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UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

CITY OF AKRON,	)	Case No. 5:96 CV 2276
	)	(Bankruptcy Court Case No. 96-50540)
Appellant,	)	
	)	Judge Sam H. Bell
	)	
vs.	)	REPORT AND RECOMMENDATION
	)	OF MAGISTRATE JUDGE
AIRSPECT AIR, INC.,	)	
	)	
Appellee,	)	Magistrate Judge James S. Gallas
	)	

This matter is before the Magistrate Judge upon referral of the appeal from the Bankruptcy Court's order of September 11, 1996 denying appellant City of Akron's motion requesting an order declaring nonresidential real property leases deemed rejected by operation of law and requesting termination of debtor's right of possession, surrender of premises, termination of lease and termination of automatic stay pursuant to 11 U.S.C. §365(d)(4).

The district court has jurisdiction over an appeal from the Bankruptcy Court in the same district pursuant to 28 U.S.C. §158. Further, pursuant to Bankruptcy Rule 8012, the Magistrate Judge finds after examination of the briefs and record that the appeal should be decided upon the briefs submitted without oral argument. This is a core proceeding governed by 28 U.S.C.

§157(b)(1) and (b)(2)(G) for which the decision is rendered in accordance with Bankruptcy Rules 9014, 7052 and 4001(a). Pursuant to Bankruptcy Rule 8013, the district court may affirm, modify or reverse a bankruptcy court's judgment, order a decree, or remand with instructions for further proceedings. For the reasons that follow, reversal is recommended.

Standard of Review:

Pursuant to Bankruptcy Rule 8013, the Bankruptcy Court's findings of fact "shall not be set aside unless they are clearly erroneous." The district court reviews the Bankruptcy Court's findings of fact under the clearly erroneously standard, and reviews its conclusions of law *de novo*. *Industrial Equipment Co. v. Emerson Elec. Co.*, 554 F.2d 276 (6th Cir. 1977); *In re Moreland*, 21 F.3d 102, 104 (6th Cir. 1994), *cert. denied* 115 S.Ct. 378 (1994); *In re Isaacman*, 26 F.3d 629, 631 (6th Cir. 1994).

Background:

The appellant the City of Akron [City] and appellee Airspect Air, Inc. [Airspect] are in consensus that the issues on appeal involve primarily issues of law. Because the facts were not in dispute the Bankruptcy Court's order contains minimal factual findings. However, for the sake of clarity, a general recitation of the underlying facts presented to the Bankruptcy Court upon which its September 6, 1996 oral decision was rendered in this case is presented. The City and Airspect had entered into an "Indenture of Lease" agreement in 1979 for a period of 50 years and an "Amended Indenture of Lease" in 1983, also to run for 50 years. Under the

agreements' terms Airspect was to build airport structures suitable for air frame and engine maintenance, flight instruction, aircraft sales and rentals, tie-downs and hangar rentals. The agreement was silent with respect to ownership of these leasehold improvements upon termination, except that pursuant to paragraph 17C of the 1983 amendment. In the event of breach of any of the non-discrimination covenants, the City would have the right to terminate the indenture of lease and repossess and land and facilities and hold the same as if the lease had never been issued. However, in all other respects the agreements were silent. Airspect was obligated for the payment of rent and fuel flowage fees to the City. Airspect under the terms of the 1983 amendment would only be compensated if the City by eminent domain appropriated the leased property (¶25). In the event of breach, First National Bank would have the right to remedy such breach and assume the lease (¶26).

As a part of the amended lease, the City was to pay for runway improvements up to $30,000.00 and Airspect was to carry the remainder of the burden. Investing nearly 1.7 million, Airspect constructed a 28,500 square foot building, hangar, ramp and fuel farm.

On December 22, 1992 the City notified Airspect by letter that it was in breach for failing to pay fuel flowage fees, delinquent rent payments and failing to pay the City for the amount of runway improvements exceeding $30,000.00.

Matters escalated when the City and Airspect began to accuse each other of breach prompting an action in the Summit County Court of Common Pleas, *First National Bank v. City of Akron, et al.*, Case No. 94-06-1978 involving the rights and obligations of Airspect and the City.

