The Application of § 502(b)(6) to Nontermination Lease Damages: To Cap or Not to Cap?

by

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INTRODUCTION

Section 502(b)(6) of the Bankruptcy Code (the “Code”) caps a creditor-landlord’s allowed claim against a debtor-tenant’s bankruptcy estate. Specifically, the statute limits a landlord’s “damages resulting from the termination of a lease of real property” to an amount equal to the rent the debtor-tenant would have paid for a period of one to three years, depending on the remaining term of the lease.1

There is no disagreement that the provision caps a landlord’s loss of unrealized future payments of rent, taxes, and other rent-like charges. Instead of allowing landlords to claim several years or decades of future rent, which may be mitigated by reletting the premises, the cap strikes a balance and allows landlords to claim one to three years of future rent and rent-like charges.2

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111 U.S.C. § 502(b)(6). The landlord’s allowed claim additionally includes damages for unpaid rent outstanding on the earlier of the date of the bankruptcy filing or repossession or surrender of the premises. Id. § 502(b)(6)(B).

2Some might argue that the § 502(b)(6) cap is unnecessary because of the typical contract-law requirement that a landlord mitigate its damages resulting from a tenant’s breach. They would argue that, if the landlord is not able to mitigate damages — e.g., is unable to relet the premises for five years instead of three years — there is no reason to shift the loss of two years’ rent from the debtor to the landlord and allow the debtor, especially a reorganizing debtor-in-possession, to avoid the consequences of entering the lease and subsequently breaching it. Others might argue the cap reflects a policy decision that the Code
Courts disagree, however, on whether the provision caps damages for past breaches of non-rent (or non-rent-like) lease covenants, such as a tenant's contractual obligation to maintain and repair the premises. If a tenant destroys the leased premises or leaves equipment or waste on the premises, should the landlord's claim for damages resulting from these actions be capped? Is the landlord's claim for "damages resulting from the termination of a lease of real property"? Courts that apply the provision narrowly do not cap damages that the landlord would have suffered regardless of the premature termination of the lease. Courts that apply the provision expansively cap all of a landlord's damages, including damages arising from the tenant's past failure to maintain or repair the premises.

The essential points of agreement and disagreement — and the practical consequences — can be easily illustrated. For example, a landlord that agrees to reconstruct a portion of the premises to accommodate a new tenant's needs does so exclusively because the former tenant terminated the lease and the landlord was forced to relet and accommodate a new tenant. Most would agree that the cap applies to these damages. A landlord that must rebuild several interior walls because a former tenant intentionally removed them in violation of a covenant not to remove walls or structures, however, reconstructs the premises merely to return the premises to their original condition. Although termination may have occasioned the landlord's discovery of the destruction, the need to reconstruct the premises is not to customize for a new tenant but to make the premises presentable enough to show to new tenants (or perhaps to make the premises structurally sound). This Article is focused, not on these policy issues, but on the proper application of the cap.


article explores whether the Code requires two such landlords to be treated identically under § 502(b)(6) — or, put differently, whether both of these landlords' claims are subject to the § 502(b)(6) cap.

The stakes can be high for tenants, landlords, and unsecured creditors in bankruptcy. Consider a tenant that conducts mining operations and stockpiles mining waste instead of removing it as the lease or environmental laws might require. Or consider an office-building tenant that conducts secret experiments in an interior laboratory that the tenant structurally modifies, contrary to the lease. In either case, a landlord's cost of repair and restoration (not customization) before reletting could exceed several million dollars. Meanwhile, the rent reserved by the lease — and thus the § 502(b)(6) cap on damages — may be a fraction of that amount. Either tenant may file for bankruptcy and reject the lease in an effort to avoid the millions of dollars in damages to which the landlord may be entitled.

Of course, this strategy is effective only if § 502(b)(6) caps the damages the tenant seeks to avoid. If the provision is read expansively to cap such repair and restoration damages, the entire cost of the repair and restoration is shifted from the tenant to the landlord. The tenant escapes liability for millions of dollars it rightfully owed, while other creditors' claims are not reduced proportionately by the landlord's damages claim. However, if the provision is read narrowly, i.e., not to cap repair and restoration damages, the landlord collects its proportionate share of the estate commensurate with other unsecured creditors. In the latter case, though, the debtor's other unsecured creditors may have their recovery reduced substantially because of the dilutive effect of the landlord's claim.

The issue garnered attention most recently in the decision by the Ninth Circuit Court of Appeals in Saddleback Valley Community Church v. El Toro Materials Co. (In re El Toro Materials Co.). The El Toro court held that a landlord's claim for an estimated $23 million in damages for "waste, nuisance and trespass" did not result from the termination of the lease but from tortious acts of the debtor-tenant in stockpiling tons of mining waste on the property. The court concluded that the landlord's damages were not recoverable under § 502(b)(6) because they were not the result of the debtor's bankruptcy.

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5E.g., El Toro, 504 F.3d at 980 n.2 (cost of removal of debtor-tenant's mining waste was estimated at $23 million on premises leased for $28,000 per month).
6E.g., El Toro Materials Co. v. Saddleback Valley Cnty. Church (In re El Toro Materials Co.), No. CC-04-1287, slip op. at 20 (B.A.P. 9th Cir. July 8, 2005) (observing that El Toro's response to the landlord's notice of alleged breach "was to seek chapter 11 relief, and in that bankruptcy case, to reject the lease"), rev'd, El Toro, 504 F.3d at 982. But see NMSBPCSLDHB, L.P. v. Integrated Telecom Express, Inc. (In re Integrated Telecom Express, Inc.), 384 F.3d 108, 112 (3d Cir. 2004) (ordering dismissal of debtor's chapter 11 case for bad faith, where solvent debtor sought bankruptcy protection primarily to reject lease and shift losses from equity holders to the landlord).
7Avoiding the cap does not guarantee the landlord payment of 100% of its claim. The claim may only be paid in pennies on the dollar, pro rata with other unsecured creditors.
the leased premises. The court concluded that the damages were not capped by § 502(b)(6).

The ruling was notable for overruling a longstanding and expansive application of the cap by the same circuit’s Bankruptcy Appellate Panel in Kuske v. Mc Sheridan (In re Mc Sheridan). Before El Toro, Mc Sheridan was the only appellate ruling on the cap’s application. The courts of appeals had only considered the issue indirectly or in dicta. The Supreme Court denied certiorari in El Toro, so courts outside the Ninth Circuit remain divided on the cap’s application. For example, just a few months before the Ninth Circuit’s El Toro ruling, the Delaware bankruptcy court joined other courts that had adopted Mc Sheridan’s expansive formulation of the cap.

The purpose of this Article is to demonstrate that § 502(b)(6) caps only those damages authorized under applicable nonbankruptcy law that are triggered by the termination of a lease, regardless whether termination occurs before or after the petition date. This conclusion follows from either a textual interpretation of the section’s key terms, or a review of the legislative history surrounding the enactment and evolution of the cap. The statute, its legislative history, and public policy all demonstrate that the cap does not limit claims for nontermination damages bearing no relationship to the rental value of the leased premises. The cap does not limit damages for repair, maintenance, and other injuries not traceable to a lease’s termination.

Part I of this Article examines the language of § 502(b)(6) and concludes that a plain reading of the section does not cap damages for repair and maintenance unless they result from a termination of the lease. Part II examines its legislative history, dating back to the allowance of future rent claims in 1933, and demonstrates that there was no congressional intent to eliminate a landlord’s historical right to assert a “provable” claim for damages when the facts necessary to establish a claim existed at the time of bankruptcy. Part III

10Id. at 980–81.
11Id.
12Kuske v. Mc Sheridan (In re Mc Sheridan), 184 B.R. 91 (B.A.P. 9th Cir. 1995), overruled in part by El Toro, 304 F.3d at 982.
13E.g., Capitol Indus., Inc. v. Regal Cinemas, Inc. (In re Regal Cinemas, Inc.), 393 F.3d 647, 651 (6th Cir. 2004) (application of the cap stipulated by the parties and so not analyzed); First Bank Nat’l Assoc. v. FDIC, 79 F.3d 362, 366 n.4, 367 (3rd Cir. 1996) (interpreting and applying the limits on claims against the FDIC under 12 U.S.C. § 1821(e)(4) and observing without analysis that the § 502(b)(6) cap is similar); Eastover Bank for Sav. v. Souwasee Venture (In re Austin Dev. Co.), 19 F.3d 1077, 1082 n.9 (5th Cir. 1994) (acknowledging, without taking a position on, divergent interpretations of the statutory cap).
16For purposes of this Article, “nonbankruptcy law” includes state law and the lease.
17See infra notes 84–87 and accompanying text; see also JACOB I. WEINSTEIN, THE BANKRUPTCY LAW OF 1938: A COMPARATIVE ANALYSIS 131-32 (1938) (analyzing 1938 Chandler Act and noting that,
analyzes the case law and concludes that McSheridan and subsequent courts applying § 502(b)(6) expansively rely upon a flawed bankruptcy court precedent. The Article concludes that § 502(b)(6) applies to damages traceable to the termination of a lease before or after the petition date.

I. THE LANGUAGE OF THE STATUTE

An overview of the Code’s treatment of the various claims a landlord may assert establishes a helpful framework for the analysis of § 502(b)(6). Landlords’ claims enter a bankruptcy case in one of two basic postures: as a result of breach or termination before bankruptcy, or as a result of breach or termination after bankruptcy. A landlord’s claim against a tenant may arise long before bankruptcy and may or may not involve termination of the lease. In such a case, the landlord may file a claim for whatever damages accrued before the tenant’s bankruptcy filing. Upon objection, § 502(b) provides that the court determine the amount of the claim as of the petition date. Section 502(b)(6) only comes into play if the objection involves damages resulting from the termination of the lease. Section 502(b)(6) is not implicated if the objection involves damages not resulting from termination. In this posture, rejection is irrelevant to the landlord’s claim, but termination — and therefore § 502(b)(6) — may be relevant.

Alternatively, a landlord’s claim against a debtor might not arise until after the bankruptcy filing when the trustee or debtor-in-possession rejects an unexpired lease. In that case, the landlord may assert a claim for damages “arising from the rejection” of the unexpired lease. Again, § 502(b)(6) is not yet relevant and only comes into play if there is an objection to the landlord’s claim and the claim involves termination damages.

In either case, § 502(b)(6) caps all of a landlord’s claims for “damages resulting from the termination of a lease of real property,” regardless when the

under preexisting law, a debt was provable “if all the facts necessary to be proved to fix the debt or liability had actually occurred at the date of bankruptcy”).

18 For example, a landlord might assert a damages claim for a covenant breach, the tenant might acknowledge the breach and agree on damages, and the lease might continue uninterrupted. But the tenant might enter bankruptcy before payment of the damages. Of course, the parties could have terminated the lease. See infra Part I.A.

19 See 11 U.S.C. § 501(a); see also, e.g., Solow v. PPI Enters. (U.S.), Inc. (In re PPI Enters. (U.S.), Inc.), 324 B.R. 197, 207-10 (3d Cir. 2003) (capping damages arising from termination of lease and surrender of property that occurred several years before tenant’s bankruptcy).


21 See id. § 365(a).

22 Id. §§ 501(a), 502(a), 502(g). As above, the court must determine and allow the claim as if the claim had arisen before the petition date. See id. §§ 502(g)(1).
termination occurs.24 The two paths a landlord's claim may follow into bankruptcy highlight that, strictly speaking, rejection has no bearing upon the cap's operation. Section 502(b)(6) caps a landlord's lease-termination claim even if the lease was never rejected. Nonetheless, the law surrounding § 502(b)(6) has been obscured because courts have conflated "rejection" and "termination," disregarding the important implications of the distinction between them.

