In re Wireless Data, Inc., 547 F.3d 484, 488 (2d Cir. 2008).

> The main purpose of Section 365 is to allow a debtor to reject executory contracts in order to relieve the estate of burdensome obligations while at the same time providing a means whereby a debtor can force others to continue to do business with it when the bankruptcy filing might otherwise make them reluctant to do so.

In re Chateaugay Corp., 10 F.3d 944, 954-55 (2d Cir. 1993) (citation omitted). The debtor's assumption of a contract entitles all parties to the contract to the rights and obligations embodied therein. See In re TSW Stores of Nanuet, Inc., 34 B.R. 299, 304 (Bank. S.D.N.Y. 1983) ("Assumption carries with it all of the burdens as well as the benefits of the contract. The contract must be rejected in its entirety, or not at all.") (emphasis in original) (citation omitted). "Where a debtor has been permitted by the bankruptcy court to assume a contract pursuant to § 365, equitable estoppel principles may be applied by the court to deny the debtor permission to escape its obligation to perform the contract it assumed." In re Ionosphere Clubs, 85 F.3d at 1000. If a debtor attempts to avoid as fraudulent a transfer that was made pursuant to a contract the debtor has assumed under Section 365, it is appropriate to dismiss the avoidance action at the pleading

stage. In re Network Access Solutions, Corp., 330 B.R. 67, 75-77 (Bankr. D. Del. 2005); In re Vision Metals, Inc., 325 B.R. 138, 145-47 (Bankr. D. Del. 2005).

A central issue in this case is whether the Lease and Lease Amendment are one entire contract that Coudert assumed, or two severable contracts, only the former of which was assumed. "For purposes of section 365, interpretation of the legal status of lease agreements is governed by state law." In re S.E. Nichols Inc., 120 B.R. 745, 748 (Bankr. S.D.N.Y. 1990). There is no dispute that New York law governs the contract at issue, given the interests of the parties and the location of the Grace Building. See Schwartz v. Liberty Mut. Ins. Co., 539 F.3d 135, 151-52 (2d Cir. 2008). Under New York law, "[w]here a lease is subsequently modified, the lease and the modification must be taken together and construed as one contract." In re S.E. Nichols Inc., 120 B.R. at 748. To determine whether a particular lease has been modified by a subsequent agreement or, alternatively, the subsequent agreement constitutes a separate a contract, courts must look at the substance of the lease rather than at its form or title. Id.

> As a general rule, a contract is entire when by its terms, nature, and purpose, it contemplates and intends that each and all of its parts and the consideration therefor shall be common each to the other and interdependent. On the other hand, the contract is considered severable and divisible when

> by its terms, nature, and purpose, it is susceptible of division and apportionment.

First Sav. & Loan Ass'n of Jersey City, N. J. v. American Home Assur. Co., 29 N.Y.2d 297, 299-300 (N.Y. 1971). A subsequent agreement modifies a lease if "any original provision of the earlier agreement was altered, changed, deleted, or cancelled by the subsequent agreement." In re S.E. Nichols Inc., 120 B.R. at 749 (citation omitted). "Typically, legitimate lease modifications will include provisions reducing rent, or surrendering unexpired terms." Id. at 748 (citation omitted). "If the original agreement was altered, then New York law mandates characterization of the two agreements as one contract incapable of separate assumption and rejection under the Code." Id. at 749. "If a lease and its modifications are straightforward and unambiguous, the interpretation of the entire contract is a question of law for the court to make." 350 East 30th Parking, Ltd. v. Bd. of Mgrs. of 350 Condominium, 280 A.D.2d 284, 287 (N.Y. App. Div. 1st Dept. 2001).

Applying these principles, the bankruptcy court correctly determined that the Lease and Lease Amendment constitute a single contract, and that the Appellant's assumption of the Lease must also be deemed an assumption of the Lease Amendment. The Lease Amendment altered several terms of the Lease, permitting Coudert to, inter alia, surrender space, change the

term of the lease on its remaining space, reduce its rental payments, recover its security deposit, assign its subleased space to the Landlord, and collect payment from Baker. These modifications of the Lease through the execution of the Lease Amendment require the two documents to be construed as a single contract.

Relying on Nichols, 120 B.R. at 745, the Appellant argues that the Lease and Lease Amendment are two separate contracts, with the Lease Amendment being a contract that does nothing more than reduce Coudert's share of space and rent pro rata. The Appellant argues that under the Assumption Order it assumed only one of the contracts -- the Lease, and not the Lease Amendment with its transfer provisions.

Nichols does not help the Appellant. In that case, the debtor had a lease for the second and third floors of a building. A lease amendment added the fourth floor and increased the overall rent. The bankruptcy court did not determine whether the amendment constituted a modification or a separate lease, because it could not assess whether the marginal increase in rent was pro rata, and therefore ascribed solely to the fourth floor. The court said that if the amendment merely included the additional subject matter of the fourth floor and did not substantively change provisions in the underlying lease

the amendment would count as a severable contract. 120 B.R. at 749-51.

As already described, the Lease Amendment in this case went far beyond simply adding subject matters to the underlying lease. It made a number of changes to the Lease, including surrendering Coudert's unexpired rights to space, changing the term of the lease in the remaining space, and reducing the rent. These changes fall squarely within Nichols's examples of "legitimate lease modifications" –- "provisions reducing rent, or surrendering unexpired terms." Id. at 748. In addition, the Lease Amendment returned Coudert's security deposit, assigned Coudert's subleases to the Landlord, and created new obligations between the Landlord, Baker, and Coudert.

The Appellant next argues that the Lease Amendment's adjustment to Coudert's rent did not actually modify the original terms of the Lease because it did not change the rent per square foot. The Appellant argues that the bankruptcy court erred by "ignoring the pro rata nature of the changes to the terms of the New York Lease." It is unnecessary to determine whether the Lease Amendment contained a "modification of rent." Even if the Lease Amendment did not change the rent per square foot, its other provisions relating to Coudert's surrender of space, the Landlord's return of the security deposit, the assignment of subleased space to the Landlord, and obligations

involving Baker clearly modify the original Lease terms. The two instruments therefore comprise one contract, which the Appellant assumed under the Assumption Order.[4]

Finally, the Appellant does not contend that it should be allowed under Section 548 to avoid the terms of a contract that it has assumed under Section 365. Nor does it dispute that it assumed the Lease under Section 365. Since the Lease and Lease Amendment constituted one entire contract, which the Appellant assumed, the Appellant cannot now avoid the transfers it made pursuant to the Lease Amendment. The bankruptcy court's dismissal of the Appellant's avoidance action was proper.

CONCLUSION

The bankruptcy court's March 5, 2009 ruling and April 20, 2009 Order granting the Landlord's motion to dismiss the Plan Administrator-Appellant's complaint in this adversary proceeding is affirmed. The appeal is dismissed.

SO ORDERED:

Dated: New York, New York
September 4, 2009

DENISE COTE
United States District Judge

[4] Having considered these and Appellant's other arguments, and finding them to be without merit, it is unnecessary to reach the alternative grounds on which the bankruptcy court based its ruling.