On March 13, 1996 Airspect filed a voluntary petition for Chapter 11 protection pursuant to 11 U.S.C. §301 and has continued in the management and operation of its business and properties as debtor-in-possession pursuant to 11 U.S.C. §1107 and 1108 of the code. No trustee or examiner has been appointed. In Chapter 11 cases, the duties of the trustee may be assumed by the debtor-in-possession pursuant to 11 U.S.C. §1107(a).

On June 27, 1996 the City filed a motion requesting an order declaring the nonresidential real property lease be deemed rejected by operation of law; termination of debtor's right to possession; surrender of premises; termination of lease; and termination of automatic stay pursuant to 11 U.S.C. §365(d)(4). A hearing was scheduled for August 21, 1996 and at the hearing the Bankruptcy Court made an oral finding that there was no action taken by Airspect within 60 days of the filing of the petition or to extend that period to take action to assume nonresidential property leases and therefore said lease was deemed rejected by operation of law.

On August 30, 1996 the Bankruptcy Court submitted an order setting a hearing on motion to leave to file amended cross-claim and on termination of the automatic stay. As part

of this order the Bankruptcy Court memorialized its finding that Airspect did not take the action required by 11 U.S.C. §365(d)(4) within 60 days of filing its petition and thus the lease was deemed rejected. However, the court denied the remainder of the City's motion by its September 11, 1996 order. The amended oral decision was transcribed and filed on November 20, 1996 with the following portions being relevant to the current appeal:

> The decision states:
>
> The issue in this proceeding is whether the City of Akron should be relieved of the restrictions that are imposed by the automatic stay . . .
>
> Page 4.
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> Movant's counsel suggested that the cause for granting relief from the automatic stay was the termination of the contract, by virtue of the failure of the debtor to take the steps necessary under 11 U.S.C. Section 365(d)(4). Again, because this Court does not view rejection as being the equivalent of termination, simply the rejection, if indeed that's what has occurred, is not in and of itself cause under the highly unusual circumstances of this case, for relief being granted from stay.
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> Page 5.
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> Among those highly unusual circumstances is the fact that the contractual relationship between the City and the debtor in possession is a ground lease on which significant improvements have been made by the Debtor. The extent of those improvements, I won't address, but the record appears to be undisputed that twenty-eight thousand, five hundred (28,500) square feet of commercial space, including twenty-two thousand (22,000) square feet of hangar space, has been developed on that property.
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> Page 6.
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> A motion for relief from automatic stay is largely procedural in nature. What it does is to clear the path for the nondebtor party to pursue remedies in some appropriate fashion. Here, the motion for relief from

> stay braided into it, in essence, a request for very significant, substantive relief: a finding that the contract was terminated. I'm not sure whether this was the intention of the moving party, but one could read the motion as seeking, in essence, a forfeiture of significant assets.
>
> In this Court's view, the automatic stay is not a vehicle for achieving substantive relief of issues which are currently the subject of litigation between the parties. It is not to shortcut either party's due process rights.

Pages 6-7.

In its appeal the City raises the following four arguments with their respective subparts:

I. THE BANKRUPTCY COURT ERRED AS A MATTER OF LAW BY FAILING TO CONCLUDE THAT THE REJECTION OF A NON-RESIDENTIAL REAL PROPERTY LEASE BY OPERATION OF LAW, TERMINATED THE LEASE AND/OR AMENDED LEASE BY AND BETWEEN THE APPELLEE AND THE APPELLANT.

II. THE BANKRUPTCY COURT ERRED AS A MATTER OF LAW BY FAILING TO CONCLUDE THAT THE APPELLEE'S POSSESSORY INTEREST UNDER A NON-RESIDENTIAL REAL PROPERTY LEASE TERMINATED UPON SAID LEASE BEING DEEMED REJECTED BY OPERATION OF LAW AND FAILING TO ISSUE AN ORDER ENTITLING THE APPELLANT TO IMMEDIATE POSSESSION OF THE SUBJECT PROPERTY AND DIRECTING APPELLEE TO SURRENDER POSSESSION PURSUANT TO BANKRUPTCY CODE §365(d)(4).

A. By Operation Of Section 365(d)(4) The Appellee's Possessory Interest In The Subject Property Terminated And The Appellant's Right To Immediate Surrender Simultaneously Accrued.