A. "Rejection" Is Breach, but "Breach" Is Not Termination

The application of § 502(b)(6) has often turned, not upon the treatment of the phrase "resulting from," but upon the treatment of the bankruptcy concept of "rejection" vis-à-vis the contract-law concepts of "termination," "nonperformance," and "breach." Although rejection of an unexpired lease usually results in its termination, courts and commentators have observed for at least two decades that "termination" and "rejection" are not synonymous and must be given their distinct meanings in the Code.25 Courts that treat "rejection" as a concept distinct from "termination" generally apply § 502(b)(6) narrowly, capping only damages actually traceable to termination.26 Courts that dismiss or ignore the distinction generally apply the provision expansively, capping all damages claims against the debtor.27 To

24 Id. § 502(b)(6) (emphasis added). The full provision provides that a creditor's claim is allowed, except to the extent that

- if such claim is the claim of a lessor for damages resulting from the termination of a lease of real property, such claim exceeds—
  - (A) the rent reserved by such lease, without acceleration, for the greater of one year, or 15 percent, not to exceed three years, of the remaining term of such lease, following the earlier of—
    - (i) the date of the filing of the petition; and
    - (ii) the date on which such lessor repossessed, or the lessee surrendered, the leased property; plus
  - (B) any unpaid rent due under such lease, without acceleration, on the earlier of such dates . . . .

Id.

25 For a discussion of the confusion over the effects of rejection, breach, and termination, see Michael T. Andrew, Executory Contracts in Bankruptcy: Understanding 'Rejection,' 59 U. Colo. L. Rev. 845, 931–32 (1988) ("Rejection is not the power to release, revoke, repudiate, void, avoid, cancel or terminate, or even to breach, contract obligations. Rather, rejection is a bankruptcy estate's election to decline a contract or lease asset. . . . Profound and pervasive confusion surrounds those simple principles. Some of the confusion results from the misleading connotations of the terms 'rejection' and 'breach,' their conceptual origins now largely forgotten."). At least two courts of appeals have taken up Andrew's cause of demystifying these concepts. See Med. Malpractice Ins. Ass'n v. Hirsch (In re Lavigne), 114 F.3d 379, 386–87 (2d Cir. 1997) ("While rejection is treated as a breach, it does not completely terminate the contract."); Eastover Bank for Sav. v. Sowashee Venture (In re Austin Dev. Co.), 19 F.3d 1077, 1080–83 (5th Cir. 1994) ("The terms rejection, breach and termination are used differently, but not inconsistently or interchangeably, as some courts have suggested.").


27 See, e.g., In re Mr.Gattis's, Inc., 162 B.R. 1004, 1013 (Bankr. W.D. Tex. 1994). But see Saddleback
understand § 502(b)(6), it helps to clarify these terms.

1. "Breach" is not termination.

The analysis of § 502(b)(6) begins outside the Code, with an examination of the nonbankruptcy terms "breach" and "termination." The Code neither defines nor purports to alter the common meanings of these terms. "Breach" is the "violation or infraction of a law or obligation."28 A contract is breached "by failing to perform one's own promise, by repudiating it, or by interfering with another party's performance."29 A covenant is breached when a party violates "an express or implied promise, usually in a contract, either to do or not to do an act."30

"Termination," on the other hand, is either "[t]he act of ending something," or "[t]he end of something in time or existence; conclusion or discontinuance."31 As this definition suggests, termination results either from an affirmative act of one party, or it results naturally and automatically from the passage of time, as by stipulation in a contractual provision.

These definitions reveal an uncontroversial principle that illuminates important distinctions. A lease can be breached — that is, some provision of it can be violated through an affirmative act or nonperformance — without the lease spontaneously terminating.32 If that were not true, contract law would have no need of the doctrine of waiver, for example, because at the moment of breach a contract would be terminated regardless whether the nonbreaching party wanted to waive the breach. Of course, a contract provision or rule of law may stipulate that a breach of any provision gives the nonbreaching party the right to terminate the contract or treat the contract as terminated.33 But typically the nonbreaching party would have to affirmatively exercise the right to terminate the contract or lease. Termination is not automatic.34

Valley Cnty. Church v. El Toro Materials Co. (In re El Toro Materials Co.), 504 F.3d 978 (9th Cir. 2007) (applying cap narrowly while using the words rejection and termination interchangeably).


29 Id.

30 Id. at 201.

31 Id. at 1511.

32 See In re Storage Tech. Corp. (Storage Tech. I), 53 B.R. 471, 474 (Bankr. D. Colo. 1985) ("Under the law of the state of California, and virtually every other state, a breach of a real property lease is not synonymous with termination of a lease." (footnote omitted)).

33 Property law generally provides that, unless the parties to a lease agree otherwise, a tenant's breach gives the landlord the right to choose either to terminate the lease and seek damages or to continue the lease and seek relief in law or equity. See RESTATEMENT (SECOND) OF PROPS: LANDLORD & TENANT § 13.1 (1977). Under contract law, there must be an uncured, material breach for rescission (termination) to be permissible. See RESTATEMENT (SECOND) OF CONTRACTS §§ 237 & cmt. b (1981).

34 RESTATEMENT (SECOND) OF PROPS: LANDLORD & TENANT § 13.1 cmt. k (1977) ("The lease is not automatically terminated by the tenant's failure to perform a promise. The right to terminate . . . is an option to terminate the lease. The exercise of this option requires that the landlord notify the tenant he
A contract provision or rule of law might also stipulate that a breach of any provision — or, more likely, occurrence of an event such as condemnation or destruction of the leased premises — constitutes automatic termination of the contract without the need for the nonbreaching party to exercise the right of termination.35 In most contracts and leases, however, breach of a provision merely gives rise to the right to terminate, not to automatic termination.

Thus, “breach” does not equal “termination.” Breach may give rise to the right to terminate, but breach does not in and of itself result in termination.36

2. “Rejection” is the decision not to assume.

The Code provides special treatment of executory contracts and unexpired leases. To maximize the value of the estate, the Code permits the trustee or debtor-in-possession to evaluate all executory contracts and unexpired leases to determine if they represent an asset or liability to the estate. The trustee or debtor-in-possession (1) may accept the contract or lease for the expected benefit of the estate (i.e., “assume” the contract or lease) or (2) may not assume (i.e., “reject”) a contract or lease that is expected to represent a liability to the estate.37 The Code provides that the court-approved “rejection” constitutes a breach of the contract or lease.38 It leaves the determination of the parties’ rights upon breach to applicable non-bankruptcy law. Nothing in the Code takes the further step of making breach equal termination.

3. "Rejection" constitutes breach — and nothing more.

Rejection is breach, but breach is not termination. To prove this essential distinction, one need look no further than the Code itself.

First, § 365(h)(1)(A)(i) expressly provides the circumstances in which a tenant may treat a rejected lease as terminated by a debtor-landlord:

[If the rejection by the trustee amounts to such a breach as would entitle the lessee to treat such lease as terminated by

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35Such a catch-all could be problematic — other than for condemnation or destruction, the occurrence of which usually would be obvious to both parties — given the uncertainty that could result if the nonbreaching party were not aware of the breach and continued performing the terminated contract. Few would structure their contractual arrangements without some provision for notice of termination or a determination that the nonbreaching party did not wish to waive the breach.


37See 11 U.S.C. § 365(a). Some courts have recognized an alternative to assumption or rejection, namely “ride through.” See, e.g., Diamond Z Trailer, Inc. v. JZ L.L.C. (In re JZ L.L.C.), 371 B.R. 412, 422 (B.A.P. 9th Cir. 2007) (noting that chapter 11 does not require assumption or rejection, and it does not provide for any change in status for executory contracts that are neither assumed nor rejected).

38See 11 U.S.C. § 365(g).
virtue of its terms, applicable nonbankruptcy law, or any agreement made by the lessee, then the lessee under such lease may treat such lease as terminated by the rejection . . . .

Notably, the Code does not give the tenant the option of termination when the debtor-landlord's rejection does not amount to a breach that would permit the tenant to treat the lease as terminated. In addition, the provision permits — but does not require — the tenant to treat the breach as termination.

Second, § 562(a), added in 2005 to clarify the treatment of certain executory contracts, juxtaposes the words "rejection" and "termination." If there were any confusion about the distinct meanings of rejection and termination, this amendment demonstrates that Congress has deliberately used and continues to use the words differently.

Third, § 502(g) of the Code, by logical inference, makes plain that termination is just one of the many possible consequences of rejection. Section 502(g)(1) provides that a claim arising from rejection should be treated as a prepetition claim. For classification purposes, this provision indulges the fiction that all claims "arising from" rejection are triggered prepetition to permit them to be included in the bankruptcy case and subject to discharge. It is generally accepted that this provision classifies as prepetition a landlord's claims for "damages resulting from the termination of a lease of real property," i.e., those damages capped by § 502(b)(6), when those damages arise from the lease's rejection. But a lease can be terminated without being rejected, and § 502(b)(6) applies to lease termination damages as well. This means that a claim "arising from the rejection" of a lease includes but cannot logically be limited to or equivalent to "the claim of a lessor for damages resulting from the termination of a lease of real property." That is, termination may arise from

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8 See Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, sec. 910(e)(1), § 562, 119 Stat. 31, 184 (codified at 11 U.S.C. § 562 (2006)). Section 562(a) provides that, when certain contracts are rejected, liquidated, terminated, or accelerated, "damages shall be measured as of the earlier of (1) the date of such rejection; or (2) the date or dates of such liquidation, termination, or acceleration.”


10 Id.

11 Id. § 502(b)(6); see In re McLean Enter., Inc., 108 B.R. 928, 933-34 (Bankr. W.D. Mo. 1989) (holding purpose of § 502(b)(6) in rejecting argument that § 502(b)(6) only allows termination damages and rejection does not equal termination, so landlord has no damages claim when lease is rejected instead of terminated).
rejection in most cases, but rejection does not arise from termination.\textsuperscript{44} Indeed, if a contract is already terminated by either party, rejection is unavailable under § 365(c)(3).\textsuperscript{45} 

\textsuperscript{44}Many kinds of damages arise from rejection, including damages for breach of contract, breach of covenants, or state-law damages. One is the damage resulting when the breach presumed from rejection allows the nonbreaching party to treat the breach as termination (i.e., termination damages). But damages "arising from rejection" and "resulting from the termination" are not always equivalent. If they were, § 365(b) analyzed above would be superfluous; § 562 would be redundant; termination of a contract before the petition date and rejection would somehow have to "equal" rejection; and one would have to conclude that Congress inexplicably used the terms "rejection" and "termination" indiscriminately throughout the Code. 

Though inconclusive by itself, even Congress's use of the article "the" in § 502(b)(6) suggests that "the termination" is a singular, discrete event, separate from rejection, and one that may even occur before a bankruptcy filing and the existence of the rejection power. No one would successfully argue that § 502(b)(6) does not cap "damages resulting from the termination of a lease of real property" (whatever those may be) when termination occurred before the bankruptcy filing and before the rejection power even arises. In such a case, the temporal fiction of § 502(g) is unnecessary, because the claim is already perfected. Yet, the cap limits the prepetition claim nonetheless, rejection aside. E.g., Solow v. PPI Enters. (U.S.), Inc. (In re PPI Enters. (U.S.), Inc.), 324 F.3d 197, 207-10 (3d Cir. 2003) (capping damages arising from termination of lease and surrender of property that occurred several years before bankruptcy filing). 

This distinction was so apparent to the drafters that the final version of the 1978 amendments deleted the explicit references in earlier drafts to a lessee's "termination" of the lease contract prior to the date of the petition. Section 502(b)(6) sets the cap based upon a portion of the lease term remaining "following the earlier of (i) the date of the filing of the petition; and (ii) the date on which such lessor repossessed, or the lessee surrenders, the leased property . . . ." 11 U.S.C. § 502(b)(6)(A). Five earlier versions of the provision set the cap based upon a portion of the lease term remaining "following (A) the date of the petition, or (B) if the contract is terminated earlier, the date on which the lessor repossessed or the lessee surrendered the leased property . . . ." See S. 236, 94th Cong. § 4-403(b)(6) (1975) (emphasis added); S. 235, 94th Cong. § 4-403(b)(6) (1975) (emphasis added); H.R. 31, 94th Cong. § 4-403(b)(6) (1975) (emphasis added); H.R. 16643, 93d Cong. § 4-403(b)(6) (1974) (emphasis added); H.R. 10792, 93d Cong. § 4-403(b)(6) (1973) (emphasis added). As discussed below, see infra Part II.C, this language appeared consistently throughout these preliminary drafts because it was taken directly from the codification proposed in 1973 by Congress's Commission on the Bankruptcy Laws of the United States. See REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. DOC. NO. 93-137, Part II, at p 100 (1973); infra text accompanying note 151. It is unlikely that the Commission used the word "termination" twice in the same provision without recognizing its distinctive meaning from "rejection" (or that they intended to collapse the terms' meanings). Likewise, legislative history throughout the 1970s consistently discusses the possibility of termination subsequent to rejection, never in any way conflating the two. See infra Parts II.C-E. 

