

# Credit Memo

## Ninth Circuit Rules for Landlords in Bankruptcy Damages (Cap) Case

On October 1, 2007, the Ninth Circuit Court of Appeals provided real property landlords with a significant victory in *In re El Toro Materials Company, Inc.*, 07 C.D.O.S. 11811 (9<sup>th</sup> Cir. 10/1/07). The Court held that the statutory “cap” contained in Bankruptcy Code §502(b)(6), limiting damages “resulting from the termination of a lease of real property,” to “the rent reserved by such lease, without acceleration, for greater of one year, or 15 percent, not to exceed three years, of the remaining term of such lease,” did not limit the Landlord’s claim for millions of dollars in damages under theories of waste, nuisance, and trespass, where the Debtor left behind one million tons of its “wet clay goo” after terminating the lease. The Ninth Circuit Court of Appeals stated that the statutory language, limiting application of the “cap” to damages “resulting from” the rejection of the lease, did not apply to the Landlord’s collateral claim for property damage and clean-up costs because those claims did not result from the rejection of the lease. The Court adopted a “simple test” to determine whether or not claimed damages result from the rejection of the lease, and stated that the test is as follows:

Assuming all other conditions remain constant, would the landlord have the same claim against the tenant if the tenant were to assume the lease rather than rejecting it?

If the answer to that question is “yes,” as it was in the *El Toro Materials* case, the Landlord’s independent damages claims are not limited by Bankruptcy Code §502(b)(6). The Court observed that any other ruling would provide incentives to tenants who had committed waste to reject a real property lease to limit damages, even though the leasehold might be beneficial to the Bankruptcy Estate.

This ruling in appropriate cases provides landlords with a green light to try to be made whole when a bankrupt tenant rejects a lease after damaging the property and/or committing acts of waste or conversion.

*If you have any questions concerning this Credit Memo, please contact the Seyfarth Shaw LLP attorney with whom you work or any Bankruptcy attorney on our website at [www.seyfarth.com](http://www.seyfarth.com).*

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