B. The "Deemed Rejection" Of The Lease And/Or Amended Lease Had The Effect Of Terminating The Appellee's Enterprise Operating At The Subject Property And The Forfeiture Of The Improvements.

III. THE BANKRUPTCY COURT ERRED AS A MATTER OF LAW BY FAILING TO CONCLUDE THAT THE APPELLEE'S NON-RESIDENTIAL REAL PROPERTY LEASE WAS NO LONGER PROPERTY OF THE BANKRUPTCY ESTATE WHEN IT WAS DEEMED REJECTED AND EXCLUDED FROM THE OPERATION OF THE AUTOMATIC STAY.

IV. THE BANKRUPTCY COURT ERRED AS A MATTER OF LAW IN FAILING TO CONCLUDE THAT WHEN A NON-RESIDENTIAL REAL PROPERTY LEASE IS DEEMED REJECTED BY OPERATION OF LAW, THE AUTOMATIC STAY AS TO THE LEASE PREMISES IS TERMINATED AS WELL.

A. The Bankruptcy Court Erred As A Matter Of Law By Failing to Conclude That The Automatic Stay Terminated As A Result Of The Deemed Rejection And Termination Of The Non-Resident Real Property Lease.

B. The Bankruptcy Court Erred As A Matter Of Law Because The Automatic Stay Was Terminated By Operation Of Law Pursuant To Section 362(b)(10) Of The Code.

C. The Bankruptcy Court Erred As A Matter Of Law By Failing To Conclude That Immediate Possession And Surrender Of The Subject Property As Provided Under §365(d)(4) Does Not Require The Appellant To Seek Relief Of The Automatic Stay.

I.

Section 365(d)(4) of the Bankruptcy Code provides in relevant part:

> . . .[I]f 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.* (emphasis supplied).

With respect to the City's first two arguments in this appeal, the Bankruptcy Court did not err in concluding that the "rejection" of the nonresidential real property lease by operation of law did not terminate the lease and/or amended lease.

In reaching this conclusion, the court must first examine whether the Indenture of Lease and its amendment constitutes a "lease" for purposes of §365. Airspect argues the case does not present a problem that §365(d)(4) was enacted to remedy, citing the fact that provision was part of the "Shopping Center Bankruptcy Amendment of 1984." Airspect argues that the present lease involved a 50 year ground lease for an airport hangar facility and that there has been no diminution in value due to Airspect's continued occupancy and further that Airspect has made nearly 1.7 million dollars in improvements.

There is no question that §365(d)(4) has caused more than its share of consternation and has been judicially interpreted to limit its application to only "true or bona fide" lease situations, as opposed to financing transactions. *In re Moreggia & Sons, Inc.*, 852 F.2d 1179, 1182 (9th Cir. 1988); *In re PCH Associates*, 804 F.2d 193, 198 (2nd Cir. 1986); *In re Port Angeles Waterfront Associates*, 134 B.R. 377, 379 (9th Cir. BAP 1991); *International Trade Admin. v. Rensselaer Polytechnic Institute*, 936 F.2d 744, 748 (2nd Cir. 1991); *Matter of Lansing Clarion Ltd. Partnership*, 132 B.R. 845, 850 (Bankr. W.D. Mich. 1991); *In re Lunan Family*

Restaurants, 194 B.R. 429, 450 (Bankr. N.D. Ill. 1996). The interpretation of the statute is a question of law subject to *de novo* review. *In re Port Angeles*, 134 B.R. at 379; *In re Moreggia & Sons, Inc.*, 852 F.2d at 1181; *In re Holm*, 931 F.2d 620, 622 (9th Cir. 1991). Courts attempt to narrow the scope of transactions affected by §365(d)(4) where "forfeiture" may occur. There is no question that both the common law and equity abhor a forfeiture. *United States v. $47,409.00 in United States Currency*, 810 F.Supp. 919, 927 (N.D. Ohio 1993); *Matter of Erie Lackawana Railway Co.*, 548 F.2d 621, 627 (6th Cir. 1977).[1] The court must analyze the circumstances to uncover the true economic substance of the lease arrangement. In resolving "economic realities of the transaction", several factors must be reviewed:

1. Is the rent calculated to compensate for the use of the land or to retire bond debt in a manner similar to repayment of a loan? *In re KAR Development Associates L.P.*, 180 B.R. 629, 639 (D. Kan. 1995); *In re Hotel Syracuse, Inc.*, 155 B.R. 824, 838-39 (Bankr. N.D. N.Y. 1993); *Matter of Lansing Clarion Ltd. Partnership*, 132 B.R. at 850-52.