Some courts misunderstand these distinctions in the Code, concluding that Congress used the terms inconsistently and confusingly. See, e.g., In re Giles Assocs., Ltd., 92 B.R. 695, 698 (Bankr. W.D. Tex. 1988) (citing a case of Bankruptcy Bank for Sav. v. Sowashee Venture (In re Austin Dev. Co.), 19 F.3d 1077, 1081-82 (5th Cir. 1994)). These courts do so despite earlier courts' thorough treatment of the issue. See, e.g., In re Storage Tech. Corp. (Storage Tech. I), 53 B.R. 471, 474 (Bankr. D. Colo. 1985) (concluding that the Code's drafters "knew the difference between breach and termination. Where the legal concept of termination is appropriate that term is used. § 365(g), however, states that rejection results only in a breach of the lease. . . . [T]he words 'breach' and 'termination' were intended to have different meanings." (citations omitted)). 

\textsuperscript{45}11 U.S.C § 365(c)(3) provides: "The trustee may not assume or assign any executory contract or unexpired lease of the debtor" if "such lease is of nonresidential real property and has been terminated under applicable nonbankruptcy law prior to the order for relief." If a contract is terminated before the rejection power arises, the parties' rights are already established: the debtor (and thus the estate) either
Congress and the experts assisting Congress throughout the past century of codification of the federal bankruptcy laws have consistently distinguished rejection from termination, recognizing the conceptual and practical differences between the two. Nothing in the Code suggests that rejection equals termination or that the terms are used interchangeably.46

B. APPLYING THE CAP’S KEY TERMS

The central disagreement over the interpretation and application of § 502(b)(6) comes into focus when one considers its predecessor, which seemed to cap expressly all lease damages, not just those resulting from termination. From 1938 until 1978, the immediate predecessor of § 502(b)(6) capped damages resulting from "rejection" and included damages resulting from breaches of any covenant in a lease.47 Since 1978, however, the cap has applied only to "damages resulting from the termination of a lease of real property."48 The disagreement has arisen because some courts have read § 502(b)(6) as "effectively synonymous" with its predecessor, applying the current cap to all of a landlord’s damages, regardless of their cause.49

Merely juxtaposing the former and current provisions should make clear that the drafters of § 502(b)(6) determined that (1) the cap should apply to all damages traceable to premature termination of a lease, whether termination resulted from rejection or occurred before bankruptcy (thus the change has an asset, or the debtor (and thus the estate) has a liability. E.g., PPI Enters., 324 F.3d 197. In the latter case, the estate cannot just magically reject the existing liability flowing from termination and make it disappear. This, however, is the logical extension of ignoring the difference between rejection and termination.

46The Fifth Circuit has acknowledged as much, instructing courts that "the terms rejection, breach and termination are used differently, but not inconsistently or interchangeably"; that "Congress knew how to authorize the termination of executory contracts and leases"; and that "Congress was not confused in its differing usages of the terms rejection, breach and termination." Asamin Des. Co., 19 F.3d at 1082–83.

47Section 502(b)(6)’s predecessor allowed proof of “claims for anticipatory breach of contracts, executory in whole or in part, including unexpired leases of real or personal property,” except as follows:

[T]he claim of a landlord for damages for injury resulting from the rejection of an unexpired lease of real estate or for damages or indemnity under a covenant contained in such lease shall in no event be allowed in an amount exceeding the rent reserved by the lease, without acceleration, for the year next succeeding the date of the surrender of the premises to the landlord or the date of reentry of the landlord, whichever first occurs, whether before or after bankruptcy, plus an amount equal to the unpaid rent accrued, without acceleration, up to such date.


49See, e.g., In re Mr. Gatti’s, Inc., 162 B.R. 1004, 1013 (Bankr. W.D. Tex. 1994) (applying § 502(b)(6) broadly as “effectively synonymous with its predecessor, § 63(a)(9)”.)
from "rejection" to "termination"); and (2) the cap should not limit any other damages arising under covenants whose violation is not caused by termination (thus the deletion of the phrase "or for damages or indemnity under a covenant contained in such lease"). As one court observed:

Use of the word "termination" simply limits the type of claims to which the subsection applies.

The general unsecured claim for damages resulting from termination of the lease is only one component of a lessor's damages. The lessor may also have administrative priority claims for occupancy of the premises after the filing of the petition. The word "termination" . . . merely limits the scope of the subsection and leaves unaffected the claims of a lessor from damages not arising from termination.50

The first step in any analysis of § 502(b)(6) is to examine its language.51 The words "resulting from" and "termination" will be considered in turn.

1. "Resulting From."

The phrase "resulting from," which appeared in the 1938 cap provision as well, introduces the limiting notion of causation to the scope of the cap. Only those damages "resulting from the termination" of the lease that the trustee rejects are capped. By its own terms, "resulting from" has (1) a temporal component (it implies consequences coming after the relevant triggering event, i.e., termination); and (2) a substantive component (it encompasses only those consequences of a kind causally linked to the relevant triggering event, i.e., termination). This would seem to dictate that "resulting from the termination" makes the cap applicable only to damages coming after and occurring because of either party's termination of the lease, whenever that termination occurs. Termination, not rejection, is the proper trigger for at least two reasons: (1) termination may occur before bankruptcy;52 and (2) § 502(b)(6) refers to "damages resulting from the termination of a lease," not from the "rejection" of a lease.53

"Resulting from" damages are prospective, in the sense that they are incurred after termination. Damages triggered by acts or omissions before termination — i.e., "non-prospective" damages — cannot result from termination.54 Termination damages must arise because of, i.e., be caused by, termi-
nation. The cap does not limit "damages resulting from a lease." The cap limits "damages resulting from the termination of a lease." Thus, both timing and substance must be considered as each relates to termination.\textsuperscript{55} It would effectively alter the statutory language to read the phrase "resulting from" to include actions or omissions coming before the triggering event. This would transform the cap to limit "damages related to the termination of a lease."

The Ninth Circuit in \textit{El Toro} recognized this "but for" causation requirement. \textit{El Toro} stated the test 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?"\textsuperscript{56} (The \textit{El Toro} court incorrectly used the term "rejecting" instead of "terminating." Nonetheless, the court accurately gave effect to the causal requirement that the "resulting from" formulation creates.)

Other courts, taking an expansive view, have read § 502(b)(6) as though it capped all damages "related to" a lease, instead of damages "resulting from the termination of" a lease. Mc\textit{Sheridan}, for example, expressly rejected the notion that the cap applies only to prospective claims, reasoning that "[t]he distinction between past obligations under the lease and damages 'caused' by the termination is incorrect because all damages due to nonperformance are encompassed by the statute."\textsuperscript{57} By assuming that the statute encompasses all damages, the court ignored the words "resulting from." Similarly, the Mc\textit{Sheridan} court cited § 502(g) for the proposition that "the claim arising from breach of the lease conceptually encompasses all time intervals and treats the claim as if the breach occurred immediately prior to the filing of the bankruptcy case."\textsuperscript{58} This statement disregards the two paths a landlord's claim can take to be allowed in bankruptcy.\textsuperscript{59} Not all landlords' damages claims come into bankruptcy via §§ 365(g) and 502(g).

There is little question that § 502(g) treats postpetition claims arising

\textsuperscript{55}The prospective versus non-prospective construct helps to highlight the timing of damages "resulting from" termination and capped, because in many cases prospective damages also are caused by termination (or rejection, under the pre-1978 cap provision, see infra text accompanying note 131). But prospective damages are not always termination damages. In \textit{El Toro}, for example the debtor had four months under the lease following termination to remove stockpiled waste. The debtor argued the damages accrued prospectively, i.e., after termination, and thus were termination damages. See Saddleback Valley Cnty. Church v. El Toro Materials Co. (\textit{In re El Toro Materials Co.}), 504 F.3d 978, 980–81 (9th Cir. 2007). Despite the timing of the accrual of damages, however, the court properly explained that the damages were caused by the stockpiling of waste that occurred long before rejection or termination and thus were not damages "resulting from" termination. Id. at 980–81 & n.4.

\textsuperscript{56}Id. at 981.


\textsuperscript{58}Mc\textit{Sheridan}, 184 B.R. at 101 (citing 11 U.S.C. § 502(g) (1994)).

\textsuperscript{59}See supra notes 18–24 and accompanying text.
from rejection as prepetition claims for purposes of allowance and discharge.\footnote{Section 502(g)(1) provides that a claim arising from the rejection of an unexpired lease shall be determined and allowed as if the claim had arisen before the date of the filing of the petition. See 11 U.S.C. § 502(g)(1). This provision creates the fiction that all rejection claims arise prepetition, which permits them to be included in the bankruptcy case and subject to discharge. Even the early legislative history made this plain: “While this is a fictional relation back, it is necessary as a mechanical device.” S. Rep. No. 75-1916, at 6 (1938); 83 Cong., 1st Sess., H.R. Rep. No. 9107 (1938) (House Report with identical statement). This provision, on the one hand, provides the debtor the relief of discharge and the landlord the possibility of proportionate recovery from the bankruptcy estate. The analysis is not affected by the debate about whether the words “determined” in § 502(g)(1) in some cases supersedes nonbankruptcy law to stipulate at which time rejection damages should be calculated. See Bank of Montreal v. Am. HomePatient, Inc. (In re Am. HomePatient, Inc.), 414 F.3d 614, 617–20 (6th Cir. 2005); Taunton Mun. Lighting Plant v. Enron Corp. (In re Enron Corp.), 354 B.R. 652, 657–60 (S.D.N.Y. 2006); see also 11 U.S.C. § 502.} That claims arising from a postpetition rejection of the lease are treated as prepetition claims, however, does not mean that all prepetition claims are treated as lease-rejection claims. McSheidan failed to consider that a landlord’s lease-related damages include those arising from rejection (§ 502(g) claims) — which in most cases are identical to damages resulting from termination (§ 502(b)(6) claims) — plus any damages not arising from rejection or resulting from termination. In other words, a landlord’s rejection or termination damages are additional to any damages the landlord could have asserted (or which had accrued) before rejection or termination. Nothing in § 502(g) suggests that it concerns damages other than those “arising from the rejection” of an unexpired lease of the debtor.

For some, focusing on the plain language of the “resulting from” phrase in § 502(b)(6) may be sufficiently persuasive of this Article’s thesis that no further analysis is necessary. Given the difficulty, however, that some courts have experienced in applying the cap, further analysis is prudent.

2. "Termination."

As discussed above, termination of a lease is the ending of the lease; but “rejection,” which constitutes breach of the lease, does not equal “termination.”\footnote{Under § 502(b)(6)(B), any past rent, taxes, insurance, or routine fees accrued and unpaid to the date of bankruptcy or surrender of the premises are included in a landlord’s prepetition claim. The concern here is with future payments the landlord expected but will not receive, not overdue rent and rent-like charges already accrued under the unexpired lease. Only the future payments are capped by § 502(b)(6).} Analytically, the breach presumed to result from rejection does not itself cause a landlord any damages. Until premature termination of a lease, a landlord has no claim for prospective rent, taxes, insurance, routine maintenance fees, and nonrenewal penalties.\footnote{See supra Part I.A.1 and text accompanying note 31.} If the landlord treats the rejection as termination (as landlords usually do), damages may result from the termination. And, because termination and termination damages arise from and after rejection in many cases under the Code, there is no disagreement that the termination will be treated as having arisen from rejection under § 502(g)(1).
for classification purposes.\footnote{See supra notes 41–43 and accompanying text.} Section 502(b)(6) properly caps the resulting termination damages, whether arising prepetition or arising after rejection, because under that provision they are "damages resulting from the termination of a lease of real property," not because they arose from rejection, postdated rejection, or postdated the bankruptcy filing.

When a tenant terminates a lease before the expiration of its term, the most obvious effect is the landlord’s loss of anticipated rent under that lease and perhaps the triggering of non-rent charges for breach. The landlord must mitigate its losses by seeking other tenants, incurring costs of advertising, incurring broker fees, and perhaps even reducing the rent. All of these damages result from termination and are capped.\footnote{See In re Bob’s Sea Ray Boats, Inc., 143 B.R. 229, 231–32 (Bankr. D.N.J. 1992); In re Atlantic Container Corp., 143 B.R. 980, 988 (Bankr. N.D. Ill. 1991) (rejecting the notion that the cap applies only to future rent).}

In contrast, other damages may already have accrued that do not result from termination or arise from rejection. These include damages for breach of repair and maintenance covenants, damages for breach of covenants not to waste or destroy the premises, and damages that the landlord could have sought even if the lease continued its full term. Covenants requiring tenants to maintain and repair leased premises, or covenants prohibiting waste or destruction, are not breached by the mere act of terminating a lease. Termination of a lease may accelerate the landlord’s ability to claim damages under such covenants; but termination does not breach such covenants.\footnote{See Saddleback Valley County, Church v. El Toro Materials Co. (In re El Toro Materials Co.), 904 F.3d 978, 980–81 (9th Cir. 2007).} Further, these damages do not result from — i.e., are not caused by — the termination. Rather, they result from — i.e., are caused by — a tenant’s failure to repair or maintain the premises during the lease term, by affirmative acts of waste or by destruction of the leased premises.\footnote{See Saddleback Valley County, Church v. El Toro Materials Co. (In re El Toro Materials Co.), 904 F.3d 978, 980–81 (9th Cir. 2007) (rejection of the lease may or may not have triggered Saddleback’s ability to sue for the alleged damages. But the harm to Saddleback’s property existed whether or not the lease was rejected); In re Kniske v. McNesherld (In re McNesherld), 184 B.R. 91, 102 (B.A.P. 9th Cir. 1995), overruled in part by El Toro, 904 F.3d at 982 (concluding that “rejection of the lease results in the breach of each and every provision of the lease, including covenants”). These cases are discussed at length, supra, Parts III.C. 9.}

These nontermination damages are properly treated independently of § 502(b)(6), usually as prepetition claims that existed at the time of the bankruptcy filing, and are allowed like any other claim unless they are the subject of a successful objection. These non-prospective damages do not result from the termination of the lease and accordingly are not capped by § 502(b)(6).
II. THE LEGISLATIVE HISTORY OF § 502(b)(6)

Section 502(b)(6) of the Code now calls "termination" damages what were referred to as "rejection" damages under the 1938 statute\(^7\) and "future rent" damages under the original 1933 and 1934 statutes.\(^8\) The cases and commentary refer to all three interchangeably, underscoring the imprecision that frustrates a consistent application of § 502(b)(6). Some courts begin analysis of § 502(b)(6) by citing the Supreme Court's direction in United States v. Ron Pair Enterprises, Inc.,\(^9\) summarized by one court as follows: "[A]bsent some ambiguity, the language of a statute should be interpreted according to its 'plain meaning' and without reference to legislative history or case law."\(^7\) Finding that § 502(b)(6) is ambiguous, these courts look to the legislative history surrounding the change in 1978 from the former sweeping cap on "rejection" and all covenant-or-indemnity damages\(^7\) to the current cap on "termination" damages.\(^7\)

The 1978 House and Senate Reports give an incomplete picture. This is partly because the "damages resulting from the termination" language was first introduced by the Commission on the Bankruptcy Laws of the United States five years earlier in 1973.\(^7\) Although the current language of § 502(b)(6) is directly traceable to the Commission, neither the Commission's nor Congress's reports fully explain the wholesale change in the provision's

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\(^8\)See 11 U.S.C. § 103(a)(7) (1934); Act of June 7, 1934, ch. 424, sec. 4(a), § 63(a)(7), 48 Stat. 911, 923-24; Act of March 3, 1933, ch. 204, sec. 1, §§ 74(a), 77(b), 47 Stat. 1467, 1467-68, 1475. Indeed, the original version of the cap provision was first written into American bankruptcy law in 1934, when the provision allowed claims for damages respecting executory contracts including future rents whether the bankrupt be an individual or a corporation, but the claim of a landlord for injury resulting from the rejection by the trustee of an unexpired lease of real estate or for damages or indemnity under a covenant contained in such lease shall in no event be allowed in an amount exceeding the rent reserved by the lease, without acceleration, for the year next succeeding the date of the surrender of the premises plus an amount equal to the unpaid rent accrued up to said date . . . .


\(^7\)In re Mr. Gatti's, Inc., 162 B.R. 1004, 1008 (Bankr. W.D. Tex. 1994). Some courts, noting the dramatic shift in statutory language in 1978, cite the Supreme Court's statement in Dewsnup v. Timm, 502 U.S. 410, 419 (1992), that unless the Code is unambiguous, it should not be interpreted to "effect a major change in pre-Code practice that is not the subject of at least some discussion in the legislative history." See, e.g., Mr. Gatti's, 162 B.R. at 1010.

\(^7\)See supra note 47.

\(^7\)See supra note 24.

\(^7\)See infra Part II.G.
operative terms. The history of the cap’s original enactment in the 1930s is more illuminating. Two initial distinctions may help to frame the discussion of the historical treatment of lease termination (or future rent) damages in American bankruptcy law.

A. Distinguishing “Landlords” from “Claims” and “Allowance” from “Limitation”

As discussed in Part I, a landlord may have several different kinds of claims against a tenant. In addition, a claim in bankruptcy must first be allowed before the claim is liquidated and then limited by the Code. The two-step “allow then limit” analysis is fundamental to a proper historical understanding of the cap. Allowance of a claim and limitation of that claim are two separate concepts, each with a distinct history and consequence.

Because of its structure, § 502(b)(6) seems to give the impression that the cap’s intended purpose is to cap claims of a disfavored party, namely a landlord, and to enhance the power of a debtor-tenant as against the landlord and all of the landlord’s claims. Understood in its historical context, the cap is not concerned with a disfavored party and all its claims. Rather, the cap is concerned with a disfavored claim, one among the many claims that the creditor, the landlord, may assert against a debtor-tenant.

The history of the cap reveals that at first there was no concern expressed regarding the size of a landlord’s claims. Instead, in 1933, the predecessor to the present-day § 502(b)(6) was enacted, allowing future rent claims (in certain proceedings) without limitations. In 1934, the allowance of future rent claims was extended to all bankruptcy proceedings but limited to one or three years’ rent. These concepts of broad allowance, so limited, were codified in the 1938 Chandler Act.

74See infra Part II.G.
75See supra notes 18-24 and accompanying text.
76The difference between the two steps is sometimes lost because the current version of the cap in § 502(b)(6) obscures the historical significance of allowing a landlord’s future rent claim in the first place, capped or otherwise. This leads some courts to suggest incorrectly that the provision’s original purpose was to limit landlords’ claims. See e.g., Solow v. PPI Enters. (U.S.), Inc. (In re PPI Enters. (U.S.), Inc.), 324 F.3d 197, 211 (3d Cir. 2003) (affirming bankruptcy court’s holding that a debtor was properly “using § 502(b)(6) for exactly its intended purpose” because “the primary purpose of the petition was to cap Solow’s claim pursuant to § 502(b)(6)” (internal quotations omitted)). The provision was instead remarkable merely for allowing previously disallowed future rent claims. Limiting the allowed claim was an afterthought, added when Congress learned that, as a practical matter, future rent claims could easily dwarf other creditors’ claims. See infra Part II.D.
77See In re Brown, No. 07-34580, 2008 WL 4693197, at *3 (Bankr. N.D. Ohio Oct. 23, 2008) (“[I]n simply because a proof of claim is filed by a lessor against a debtor/lessee, it does not result in the applicability of the § 502(b)(6) cap.”).
B. BEFORE 1933: FUTURE RENT CLAIMS DISALLOWED, BUT OTHER CLAIMS ALLOWED

Before 1933, landlords' claims for future rent were not provable in bankruptcy. In other words, future rent claims neither shared in the assets distributed in a bankruptcy case nor were discharged by the bankruptcy proceeding. Future rent claims were not provable because rental payments did not accrue until each installment came due; the total amount could not be recovered in a lump sum in advance of the accrual of the installments. Since such claims were not provable in bankruptcy, they were not dischargeable. Instead, rent continued to accrue as each installment came due, throughout and even after the bankruptcy case. This benefited neither landlord nor tenant. The landlord stood little chance of collecting from an impoverished debtor, and the impoverished debtor was never fully relieved of its debts.

Future rent claims, however, were the exception, not the rule. Other contingent claims not in the nature of future rents — and certainly noncontingent pretension claims that could be liquidated without delaying the bankruptcy case — had long been provable in bankruptcy.

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79Id. cf. A.W. Perry, Inc. v. Irving Trust Co. (In re Outfitters' Operating Realty Co.), 69 F.2d 90, 91–92 (2d Cir. 1934), aff'd, Irving Trust Co. v. A.W. Perry, Inc., 293 U.S. 307 (1934) (applying pre-1933 law and allowing proof of indemnity damages immediately due upon filing of a bankruptcy petition under a lease's then-novel 'nolo contigui' clause); see infra note 115. An earlier case, Manhattan Properties, Inc. v. Irving Trust Co., 291 U.S. 320, 332–36 (1934), provides a detailed history of the provability of contingent claims generally. American bankruptcy statutes made no reference to future rents, and the federal courts originally followed an English statute that claims for future rent were incapable of proof. Id. Contingent claims had been allowed under American law since at least 1841, but the majority of courts held future rents not within the statutory definition of contingent claims. Id. at 333–34. An 1867 statute permitted proof of accrued rent due at bankruptcy, but the explicit reference to accrued rents was read as an implicit exclusion of future rent claims. Id. (citing Act of March 2, 1867, § 19, 14 Stat. 517, 525). Indeed, legislation proposed in 1880 would have allowed lease-rejection damages, but Congress did not pass it. Id. at 334 (citing 14 Cong. Rec. 42–48 (1882)). When the 1898 Act failed to include a provision allowing for future rent losses, courts continued to view this as an indication of congressional "intent not to depart from the precedents disallowing them." Id. at 335–36.
80City Bank, 299 U.S. at 437.
81Id. ("The tenant's liability for future rent was not discharged and remained enforceable as installments of rent fell due.").
82See id.
83See generally infra Part III.A.
84See Manhattan Props., 291 U.S. at 332–34; cf. Tipton v. Irving Trust Co. (In re F. & W. Grand 5-10-25 Cent Stores, Inc.), 74 F.2d 45, 47 (2d Cir. 1934) (disallowing claim for debtor-tenant's promised capital improvements "except so far as damages accrued prior to bankruptcy," and noting that whatever damages had not accrued before bankruptcy were "of the nature of claims for future rents, or for restoration of premises, or for payment of all future rents at the termination of the lease which have been held nonprovable"); see also J. Mark Jacobson, Landlord's Claims Under Section 77B of the Bankruptcy Act, 45 YALE L.J. 422, 426 (1936) (noting that, even after Manhattan Properties, if "a claim is strictly one of unaccrued rent, it is contingent and unprovable. But if the breach of a lease covenant may be classed in some other category, it might be provable.")
could be liquidated and allowed so long as damages had accrued before the petition date or any necessary contingency had occurred before the resolution of the case. An accrued claim not contingent on the petition date needed only to be liquidated. So nothing would have stopped a landlord from filing other claims, such as claims for damage to the leased premises, for prepetition rent, and for damages awarded in prepetition lawsuits. Only future rent claims, or claims in the nature of future rents, suffered this affliction, not landlords' claims generally. This distinction is important to an understanding of the problem Congress addressed in creating and then altering the cap.