2. Does the lessee hold an option to purchase the leased premises for "nominal" consideration? *Matter of Lansing Clarion Ltd. Partnership*, 132 B.R. at 850-52.

3. Does the lessee assume and discharge substantially all risks and obligations ordinarily attributed to ownership of the property? *Id.*

4. Is the rent on the ground lease paid in the first few years of the lease? *Id.*

5. Is there a sale-leaseback arrangement e.g. was the transaction constructed for tax benefit purposes? *Id.*

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[1] Case holding superceded by ERISA see *Cattin v. General Motors Corp.*, 955 F.2d 416, 425 (6th Cir. 1992).

6. Does the lessee retain a substantial interest ~~in~~ the leased premises after the expiration of the lease term? *Lunan*, 154 B.R. at 450.

7. Was the property purchased by the lessor specifically for the lessee's use? *KAR Development*, 180 B.R. at 639; *In re Hotel Syracuse, Inc.*, 155 B.R. at 838-39.

8. Did the lessee assume obligations normally reserved for the lessor? *Id.*

9. Was the lessee permitted to alter the facility without the lessor's consent? *In re KAR*, 180 B.R. at 639.

Overriding these factors, though, is a presumption that "what is denominated or labeled as a lease is presumed to be a true lease absent compelling factors to the contrary." *In re P.C.H. Associates*, 804 F.2d at 200; *Matter of Lansing Clarion*, 132 B.R. at 850; *In re Lunan Family Restaurants*, 194 B.R. at 450-51. This burden is upon the party seeking to overcome the presumption. *Lunan*, 194 B.R. at 451. None of the factors is alone dispositive but must be considered as a whole to determine whether the transaction was a lease or financing transaction under the "economic realities" test.

In the Indenture of Lease and amendment in issue, the rental payments were based upon "such amount as is necessary to yield the return of ten percent (10%) per year on the value of the land." The rent clearly was not an equivalent to a retirement of debt or repayment of a loan. Also rent was not paid early in the life of the lease but was a continuing obligation throughout the lease term.

The lease transaction fits neatly into the typical "triple net lease" which requires the lessee to be responsible for taxes, insurance and maintenance of the premises. See *Matter of Lansing Clarion*, 132 B.R. at 847. Thus, some obligations of ownership existed. See also *In re KAR*, 180 B.R. at 639. However, this lease situation in many ways is analogous to a shopping center. While Airspect was responsible for insurance, taxes and maintenance of its facilities, it utilized a runway which was operated by the City similar to the mechanism which exists between the store rental and the parking lot of a shopping center. Airspect did not control the runway on which its operation was dependent. Moreover, the real property had been owned by the City prior to the lease, so it was not purchased on behalf of Airspect and there was no sales-leaseback arrangement.

Finally, the City retained control over the property and its use. The City dictated hours of operation, the types of structures which Airspect could construct, the uses of these structures and the City retained the exclusive right to provide aeronautical services to the public or grant that right to others.

Based upon the foregoing factors, the Indenture of Lease and its amendment between Airspect and the City was in economic reality, just what it purported to be, a true "lease" governed by §365(d)(4). Consequently, the Bankruptcy Court did not err in finding that this provision governing nonresidential leases applies to the situation.

The impact of §365(d)(4) was correctly not avoided. This requires analysis of the implications arising from the final phase of §365(d)(4): "that such lease is deemed rejected, and the trustee shall immediately surrender such nonresidential real property to the lessor." Nonresidential real property leases are an exception to the general rule under Chapter 11 that when a debtor has failed to expressly assume or reject a pre-petition lease agreement, the lease will be unaffected by the bankruptcy. Compare *Matter of Greystone III Joint Ventures*, 98 F.3d 134, 141 (5th Cir. 1991), *cert. denied* 113 S.Ct. 72 (1992); *In re Polysat, Inc.*, 152 B.R. 886, 890 (Bankr. E.D. Pa. 1993). And 365(a). Nonresident real property leases must be assumed within 60 days following the order for relief or upon debtor's motion to extend time to assume or reject otherwise they are "deemed rejected." See 11 U.S.C. §365(d)(4) and (5).

The debtor technically may have no equity in the leasehold, but at least initially an unexpired nonresidential lease is deemed property of the estate pursuant to 11 U.S.C. §541(a)(1). *Manhattan King David Restaurant, Inc. v. Levine*, 154 B.R. 423, 429 (S.D. N.Y. 1993). Even though the unexpired lease is property of the estate, the debtor cannot assume it unless at the time of the assumption the debtor:

> (A) cures, or provides adequate assurance that the trustee will promptly cure, such [lease] default;
>
> (B) compensates, or provides adequate assurance that the trustee will promptly compensate, a party other than the debtor to such contract or lease, for any actual pecuniary loss to such party resulting from such default; and

> (C) provides adequate assurance of future performance under such contract or lease.

11 U.S.C. §365(b)(1); and see *Manhattan King David Restaurants, Inc.*, 154 B.R. at 429; *In re Flexipak, Inc.*, 49 B.R. 641, 643 (S.D. N.Y. 1985). If the debtor does not satisfy the requirements within 60 days or within the extended period as the court shall allow, the lease is deemed rejected by operation of law. *In re Flexipak, Inc.*, 49 B.R. at 643; *In re Fosko Markets, Inc.*, 74 B.R. 384 (Bankr. S.D. N.Y. 1987); *Manhattan King David Restaurant*, 154 B.R. at 429.[2]

However, the City is incorrect in its contention that the "rejection" by operation of law is tantamount to "termination," although there is case law from which such conclusion could be drawn. In *Sea Harvest Corp. v. Riviera Land Co.*, 868 F.2d 1077 (9th Cir. 1989), the court stated, "[s]urrender of the property, whether its use is for a retail store in a mall or a clam harvesting operation in the tidelands, has the effect of terminating the enterprise that operates there. If Congress intended passive rejection of a lease to be subject to court approval, it would

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[2] Only when the debtor establishes cause may the court extend the 60 day provision of §365(d)(4) without regard to §365(d)(3). *In re Perfectlite Co.*, 116 B.R. 84, 86 (Bankr. N., D. Ohio 1990); *In re Wedtech Corp.*, 72 B.R. 464, 472 (Bankr. S.D. N.Y. 1987); *In re Beker Indus. Corp.*, 64 B.R. 890, 898 (Bankr. S.D. N.Y. 1986). This, however, is not an issue in this appeal since no extension was requested nor granted to Airspect. Consequently, there was no error in the Bankruptcy Court's decision on this point because the leasehold was deemed rejected by operation of law.

not have required the drastic step of immediate surrender." *Id.* at 1080-81. The City has produced a list of the numerous cases which hold that rejection is "termination."

Nevertheless, the better view is that "rejection" and "termination" are distinct concepts. 11 U.S.C. §365(g) specifically states . . . "the rejection of an executory contract or unexpired lease of the debtor constitutes a breach of such contract or lease . . ." Under the Bankruptcy Code rejection does not mean the executory contract or lease has been terminated -- only that a breach has been deemed to occur. *Matter of Austin Development Co.*, 19 F.3d 1077, 1082 (5th Cir. 1994); *In re Modern Textile, Inc.*, 900 F.2d 1184, 1191 (8th Cir. 1990); *Leasing Service Corp. v. First Tennessee Bank National Assoc.*, 826 F.2d 434, 436-37 (6th Cir. 1987). In view of the Sixth Circuit's holding on this issue in *Leasing Service Corp.*, the District Court and the Bankruptcy Court are bound not to equate rejection with "termination." A claim arises from "rejection" of an unexpired lease under §365 which may be allowed against the estate pursuant to §502(g). See *Matter of Austin Development Co.*, 19 F.3d at 1084. This distinction between rejection as "breach" versus "termination", while not critical to the facts at hand, is crucial where subleases are involved creating third party interests in the leases. *Id.* Consequently, the

Bankruptcy Court did not err on this point of law.[3] Rejection of a lease obligation has the effect of breach of contract.