In contrast to bankruptcy law, some state laws were generous to landlords' accrued (prepetition) rent claims. Under some state statutes, claims for rent due at the time of bankruptcy were given priority in payment over other unsecured claims. These state-law priorities mattered in bankruptcy because until 1978 federal bankruptcy law recognized and incorporated all state-law priorities in payment, albeit with some limitations. Although landlords disliked the disallowance of future rent claims, other creditors disliked the Bankruptcy Act's recognition of state-law priorities for accrued rent.

In 1932, in the midst of the Great Depression, Congress held joint hearings on several bills extending emergency bankruptcy and reorganization relief to four distinct groups — individuals, farmers, railroads, and corporations — supplementing the existing law of liquidations. Initially, none of the...
proposed legislation addressed making provable (or limiting) claims for future rent. Indeed, throughout the joint hearings, the only discussion of landlords or rents concerned creditors' desired repeal of the landlords' state-law priority for accrued rent, not the provability of future rent claims.

C. 1933: Future Rent Claims Allowed Without Limit

Despite creditors' requests, Congress left the state-law priorities intact. But Congress went further. By January 1933, the proposed legislation defined the terms "debt" and "creditor" to include "claims of whatever character against the debtor or his property, whether or not such claims would otherwise constitute provable claims under this act." These provisions would have effectively allowed, in individual debtor compositions (i.e., payment plans) and corporate reorganizations, the inclusion and discharge of debts not "provable" in liquidation proceedings, such as future rent claims.

Early in the legislation's consideration, Representative Carl R. Chindblom (R-Illinois) pointed out that the term "creditors" had not been defined as he understood had been intended. The next version of the bill discussed in the Senate accommodated him by defining "creditors" to include "all hold-

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91 See S. 3866, 72d Cong. (1st Sess. 1932) § 1, at 2-3 (definitions of "creditor," "debt," and "claim"); id. § 63, at 85-86 (defining provable claims); H.R. 9968, 72d Cong. (1st Sess. 1932) § 63, at 85-86 (defining provable claims).
92 See 1912 Hearings, supra note 88, at 1095-1117 (index of subjects discussed in hearings); id. at 1114 (entry for "landlords, priority in debts of a bankrupt estate"); id. at 370-72 (discussion noted in index). H. M. Oliver, a representative of the Credit Association of Western Pennsylvania, advocated repealing the federal bankruptcy law's recognition of state-law priorities, id. at 370-72, arguing that "in a great many cases the receiver and trustee is [sic] simply administering the estate for the benefit of the landlord." Id. at 370 (providing as an example the Pennsylvania priority for one year's accrued rent, which received priority of payment over other creditors); see also id. at 371 (arguing that a creditor in Pittsburgh should be given the same treatment as a creditor on the Pacific coast, without regard to state law). He described the collusion and perverse incentives the priorities created, arguing that landlords would not be harmed if federal law stopped recognizing them. Id. at 372 (arguing that repeal would simply force landlords to "keep up with [their] rent collections").
93 See H.R. 14359, 72d Cong. § 74(a) (2d Sess. 1933), 76 CONG. REC. 2002 (Jan. 20, 1933) (individual debtor compositions); H.R. 14133, 72d Cong. § 75(b), at 8-9 (2d Sess. 1933) (corporate reorganizations); H.R. 14110, 72d Cong. § 76(b), at 4-5 (2d Sess. 1933) (railroad reorganizations); see also S. 5551, 72d Cong. §§ 74(a), 75(b), 76(b) (2d Sess. 1933) (same). Unlike the current Code, each bankruptcy subject was self-contained. These definitions were repeated in the sections covering individual debtor compositions (i.e., extended payment plans), railroad reorganizations, and corporate reorganizations. Acting under unusual time pressure, Congress intentionally chose not to tinker with the estate liquidation provisions in 1933, so this amendment did not yet apply to traditional liquidation proceedings. See infra note 96.
94 See CONG. REC. 2930-31 (Jan. 30, 1933) (statement of Rep. Chindblom) ("I am advised that it was the intention to include under 'claims,' any liability for damages under executory contracts. Of course, it would have been better, and very easy, indeed, to make this intention perfectly clear.")
ers of claims, interests, or securities of whatever character against the debtor or its property, including a claim for future rent, whether or not such claims, interests, or securities would otherwise constitute provable claims under this act."95

In the days before final passage of the 1933 Act, Senator Sam G. Bratton (D-New Mexico) offered two amendments on the floor of the Senate: one to add the words "including a claim for future rent" to the definition of "debt" (to mirror the definition of "creditor" that Rep. Chindblom had prompted), and another to add a sentence providing that "[a] claim for future rent shall constitute a provable debt," treated like all other provable debts of the debtor.96 The amendments passed without opposition and appeared in the final statute.97 Thus, the bankruptcy law as of 1933 allowed claims for future rent, without even the one- or three-year limitation, in individual debtor compositions (payment plans) and railroad reorganizations.98

The legislative history from 1932 to 1933 is devoid of any evidence that these provisions were intended to disallow or limit noncontingent, existing claims for landlords' damages for items such as affirmative waste, destruction to premises, or other breaches unrelated to future rents. These claims would have existed at the time of bankruptcy and could have been proved and allowed the same as any other claim.99 Congress not only did not limit landlords' state-law priorities for their accrued rent claims, but Congress allowed additional claims for future rent that were previously unprovable. The simultaneous retention of the state-law priorities demonstrates that Congress intended to add to the body of claims landlords could assert, not to limit those claims.100

9576 CONG. REC. 4905 (Feb. 24, 1933); see also Act of March 3, 1933, ch. 204, sec. 1, § 74(a), 47 Stat. 1467, 1467–68.

9676 CONG. REC. 4905–06 (Feb. 24, 1933); 76 CONG. REC. 5135 (Mar. 1, 1933). The Senate manager of the bankruptcy legislation, Senator Daniel Hastings (R-Delaware), concurred, clarifying that the amendments would affect only the new reorganization provisions and not the old law concerning estate liquidations. 76 CONG. REC. 4905–06 (Feb. 24, 1933); 76 CONG. REC. 5135 (Mar. 1, 1933) (Sen. Hastings noting he had received many calls and inquiries about permitting future rent claims). Senators Bratton and Hastings at first believed the latter amendment could risk redefining provable claims for the existing provisions of the Code related to estate liquidations, and they expressly wanted to avoid disrupting existing law when they passed emergency legislation in 1933. Once both were confident that offering the amendment would not encourage others to offer other amendments that might inadvertently affect existing law, Senator Bratton reintroduced the amendment and Senator Hastings concurred. See their exchanges at 76 CONG. REC. 4905–06 (Feb. 24, 1933); 76 CONG. REC. 5135 (Mar. 1, 1933).

9776 CONG. REC. 4905–06 (Feb. 24, 1933); 76 CONG. REC. 5135 (Mar. 1, 1933); Act of March 3, 1933, ch. 204, sec. 1, § 74(a), 47 Stat. 1467, 1467–68.

98See generally Act of March 3, 1933, ch. 204, 47 Stat. 1467.

99See supra Part II.B; infra notes 165–167 and accompanying text.

100See City Bank Farmers Trust Co. v. Irving Trust Co., 299 U.S. 433, 444 (1937); see also In re Benguet, 20 F. Supp. 504, 508 (S.D. Cal. 1937).
D. 1934: Future Rent Claims Capped

In the year following the 1933 enactments, Congress took up the issue of authorizing corporate reorganizations. The first drafts of the bill eventually enacted in 1934 mirrored the 1933 provisions, allowing proof of future rents without any limitation.\(^{101}\) Again, "creditors" included future rent claimants.\(^{102}\) The distinctions among rejection, breach, and termination were clear from the start.\(^{103}\) Rejection constituted a breach, provided the contract had not been terminated,\(^{104}\) and so the bills essentially approved and codified the Supreme Court's holding in *Central Trust Co. of Illinois v. Chicago Auditorium Ass'n* that rejection of executory contracts and unexpired leases amounts to an anticipatory breach of the contract or lease.\(^{105}\) These amendments, together with the 1933 amendments, would make future rent claims comprehensively allowable across the spectrum of bankruptcy law, without any limitation as to amount.

The 1934 statute that resulted, however, restricted future rent claims to one year for liquidations and three years for compositions and reorganizations.\(^{106}\) In addition, the broader provision limiting "damages or indemnity under a covenant contained in" an unexpired lease first appeared in 1934\(^ {107}\) — and survived until 1978.\(^ {108}\) What was Congress's purpose in adding limiting language in a statute originally intended to make provable previously unprovable claims? Did Congress intend to cap all of a landlord's claims of whatever type? The legislative history is silent about any intention to cap these previously provable damages. But Supreme Court cases decided while the legislation was pending suggest Congress's purpose, because the cases used the precise language that ultimately appeared in the 1934 legislation.

\(^{101}\) *H.R. 5884, 73d Cong. sec. 1, § 79(b), at 9* (1st Sess. June 2, 1933); *id. sec. 4(a), § 63(a), at 30*; *H. Rep. No. 73-194, at 4, 12-13* (1933). The draft bill also amended the law of estate liquidations, which Congress had intentionally avoided in 1933. Specifically, section 63(a) of the existing Act (the direct predecessor of current § 502(b)) was proposed to allow "claims for damages respecting executory contracts including future rents whether the bankrupt be an individual or a corporation . . . ." See *H.R. 5884, 73d Cong. sec. 4(a), § 63(a)(7), at 30* (1st Sess. June 2, 1933).

\(^{102}\) *H.R. 5884, 73d Cong. sec. 1, § 79(b), at 9* (1st Sess. June 2, 1933).

\(^{103}\) *Id.* at 10.

\(^{104}\) *Id.* ("In case any executory contract shall be rejected, the same shall be deemed to have been breached and the holder shall be entitled to file a claim for damages for such breach and such claims may be allowed provided such contract shall not have been terminated by forfeiture, reentry or otherwise.").

\(^{105}\) *See Cent. Trust Co. of Ill. v. Chi. Auditorium Ass'n*, 240 U.S. 581, 592 (1915) ("[P]roceedings, whether voluntary or involuntary, resulting in an adjudication of bankruptcy, are the equivalent of an anticipatory breach of an executory agreement . . . .").

\(^{106}\) *See 11 U.S.C. § 103(a)(7) (1984).*

\(^{107}\) *Id.*

\(^{108}\) *See 11 U.S.C. § 103(a)(9) (1976)*; supra note 47. The 1938 provision survives today in jurisdictions where courts have effectively read the 1938 provision into § 502(b)(6). See, e.g., *In re Mr. Gatti's, Inc.*, 162 B.R. 1004, 1013 (Bankr. W.D. Tex. 1994) (applying § 502(b)(6) as "effectively synonymous with its predecessor, § 63a(9)"."
While the draft bill — then imposing no limitations on future rent claims — was pending in Congress, the Supreme Court decided two cases involving liquidations, the law of which was not amended by the 1933 Act relating to compositions and reorganizations. In January 1934, the Supreme Court confirmed in Manhattan Properties, Inc. v. Irving Trust Co. that the 1933 amendments allowed claims for future rent in individual debtor compositions and railroad reorganizations but did not change the existing law of liquidations. Future rent claims were not provable and remained disallowed in liquidations under existing bankruptcy law.

Manhattan Properties was decided with another case, Brown v. Irving Trust Co. The facts of both made clear that money damages resulting from termination of a lease were not limited to "future rents." These two cases alerted Congress that leases could provide for damages consisting not only of "future rent" but also of other future money damages, such as indemnification or future costs of cover. Moreover, the examples of Manhattan Properties and Brown demonstrated the potential immensity of a landlord's claim for uncapped future rent or indemnification. These cases made plain

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109See supra note 96.

110Manhattan Props., Inc. v. Irving Trust Co., 291 U.S. 320, 332 (1934) ("The issue is not one of power, for plainly Congress may permit such claims or exclude them.").