Since rejection is not termination, but is a deemed breach of the lease, the implications which arise as to what is the effect of this breach require discussion. This issue has been recently analyzed in *In re Lavigne*, 114 F.3d 379 (2nd Cir. 1997). Rejection merely frees the estate from the obligation to perform; it does not make the contract disappear." *Id.*, 114 F.3d at 387; *In re The Drexel Burnham Lambert Group*, 138 B.R. 687, 703 (Bankr. S.D. N.Y. 1992); and see *Austin Development Group*, 19 F.3d at 1082-83. The debtor's obligations are unaffected by rejection and the non-debtor would generally have their claims treated a pre-petition, with their rights determined according to state law. *In re Lavinge*, 114 F.3d at 387.[4]

II.

Although the lease was rejected and is deemed to have been breached pursuant to §365(d)(4) and §365(g)(1), the Bankruptcy Court allowed Airspect, as debtor-in-possession, to

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[3] *Leasing Service Corp. v. First Tenn. Bank Nat. Assoc.*, 826 F.2d 434 (6th Cir. 1987) discussed identical wording under §365(d)(1) governing leases of personal property which reads " . . . if the trustee does not assume or reject an executory contract or unexpired lease of . . . personal property of the debtor within 60 days after the order for relief . . . then such contract or lease is deemed rejected. *Id.* at 436 n. 1.

[4] There are situations when rejection or deemed rejection of an unexpired lease of real property constitutes a "termination" as set out in §365(h)(1) and (i) which occur when there is a sale of real property or sale of a time share interest. These provisions have no application to the circumstances in this case.

retain the leasehold as property of the estate by denying the City's motion for relief from automatic stay. This is the subject of the City's third and fourth grounds in this appeal. The key point is whether it matters if rejection is deemed "termination" or "breach". It does not matter. The governing statute §365(d)(4) clearly requires "immediate surrender," regardless.

The statute, §365(d)(4), is quite plain. Upon rejection, or rejection by operation of law, "the trustee shall immediately surrender such nonresidential real property to the lessor." Unless the lease is timely and properly assumed and with the debtor satisfying the care and adequate assurance provisions contained within §365(b)(1), the result is immediate surrender of the premises. *In re Flexipak, Inc.*, 49 B.R. at 643; *In re Chris-Kay Foods East, Inc.*, 118 B.R. 70, 72 (Bankr. E.D. Mich 1990); *Matter of Austin Development Co.*, 19 F.3d at 1084; *In re Morningstar Enterprises*, 128 B.R. at 105-06. The Bankruptcy Court erred in not permitting surrender of the property, apparently due to the fact that Airspect had made substantial investment.

In re Locke, 180 B.R. 245 (Bankr. C.D. Calif. 1995) and *In re Port Angeles Waterfront Associates*, 134 B.R. 377 (9th Cir. BAP 1991) are particularly illustrative of forfeiture in ground lease situations such as this one. Although the forfeiture may result in termination of the business and may involve a substantial amount of investment of the debtor in the ground lease, those concerns do not override the plain meaning of §365(d)(4).

There are only procedural issues concerning the method of immediate surrender. There is a distinct minority represented by such cases as *In re Boston Business Machines*, 87 B.R. 867 (Bankr. E.D. Pa. 1988); *In re Adams*, 65 B.R. 646, 649 (Bankr. E.D. Pa. 1986); *In re Re-Trac Corp.*, 59 B.R. 251 (Bankr. D. Minn. 1986); *In re Cybernetic Services, Inc.*, 94 B.R. 951, 954 (Bankr. W.D. Mich. 1989); *In re Morningstar Enterprises*, 128 B.R. at 105, and *In re Williams*, 171 B.R. 420 (Bankr. S.D. Ga. 1994), which hold before the lessor can physically possess the leased premises under the immediate surrender language, the lessor must obtain an order of relief from stay to be followed by state eviction proceedings before the lessor can physically possess the leased premises. Further *Re-Trac* and *Williams* both stand for the proposition that direct relief by way of order to surrender and vacate premises from the bankruptcy court itself may only be obtained under Bankr. Proc. Rule 7001(1) by way of complaint in adversary proceeding. Thus for example in *Re-Trac* the court rejected the request for a bankruptcy court order to immediately surrender and vacate the premises, but did modify the §362 automatic stay to allow the landlord to pursue its state law remedies of eviction.