111Id. at 336 ("If the rule is to be changed, Congress should so declare.").

112The Court's opinion discussed the facts of each case separately, referring to each case by its docket number (Manhattan Properties as No. 505 and Brown as No. 506) and not its name. See id. at 328-29.

113In Manhattan Properties, the landlord claimed damages for termination of the lease under a "covenant" that provided the landlord the right, upon the tenant's breach, insolvency, bankruptcy, or default, to reenter and relet the premises

as agent for the tenant, for the whole or any part of the term, and from time to time,

and: "The Tenant further agrees to pay each month to the Landlord the deficit accruing from the difference between the amount to be paid as rent as herein reserved and the amount of rent which shall be collected and received from the demised premises for such month during the residue of the term . . . ."

Manhattan Props., 291 U.S. at 328-29 (quoting the lease covenant). Similarly, in Brown, a covenant specifically provided that "the Lessee covenants that in case of such termination it will indemnify the Lessor against all loss of rent which the Lessor may incur by reason of such termination, during the residue of the [lease] term." Id. at 329 (quoting the lease covenant).

114Residual guarantee clauses, discussed infra at note 273, are another example.

115See Manhattan Props., 291 U.S. at 328-29. The two leases had respective terms of nine years, eight months, with over five years remaining at default, and twenty-five years, with over twelve years remaining at default. Id. The claim under the latter lease, in 1934 dollars, was over $140,000. Similarly, just a few days after the Manhattan Properties decision, the Second Circuit applied pre-1933 law to allow a landlord's claim for indemnification of future rent under a then-novel ipso facto clause that terminated the lease and accelerated damages at the moment of the tenant's bankruptcy. A.W. Perry, Inc. v. Irving Trust Co. (In re Outfitters' Operating Realty Co.), 69 F.2d 90, 91-92 (2d Cir. 1934), aff'd, Irving Trust Co. v. A.W. Perry, Inc., 293 U.S. 307 (1934). The court distinguished the lease provision at issue in Manhattan Properties and Brown, signaling to landlords that the provability and allowance of their indemnification claims would turn upon the particular terms of their lease covenants. Id. The Supreme Court upheld the Second Circuit's decision in a summary opinion issued after the 1934 statute's enactment, but
that the phrase "future rent" was too narrow to capture the many kinds of prospective damages to which landlords might be entitled under lease covenants, and that uncapped future rent claims could be enormous. The rulings did not, however, affect the treatment of non-prospective damages.

One month after Manhattan Properties, the Senate committee considering the bill reported it favorably but with an amendment capping the landlord's claim in liquidation proceedings: "[T]he claim of a landlord for anticipatory breach of an unexpired lease of real estate shall in no event be allowed in an amount exceeding the rent reserved by the lease for the year next succeeding the date of the surrender of the premises."116 Initially, the amendment only limited damages from anticipatory breaches presumed from rejection — not preexisting, actual breaches, and not all breaches of any lease provision at any time.117 In corporate reorganization cases, one year's future rent was given the same priority as other debts ordinarily provable in liquidation, whereas the remaining claim (for an unlimited number of years) was allowed but subordinated to debts ordinarily provable in liquidation.118 Though the caps were limited, the bill still made provable claims that just one year earlier had been unprovable.

Over a month passed after the Senate committee's action. Then, the sweeping covenant-or-indemnity language that survived until 1978 was introduced by floor amendment.119 The Manhattan Properties and Brown decisions used the words "covenant" and "indemnify."120 These cases provide context for the Senate's amendment and suggest that the amendment was intended to limit covenant-or-indemnity damages like those at issue in Manhattan Properties and Brown, which were prospective, not non-prospective, damages.

At the same time that the one-year limitation was placed on the cove-

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117 But cf. Koike v. McSherry, 114 B.R. 91, 102 (B.A.P. 9th Cir. 1991) (concluding that "rejection of the lease results in the breach of each and every provision of the lease, including covenants").

118 H.R. 5884, 73d Cong. sec. 1, § 79(b), at 11 (2d Sess. May 7, 1934) (showing Senate amendment number 14); 78 Cong. Rec. at 7889 (May 2, 1934). This complication was later eliminated in favor of the one-year limitation on liquidations and three-year limitation on reorganizations.

119 78 Cong. Rec. 7889 (May 2, 1934). Senator Hastings, the Senate manager of the bill, offered amendments on the Senate floor removing the reference to "anticipatory breach" and applying the one-year limitation generally to "the claim of a landlord for injury resulting from the rejection of an unexpired lease of real estate or for damages or indemnity under a covenant contained in such lease." Id. (emphasis added).

120 See supra note 113.
nant-or-indemnity damages, Senator Hastings offered another amendment making explicit that these limited damages were in addition to an uncapped claim for "an amount equal to the unpaid rent accrued up to" the date of surrender or rejection.\textsuperscript{121} Both amendments were approved in the Senate without discussion.\textsuperscript{122} Notably, the proposed (and enacted) statute continued to recognize priority of payment that any state law might grant a landlord for accrued (prepetition) rent.

But the House objected to the Senate's amendments. The House did not want future rent claims capped at one year. The Senate's amendments were altered in the conference committee which issued a report describing the purpose and scope of the amendments as the House understood them.\textsuperscript{123} Specifically, the conference report described the cap provisions in the corporate reorganization section of the statute entirely in terms of "future rent" and prospective damages.\textsuperscript{124} Likewise, the report summarized the cap provisions for liquidations entirely in terms of "future rent" and prospective damages, underscoring that the amendment's effect was remedial rather than

\textsuperscript{121} 78 CONG. REC. 7889 (May 2, 1934).

\textsuperscript{122} Id. The only reference to the general issue of lease rejection in either the House or Senate after Senator Hastings's floor amendment came later when Senator Shipstead urged that the rejection power accorded to corporations should likewise be accorded to farmers. See 78 CONG. REC. 8081 (May 4, 1934).

\textsuperscript{123} The Conference Committee report, H. Rep. No. 73-1773 (May 24, 1934) (Conf. Rep.), reprinted in 78 CONG. REC. 9547-50 (May 24, 1934), was later withdrawn and recommitted to the conference for corrections to the very provisions discussed here. See 78 CONG. REC. 9760 (May 28, 1934). The final version of the Conference Committee report was submitted five days later. H. Rep. No. 73-1821 (May 29, 1934) (Conf. Rep.), reprinted in 78 CONG. REC. 9897-99, 10208-09 (1934). In sum, the conference committee (1) eliminated the subordination scheme for damages in excess of one year's rent and limited damages to no more than one year's rent in liquidation cases and no more than three years' rent in reorganization cases; (2) provided that the future rent calculation was "without acceleration"; and (3) directed courts to scrutinize any assignment of future rent claims in determining the amount of damages allowed. H. Rep. No. 73-1773, at 2, 3, 5-7 (May 24, 1934) (Conf. Rep.), reprinted in 78 CONG. REC. 9547-50 (May 24, 1934); H. Rep. No. 73-1821, at 2, 3, 5-7 (May 29, 1934) (Conf. Rep.), reprinted in 78 CONG. REC. 9897-99, 10208-09 (1934).

\textsuperscript{124} The conference report explained:

Under the House bill, executory contracts, including claims for future rent, are made provable claims... The Senate amendment limited claims for future rent to an amount equal to the rent reserved by the lease for 1 year.

The amendment agreed to by conference makes any person injured by the rejection of an executory contract or unexpired lease of real estate a creditor... The claim of the landlord for injury resulting from loss of future rent is limited to an amount not to exceed the rent reserved by the lease for 3 years next succeeding the date of surrender of the premises or the date of reentry of the landlord, whichever first occurs, plus unpaid rent accrued up to such date of surrender or reentry of the landlord.

This amendment has to do with claims for future rent under the general bankruptcy act. As agreed upon by the conferrees, such claims are permitted to be provable claims, provided that in no event shall a claim for damages be allowed in an amount exceeding the rent reserved by the lease for 1 year after surrender of the premises, plus the unpaid rent accrued to said date. . . . The provisions of this clause are made to apply to estates pending at the time of the enactment of this amendatory act.126

In the end, after the 1934 amendments, the statute governing liquidations allowed claims for damages respecting executory contracts including future rents whether the bankrupt be an individual or a corporation, but the claim of a landlord for injury resulting from the rejection by the trustee of an unexpired lease of real estate or for damages or indemnity under a covenant contained in such lease shall in no event be allowed in an amount exceeding the rent reserved by the lease, without acceleration, for the year next succeeding the date of the surrender of the premises plus an amount equal to the unpaid rent accrued up to said date . . . .127

The parallel provision providing for lease termination damages in newly authorized corporate reorganizations operated similarly, except that it limited the claim to three years' rent reserved, without acceleration, plus unpaid rent accrued to the date of surrender or reentry.128

Taken in context, the conference report suggests that, despite the broad

127 Act of June 7, 1934, ch. 424, sec. 4(a), § 63(a)(7), 48 Stat. 911, 923-24 (emphasis added). This provision was amended eleven days later in a one-sentence Act to clarify that the new subsection (7) applied to claims filed in cases pending at the time of enactment only where "the time for filing such claims has not expired." Act of June 18, 1934, ch. 580, 48 Stat. 991. The complete provision was codified as amended at 11 U.S.C. § 103(a)(7) (1934).
128 Act of June 7, 1934, ch. 424, sec. 1, § 77B, 48 Stat. 911, 915 (codified at 11 U.S.C. § 207(b) (1934)) (providing that "any person injured by . . . rejection shall, for all purposes of this section and of the reorganization plan, its acceptance and confirmation, be deemed to be a creditor," and that a landlord's claim "for injury resulting from the rejection of an unexpired lease of real estate or for damages or indemnity under a covenant contained in such lease shall be treated as a claim ranking on a parity with debts which would be provable under section 63(a).")
language used to account for covenants and indemnification provisions in Manhattan Properties, Congress was aiming at claims for future rent and other prospective charges and indemnities under unexpired leases rejected in bankruptcy.\textsuperscript{129} That Congress could have intended (without even mentioning) a sweeping limitation of previously uncapped, provable, accrued, noncontingent, easily liquidated damages preceding bankruptcy is difficult to reconcile with the legislative history.\textsuperscript{130} Moreover, the legislative history contemporaneous with the adoption of the "damages or indemnity under a covenant contained in such a lease" language suggests an intention to address lease provisions that provided prospective damages resulting from lease rejection.\textsuperscript{131}

E. 1934 TO 1938: FOUR SUPREME COURT CASES AND FURTHER STATUTORY REFINEMENTS

The key terms of the 1934 statute did not change significantly in the 1938 Chandler Act. In the case law and legislative history, moreover, there continued to be no discussion indicating that either the 1934 cap provision or the version enacted in the 1938 Chandler Act aimed at any damages other than prospective damages such as future rent and rent-like charges permitted by applicable nonbankruptcy law. Nonetheless, a few developments after 1934 are illuminating.

In 1936, the Supreme Court considered four cases arising from the 1934 cap. The cases involved the constitutionality, interpretation, and application

\textsuperscript{129} The statute referred to rejection, not termination, until 1978. See supra notes 24 and 47.

\textsuperscript{130} For example, Senator Hastings, who introduced the key language, was a proponent of landlords' rights and said nothing to suggest a broader intention to eliminate non-prospective damages claims. See supra notes 119-122 and accompanying text.

\textsuperscript{131} Admittedly, there is some tension between the 1934 legislative history and the sweeping text of the 1934 statute. E.g., 2 Harold Remington, Remington on Bankruptcy § 652.03, at 279 (1956) (noting that the history of § 65(a)(9) indicates the cap was aimed only at future rent claims, and that it is fair to assume Congress did not intend to change existing law except as to future rent, but acknowledging that the language of § 65(a)(9) is "broad enough to cover any kind of a damage claim by a landlord" even though the cap ties provable damages to "rent reserved"). Despite this tension, cases decided under the 1934 cap indicate that courts allowed "the estimated cost of repairs and maintenance" to be included in calculating the three years of "rent" to which the landlord was entitled under the cap. E.g., Picker v. Irving Trust Co. (In re United Cigar Stores Co. of Am.), 86 F.2d 629, 631, 633 (2d Cir. 1936). If courts had allowed landlords to recover estimated future maintenance costs as "rent," it would have been unusual for courts not also to have allowed actual repair and maintenance costs in calculating "unpaid rent accrued" before bankruptcy, which has never been capped. This suggests that courts after 1934 were not so categorical as to place all damages for breaches of covenant outside the scope of "rent" and to cap the damages.