The reasoning behind these cases is that these courts followed a more familiar approach to the situation by placing §365(g)(1) rejections on common footing with the trustees avoidance powers under 11 U.S.C. §544, 547 and 548. These extraordinary powers may only be exercised by way of an adversary proceeding. *Matter of Austin Development Co.*, 19 F.3d at 1083; *In re Locke*, 180 B.R. at 260. These avoidance powers provided by Congress insure that the property

constituting the bankruptcy estate is fairly distributed and that the administration of the bankruptcy case is carried out efficiently.

However, once the lease is deemed rejected, the property must be "immediately surrendered" and the Bankruptcy Court for all intents and purposes loses control over its distribution because the leasehold is no longer part of the bankruptcy estate. The majority view holds that upon rejection of the lease, the Bankruptcy Court is authorized to order immediate surrender of the debtor's nonresidential real property to the lessor without resorting to state law or necessity for adversary proceeding. See *In re Elm Inn, Inc.*, 942 F.2d 630, 633 (9th Cir. 1991); *In re Flexipak*, 49 B.R. at 642-43; *In re BSL Operating Corp.*, 57 B.R. 945, 947 (Bankr. S.D. N.Y. 1986); *In re Tri-Glied Ltd.*, 179 B.R. 1014, 1019 (Bankr. E.D. N.Y. 1995); *In re Damianopoulos*, 93 B.R. 3, 7 (Bankr. N.D. N.Y. 1988); *In re 6177 Realty Assoc., Inc.*, 142 B.R. 1017, 1019-20 (Bankr. S.D. Fla. 1992) (lessor entitled to immediate possession but also equating rejection with termination of the lease); *In re Fosko Markets, Inc.*, 74 B.R. 384, 390 (Bankr. S.D. N.Y. 1987); *In re Hearst Lincoln-Mercury, Inc.*, 70 B.R. 815, 817 (Bankr. S.D. Ohio 1987); *In re U.S. Fax, Inc.*, 114 B.R. 70, 73 (Bankr. E.D. Pa. 1990). *In re Chris-Kay Foods East, Inc.*, 118 B.R. 70, 72 (Bankr. E.D. Mich. 1990).

Airspect maintains that the Bankruptcy Court's order denying relief for stay is based upon the court's equitable powers and refers to *In the Matter of Curio Shoppes, Inc.*, 55 B.R. 148 (Bankr. D. Conn. 1985), which similar to Airspect's circumstances involved the debtor

where rejection of the lease and subsequent forfeiture would undermine reorganization. *Curio Shoppes* held the equitable powers of the organization override the "statutory presumption." *Id.* 55 B.R. at 154. However:

> The bankruptcy court's equitable powers emanate from section 105, which provides that 'the court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title.' 11 U.S.C. §105(a). Careful reading of this section indicates that the court is only empowered to issue orders, etc. that are necessary to carry out the provisions of this title. The court is not empowered to so broadly interpret a code section *as to nullify it*. (emphasis supplied.)

In re Sonora Convalescent Hospital, Inc., 69 B.R. 134, 138 (Bankr. E.D. Calif. 1986).

In re Elm Inn, Inc. held that it was this equitable power under §105(a) which permitted granting an application to surrender property to the lessor. *Id.*, 942 F.2d at 634.

"If Congress intended passive rejection of a lease to be subject to court approval, it would not have required the drastic step of immediate surrender." See *Sea Harvest Corp. v. Riviera Land Co.*, 868 F.2d at 1080-81; *In re Locke*, 180 B.R. at 253. The deemed rejection under §364(d)(4), "while not necessarily extinguishing the rights of nondebtor third parties nevertheless automatically extinguishes the rights therein of the debtor and/or bankruptcy trustee." *In re Elephant Bar Restaurant, Inc.*, 195 B.R. 353, 356 (Bankr. W.D. Pa. 1996);

Matter of Austin Development Co., 19 F.3d at 182-84; *In re Locke*, 180 B.R. 245, 254-56. Consequently, the Bankruptcy Court did err in interpreting the law when it denied the City's motion filed June 27, 1996 to surrender the premises and terminate the lease and terminate the automatic stay.