For purposes of this Article, however, any tension between the text of the 1934 statute and its legislative intent need not be resolved. It is sufficient to recognize that, in interpreting § 502(b)(6) after 1978, courts should not rely upon assumptions about the pre-1978 statute to conclude that references to "current law" in the 1978 legislative history mean Congress — despite its wholesale reformulation of the cap's language — nonetheless intended § 502(b)(6) to include damages beyond the current statute's own terms. See supra notes 47-50 and accompanying text; infra Part III.B.
of the cap to certain lease provisions. Each was decided unanimously with an opinion by Justice Roberts, who had written the opinion in Manhattan Properties. The Court's discussion in these cases, particularly City Bank Farmers Trust Co. v. Irving Trust Co. and Kuehner v. Irving Trust Co., consistently respected the distinction between "rejection" and "termination."

In all four opinions, the Court also referred to the legislation having made provable claims that were traditionally not easily quantifiable and therefore considered not provable. In City Bank, the Court expressly acknowledged "the remedial purposes of the act, which demand a liberal construction in favor of the claimants for whom relief was intended." In Kuehner, the Court upheld the constitutionality of the cap only after holding that the relationship between the capped damages and the measure of the cap was reasonable. Nowhere in the discussion did the Court suggest that the cap would have applied — permissibly or otherwise — to damages that were not "of a peculiar class of claims, difficult of liquidation" and "ha[ving] some relation-

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132 See Meadows v. Irving Trust Co., 299 U.S. 464 (1937) (holding that a lease provision may cut off a landlord's right to damages); Schwartz v. Irving Trust Co., 299 U.S. 456 (1937) (holding that a landlord's rights may be released for adequate consideration); Kuehner v. Irving Trust Co., 299 U.S. 445 (1937) (upholding the cap under the Fifth Amendment's Due Process Clause); City Bank Farmers Trust Co. v. Irving Trust Co., 299 U.S. 433 (1937) (holding that landlords may claim lease-rejection damages whether or not the lease provided for them).

133 E.g., Meadows, 299 U.S. at 466-67; City Bank, 299 U.S. at 438-40, 443 ("[P]rovability of ... a claim is unaffected by any termination of the leasehold subsequent to rejection of the lease.").

134 City Bank, 299 U.S. at 444. The Court discussed at length the history of lease termination damages in bankruptcy and concluded that, regardless whether a lease provides for damages upon breach, the recent legislation's "purpose is clearly to give a landlord a provable claim for injury due to the rejection of his lease, whether the instrument contains a covenant of indemnity or not." Id. at 441 (emphasis added). Rejecting the assertion that a landlord's claim is destroyed if the landlord enters and repossesses the land after rejection, the Court stated:

In view, however, of the obvious intent of the statute to extend relief not only to landlords whose leases may in future be rejected, but also to those whose leases have been rejected in prior bankruptcy or equity proceedings, such a construction would ill accord with the remedial purposes of the act, which demand a liberal construction in favor of the claimants for whom relief was intended.

Id. at 444. The Court described the statute's effect as making provable and thus dischargeable claims "for rent to accrue under a lease, or for damages or indemnity payable because of the termination of a leasehold." Id. at 439 (emphases added). Nowhere in its discussion of the cap provision did the Court indicate any concern with non-protective damages not flowing from the act of rejection.

135 See Kuehner, 299 U.S. at 454-55. The Court held that the three-year cap on damages — and, thus, the discharge of all additional future rent claims — was not an unconstitutional deprivation of property under the Fifth Amendment's Due Process Clause. Id. Notably, Kuehner did not dismiss the constitutional challenge out of hand. Rather, the Court explored the reasonableness of the relationship between the capped damages (i.e., future rents and rent-like charges) and the measure of the cap (i.e., a number of years of rent). Kuehner's rationale was tied to the landlords' loss of "merely of a bargain for the use of real estate," as opposed to damages for tangible costs — for example, when "merchandise creditors, lenders, and others, recover in specie none of the property or money which passed from them to the debtor." Id. at 455 ("[T]he rent reserved, broadly speaking, has some relationship to the value of the property and the value of a lease thereon.").
ship to the value of the property and the value of a lease thereon.”

Shortly after these four cases were decided, Congress held hearings to consider draft bills that would ultimately lead to the 1938 Chandler Act. Throughout the testimony, floor debates, and committee reports, references to the relevant provisions addressed only the “highly controversial question for claims for unpaid rent due landlords on long leases.” In the end, Congress made minor changes to § 63(a) of the Act — § 502(b)(6)’s direct predecessor — and added parallel cap provisions to the other non-liquidation chapters of the Bankruptcy Act. Both House and Senate statements refer

136Id. at 455. Although this constitutional issue is beyond the scope of this Article, it is fair to ask whether the *Kuehner* holding allows all of a landlord’s claims to be capped by relation to rent reserved, even where the damages capped bear no relationship to the rental premium or the value of the premises. As the *El Toro* court observed:

The structure of the cap — measured as a fraction of the remaining term — suggests that damages other than those based on a loss of future rental income are not subject to the cap. It makes sense to cap damages for lost rental income based on the amount of expected rent. Landlords may have the ability to mitigate their damages by re-leasing or selling the premises, but will suffer injury in proportion to the value of their lost rent in the meantime. In contrast, collateral damages are likely to bear only a weak correlation to the amount of rent. A tenant may cause a lot of damage to a premises leased cheaply, or cause little damage to premises underlying an expensive leasehold.

Saddleback Valley Cnty. Church v. El Toro Materials Co. (*In re El Toro Materials Co.*), 504 F.3d 978, 980 (9th Cir. 2007).

137See H.R. 8046, 75th Cong. (1st Sess. 1937); H.R. 6439, 75th Cong. (1st Sess. 1937).


to the provisions permitting “future rent” claims without any mention of
limiting non-prospective damages more broadly.\textsuperscript{140}

The 1938 provision, which continued in effect until 1978, allowed proof
of “claims for anticipatory breach of contracts, executory in whole or in part,
including unexpired leases of real or personal property.”\textsuperscript{141} A landlord’s claim
“for damages for injury resulting from the rejection of an unexpired lease of
real estate or for damages or indemnity under a covenant contained in such
lease” was capped at an amount equal to one year’s “rent reserved” following
surrender or reentry, plus any “unpaid rent accrued” prior to surrender or
reentry.\textsuperscript{142}

In sum, there is no evidence in the 1930s House or Senate reports, House
or Senate hearings, or Congressional Record that Congress intended to cap
damages to which a landlord may have been entitled before termination,
surrender, reentry, or rejection.\textsuperscript{143} Nothing in the cap’s history supports an
application of the current § 502(b)(6) to damages beyond those “resulting
from the termination of a lease of real estate.”

F. DEVELOPMENTS BETWEEN 1938 AND 1978

Between 1938 and 1978, an issue ancillary to the inclusiveness of the cap
surfaced, namely the proper application of a debtor-tenant’s security deposit
held by a landlord. The issue was addressed in the seminal case on the issue,

\textit{House Hearings}, supra note 138, at 158 (statement of Mr. Adair); \textit{Revision of the National Bankruptcy Act: Hearing on H.R. 8046 Before Subcomm. of the S. Comm. on the Judiciary, 75th Cong. 120 (2d Sess. Nov.

\textsuperscript{140} See S. REP. NO. 75-1946, at 8–10, paras. 23, 30, 38 (3d Sess. 1938); 83 CONG. REC. 9108–99 (June 13, 1938). The provisions added the cap to chapters dealing with arrangements (section 353), real
property arrangements (section 458), and wage earner plans (section 642).


\textsuperscript{143} Sections 602, 753, and 838 of the pre-1978 Code included nearly identical language, except that they
allowed claims for up to three years’ rent for landlords of reorganizing corporations or those subject to

\textsuperscript{144} Jacob Weinstein, who had represented the National Bankruptcy Conference before the Senate, see,
\textit{e.g.}, 1937–38 Senate Hearings, supra note 139, at 117–20 (statement of Mr. Weinstein, including the
National Bankruptcy Conference’s explanations of recommended amendments), wrote a “comparative analysis” of the Chandler Act. \textit{Weinstein, supra} note 17. Throughout, Weinstein indicated that contemporary
experts viewed the broadly worded cap as a “provision dealing with future rent claims.” \textit{Weinstein, supra}
note 17, at 120 (introducing analysis of section 63). Comparing the 1934 and 1938 cap provisions,
Weinstein observed that the 1934 provision “provided that a claim for damages respecting executory
contracts, including future rents, shall be provable. The new language makes no change in substance.” \textit{Id.}
at 132; see \textit{also} id. at 227, 277, 311, 344 (referencing “future rent” claims under other chapters of Act).
According to Weinstein, the 1934 cap provision “limited the amount to be allowed for a future rent claim.
It has been rewritten in the Chandler Act to make its scope and meaning clear and certain.” \textit{Id.} at 132.
Because none of the operative language regarding rejection damages or covenant-or-indemnity damages
was amended in 1938, Weinstein referenced the several minor amendments clarifying temporal scope and
so forth, detailed above. See \textit{supra} note 139.
Olden v. Tonto Realty Corp. Since Olden is the only case mentioned in the 1970s legislative history of § 502(b)(6), a discussion of the case is in order.

Olden dealt with the application of the cap in the context of a security deposit. The court held that the statutory cap on damages should be calculated, and the landlord’s security deposit then should be applied to reduce the capped amount. Any amount of capped damages remaining after the application of the security deposit would be allowed as an unsecured claim against the estate, but if the security deposit exceeded the capped amount, the estate could recover the surplus security deposit from the landlord. Olden disallowed a landlord’s attempt to retain the security deposit in full and then seek the capped amount as an additional unsecured claim against the estate.

Olden, which was cited by the drafters of the 1978 Code, contains a useful discussion of both the pre-1934 law regarding landlords’ claims and the factors leading to the 1934 compromise. However, Olden involved only rent damages. It dealt solely with the application of a landlord’s security deposit — a subject on which the pre-1978 statutes were silent. The case provides no support for the expansion of the word “termination” in the 1978 cap provision. Accordingly, any discussion of Olden in the 1970s is properly understood to relate to Olden’s holding regarding the treatment of security deposits.

G. The 1970s Revisions

An analysis of how Congress started with the 1938 version of the cap and ended with the 1978 version begins with the 1973 report of the Commission on the Bankruptcy Laws of the United States. The Commission proposed combining Title 11’s existing sections 103(a)(9), 602, 753, and 858 into one provision (now 11 U.S.C. § 502(b)(6)). The Commission proposed to allow a landlord’s damages claim, except to the extent that the claim of a lessor for damages resulting from the termination of an unexpired lease of real property exceeds the rent reserved by the lease, without acceleration, for a year following (A) the date of the petition, or (B) if the contract is ter-

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11 Olden v. Tonto Realty Corp., 143 F.2d 916 (2d Cir. 1944).
12 See id. at 921-21.
13 See id.
14 See id. at 918-20.
15 See In re Best Prods. Co., 229 B.R. 673, 678 n.9 (Bankr. E.D. Va. 1998) (observing, in discussing the citation of Olden in the 1970s legislative history, that “§ 502(b)(6) is not a codification of the ruling in Olden v. Tonto Realty Corp., as has been mistakenly stated”)
17 See id., Part II, at 106.
minated earlier, the date on which the lessor repossessed or the lessee surrendered the leased property, plus an amount equal to the unpaid rent accrued, without acceleration, up to such date, provided that the claim as allowed shall be offset against any security held by the lessor and that any excess of the security over the allowed claim shall be recoverable by the trustee. ... \(^{151}\)

The Commission transformed a provision that previously limited “damages for injury resulting from the rejection of an unexpired lease of real estate or for damages or indemnity under a covenant contained in such lease”\(^{152}\) into one that limited “damages resulting from the termination of an unexpired lease of real property ...”\(^{153}\) The Commission’s entire commentary on this provision was to note that it replaces the first proviso in § 63a(9). The only substantive change is found in the proviso. It codifies the decision in *Oldden v. Tonto Realty Corp.* The second clause of the proviso extends the decision in *Oldden* to authorize the recovery of security that exceeds the portion of the claim allowed.\(^{154}\)

Despite the wholesale abandonment of the earlier provision’s operative terms, the Commission observed simply that the revision intended no substantive change. The Commission’s reference to *Oldden* plainly related to the proposed provision’s addition of language allowing an offset against security deposits and recovery by the trustee of any excess security.