Finally, the City brings up a subargument that the Bankruptcy Court erred as a matter of law because the automatic stay was terminated by operation of law pursuant to §362(b)(10) of the Code, which governs leases terminated upon expiration of their stated terms. The City maintains that if the lease and amended lease are terminated as a result of rejection by operation of law then according to case precedent the termination is deemed effective as of the date the debtor filed the bankruptcy petition. The City's argument in reading of §362(b) is based on *In re Urbanco, Inc.*, 122 B.R. 613 (Bankr. W.D. Mich. 1991). *Urbanco* is in reality a rationalization to support the minority view of an earlier bankruptcy case from the Western District of Michigan, *In re Cybernetics*. *Cybernetics*, as explained previously, is one of those line of cases following the minority view that state action is necessary to effect possession of the property to the lessor. *Urbanco* reaffirmed the view that state eviction action was necessary, "if the debtor does not voluntarily comply with the court's surrender order." *Urbanco*, 122 B.R. at 519. The court then added that the lease "terminated" upon rejection, so that an earlier order to permit the lessor to proceed to state court had become superfluous. *Urbanco*'s rationalization demonstrates the flaws of the minority view. §362(b)(10) clearly applies to a very restricted area of leases of nonresidential real property which have *terminated* upon the expiration of their

stated terms. The leases in question between the City and Airspect were to run for 50 years and clearly have not "terminated" by expiration of their terms.

An order granting relief from the stay would be superfluous when §541(b)(2) and 362(b)(10) are read together because such a lease is not "assumable." The City's contention has no merit. Pursuant to §541(b)(2) the property of the estate does not 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 before the commencement of the case . . . and ceases to include any interest of the debtor as a lessee under the lease of nonresidential real property . . . of such lease during the case." Under these provisions the automatic stay of §362 does not operate because the lease which expired by its own terms *is not part of the estate*.

The Indenture of Lease and its 1983 amendment had not yet expired upon their stated terms when the voluntary petition was filed. Initially these leaseholds were potentially "assumable." Under §365(c)(3) the lease must have been "terminated under applicable non Bankruptcy law *prior to the order for relief* (emphasis added)." Thus there is no basis for treating the deemed rejection of a potentially assumable lease as "terminated", because no "termination" by operation of state law occurred prior to the order of relief. Compare *In re DiCamillo*, 206 B.R. 641 (Bankr. D. N.J. 1997) (nonresidential debtor may assume unexpired lease only if lease has not been terminated pre-petition under state law).

The interpretation in *Urbanco* of §362(b)(10) is therefore flawed. That provision clearly relates to those leases which were not assumable or became nonassumable during the case. In those situations the automatic stay under §362 simply dissolves. This statutory scheme to be followed under §365(d)(4), rather than simply dissolving the automatic stay clearly provides for immediate surrender of the nonresidential real property to the lessor. No automatic stay is necessary to achieve this and for all intents and purposes §362 is simply bypassed. As mentioned earlier, many bankruptcy courts are apparently uncomfortable with this because it departs from the normal course of events of the bankruptcy courts overseeing the orderly and efficient administration of the assets. Nonetheless, it is the law, and the Bankruptcy Court clearly erred by its failure to immediately surrender Airspect's leasehold premises to the City of Akron.

CONCLUSION AND RECOMMENDATION

For the foregoing reasons, it is recommended that the decision of the Bankruptcy Court be modified and reversed and an order from the District Court should issue entitling the City to immediate possession pursuant to 11 U.S.C. §365(d)(4), moreover, for purposes of allowance

of claim and administration of such claim, the rejection should continue to be treated as a "breach" in the Bankruptcy Court's administration of the petition.

James S. Gallas
United States Magistrate Judge

ANY OBJECTIONS to this Report and Recommendation must be filed with the Clerk of Court within ten (10) days of receipt of this notice. Failure to file objections within the specified time WAIVES the right to appeal the Magistrate Judge's recommendation. *See*, *United States v. Walters*, 638 F.2d 947 (6th Cir. 1981); *Thomas v. Arn*, 474 U.S. 140, 106 S.Ct. 466, 88 L.Ed.2d 435 (1985).