The Commission’s statement that no substantive change was made by the substitution of the word “termination” for “rejection” and deletion of the covenants-or-indemnity phrase seems counterintuitive, unless the Commission understood the deleted phrase to limit only claims for “damages or indemnity” resulting from the rejection of an unexpired lease. Otherwise, the Commission’s deletion of the covenants-or-indemnity phrase — which in the 1938 provision was not modified or limited by the words “resulting from” — could not reasonably be read to effect no substantive change.

In the final 1978 statute, Congress removed the proviso regarding the treatment of security deposits, apparently trusting that statements in the committee reports would lead courts to apply *Oldden’s* treatment of security

\(^{151}\) *Id.*, Part II, at 100 (setting forth proposed section 4-403(h)(6)).


deposits.\textsuperscript{155}

The House and Senate reports contained identical statements that a landlord’s “allowed claim is for his total damages, as limited by this paragraph.”\textsuperscript{156} This ambiguous statement could stand for either of the following propositions:

\textsuperscript{155}The 1977 House report explained:

Paragraph (7), derived from current law, limits the damages allowable to a landlord of the debtor. The history of this provision is set out at length in Oldden v. Tonto Realty Co. It is designed to compensate the landlord for his loss while not permitting a claim so large (based on a long-term lease) as to prevent other general unsecured creditors from recovering a dividend from the estate. The damages a landlord may assert from termination of a lease are limited to the rent reserved for the greater of one year or ten percent of the remaining lease term, not to exceed three years, after the earlier of the date of the filing of the petition and the date of surrender or repossess. The sliding scale formula is new, [and] is designed to protect the long-term lessor. . . . This subsection does not apply to limit administrative expense claims for use of the leased premises to which the landlord is otherwise entitled.

This paragraph will not overrule Oldden, or the proposition for which it has been read to stand: to the extent that a landlord has a security deposit in excess of the amount of his claim allowed under this paragraph, the excess comes into the estate. Moreover, his allowed claim is for his total damages, as limited by this paragraph. By virtue of proposed 11 U.S.C. 506(a) and 506(d), the claim will be divided into a secured portion and an unsecured portion in those cases in which the deposit that the landlord holds in [sic] less than his damages. As under Oldden, he will not be permitted to offset his actual damages against his security deposit and then claim for the balance under this paragraph. Rather, his security deposit will be applied in satisfaction of the claim that is allowed under this paragraph.


Apparently, in the months between the House and Senate reports, Congress’s attention was focused less on the effect of changing the terms of the cap and more on the treatment of lease financings under the cap provision. The Senate Report, issued several months later, repeated the House Report’s two paragraphs nearly verbatim but continued to distinguish between “true” or “bona fide” leases and “financing leases of real property or interests therein, or to leases of such property which are intended as security.” S. Rep. No. 95-989, at 63–64 (1978), reprinted in 1978 U.S.C.C.A.N. 5787, 5849–50. The Senate report continued, in relevant part:

Historically, the limitation on allowable claims of lessors of real property was based on two considerations. First, the amount of the lessor’s damages on breach of a real estate lease was considered contingent and difficult to prove. Partly for this reason, claims of a lessor of real estate were not provable prior to the 1934 [sic] amendments to the Bankruptcy Act. Second, in a true lease of real property, the lessor retains all risk and benefits as to the value of the real estate at the termination of the lease. Historically, it was, therefore, considered equitable to limit the claims of a real estate lessor.

However, these considerations are not present in “lease financing” transactions. . . .


tions: (1) all damages a landlord might claim are capped by the provision, notwithstanding the phrase “resulting from the termination”; or (2) all damages “resulting from the termination” of a debtor-tenant’s lease are capped. Consequently, the “total damages” sentence in the reports is at best unhelpful and at worst misleading.157

In summary, there is nothing in the legislative history from 1932 to 1978 to suggest that “Congress intended to do more than change common law rules of law so as to allow landlords to receive a limited portion of future rents in bankruptcy.”158 At all times, Congress expressed a concern for allowing, but limiting, a portion of a landlord’s prospective damages. Little suggests that Congress intended to eliminate a landlord’s historical right to claim non-prospective damages accrued prior to, and provable in, bankruptcy proceedings. To the contrary, the legislative history demonstrates that the § 502(b)(6) cap was intended to limit prospective damages in the nature of future rent or rent-like charges.

III. THE CASE LAW

There appear to be no published decisions before 1994 that cap damages not traceable to rejection (or, after 1978, termination), at least where the issue was disputed.159 Courts consistently analyzed the nature of a landlord’s various claims, capping only those “of the nature of claims for future rents.”160 In 1994, however, the court in In re Mr. Gatti’s, Inc.161 concluded that § 502(b)(6) capped all claims a landlord might assert, of whatever kind and accruing at whatever time.162 Mr. Gatti’s led to a series of conflicting cases, creating a split where none existed before.163

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157Other portions of the House and Senate reports suggested that Congress appreciated the difference between “rejection” and “termination.” The discussion of § 365 regarding rejection of executory contracts and unexpired leases distinguished between “termination” and “rejection.” For example, the reports noted that § 365(b) “permits the lessee to remain in possession of the leased property or to treat the lease as terminated by the rejection” and explained that under § 365(i) a “purchaser, if the contract is rejected, may remain in possession or may treat the contract as terminated.” See S. Rep. No. 95-989, at 60 (1978), reprinted in 1978 U.S.C.C.A.N. 5787, 5810 (emphases added); H.R. No. 95-985, at 349 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6305-06 (emphases added).


159See infra Part III.A.

160Tipton v. Irving Trust Co. (in re F. & W. Grand 5-10-25 Cent Stores, Inc.), 74 F.2d 45, 47 (2d Cir. 1934) (under pre-1933 law, disallowing claim for debtor-tenant’s promised capital improvements “except so far as damages accrued prior to bankruptcy,” noting that whatever damages had not accrued prior to bankruptcy were “of the nature of claims for future rents, or for restoration of premises, or for payment of all future rents at the termination of the lease which have been held nonprovable”).


162See id. at 1015; infra Part III.B.

163Even the now-overruled McShenandoa case can be traced to Mr. Gatti’s.
A. Before Mr. Gatti’s

Few decisions between 1933 and 1978 discussed the scope of the predecessors of § 502(b)(6). What case law there was reinforced the conclusion that accrued, prepetition damages were not encompassed under those broader provisions.

Though landlords’ claims for future rent and future rent-like charges had been disfavored before 1933, the Second Circuit in 1934 clarified that landlords’ claims for “damages accrued prior to bankruptcy” were provable. Even the Supreme Court noted that bankruptcy rules had always allowed a claim that matured “at or before the filing of the petition.” Cases focused closely on the particular terms of the lease at issue and the accrual of damages under the lease terms, but the general principle that accrued damages were provable appears to have been well settled. Moreover, after the 1934 legislation — which included the facially sweeping rejection and covenant-or-indemnity clauses — both the Supreme Court and at least one bankruptcy

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145 F. & W. Grand, 74 F.2d at 47; see also Trust Co. of Ga. v. Whitehall Holding Co., 53 F.2d 635, 635–36 (5th Cir. 1931) (affirming allowance of accrued prepetition expenses, including taxes, reconstruction, and “other changes, repairs, and restorations of the property”). In F. & W. Grand, often cited in § 502(b)(6) cases, the court disallowed a landlord’s claim for capital improvements a tenant had promised to make but did not make during the tenancy and before bankruptcy. The issue was whether the tenant’s duty to make the improvements arose before bankruptcy, in which case the claim would be provable. See F. & W. Grand, 74 F.2d at 47. If the duty did not arise before bankruptcy, the claim for capital improvements would be disallowed, just as claims for routine restoration of premises, future rents, and other costs of cover. See id. Because the court found the tenant was required under the lease to have begun the capital improvements before bankruptcy but not actually to have finished them by that date, the court held that damages for failure to finish the improvements did not accrue prepetition. See id. The proposition seemed unexceptional, however, that a landlord’s claims for “damages accrued prior to bankruptcy” were fully provable. See id. Earlier cases had reached the same conclusion regarding capital improvements. E.g., In re Schulte-United, Inc., 2 F. Supp. 285, 285–86 (S.D.N.Y. 1932) (disallowing landlord’s claim for future capital improvements promised in lease and observing that the rule disallowing the provability of future rent applies equally to covenants whose effect is to give “additional compensation to the lessor at the end of the term and to afford him additional security” for payment of rent).

146 See City Bank Farmers Trust Co. v. Irving Trust Co., 299 U.S. 433, 440 (1937) (“One having a demand against a debtor whose affairs are in the hands of an equity receiver, if the claim matured after the receiver’s appointment but before the expiration of the period fixed for presentation of claims, is entitled to prove and to share in distribution; but the rule in bankruptcy has been that the claim under an executory contract must mature at or before the filing of the petition.” (footnote omitted)).

147 E.g., First Nat’l Bank of Canton v. Irving Trust Co. (In re Metropolitan Chain Stores, Inc.), 66 F.2d 485, 486 (2d Cir. 1933) (observing that “some obligations of the lessee found in a lease, unlike rents unaccrued when the petition is filed, are provable” and allowing landlord’s claim for restoration of property, even though the obligation to restore did not technically arise under the lease until after termination and thus after the petition date). This focus on the terms of a lease prompted the Second Circuit’s application of pre-1933 law to allow a claim for indemnity damages due immediately upon filing of bankruptcy under a lease’s then-novel ipso facto clause. See A.W. Perry, Inc. v. Irving Trust Co. (In re Outfitters’ Operating Realty Co.), 69 F.2d 90, 91–92 (2d Cir. 1934), aff’d, Irving Trust Co. v. A.W. Perry, Inc., 293 U.S. 307 (1934); see supra note 115.
court observed that the legislation was "remedial" and "did not purpose to deprive the landlord of any right which he had." The Supreme Court in City Bank stated that the amendments "demand a liberal construction in favor of the claimants for whom relief was intended." In practice, the 1934 statute was not generally viewed to cap all rejection damages and all non-rent prepetition charges.

Until 1994, the decisions under § 502(b)(6) were consistent with the

168 City Bank, 299 U.S. at 444.
169 In re Bengquist, 20 F. Supp. 504, 508 (D.C. Cal. 1937) ("The aim of the amendment was not to deprive the landlord of [existing] rights, but to enlarge his rights against the debtor, while, at the same time, relaxing the debtor from future liability."); see also Jacobson, supra note 84, at 429 (noting that preexisting rights of landlords were not repealed by the 1934 statute, in accord with the "usual rule of statutory construction, that already existing rights are only to be overruled by express repeal"). The Bengquist court, like many, did not distinguish the anticipatory breach bankruptcy causes (described in Central Trust Co. of Illinois v. Chicago Auditorium Ass'n, 240 U.S. 531, 592 (1916)) from the termination that results from that breach. Instead, the court incorrectly characterized bankruptcy as terminating the landlord-tenant relationship. See Bengquist, 20 F. Supp. at 507-08. Part I.A, supra, attempts to dispel this misunderstanding.
170 In re Owl Drug, 12 F. Supp. 447, 448 (D. Nev. 1935), for example, the parties did not dispute that two separate claims were fully allowable, one for prepetition rent and the other for prepetition light and heat charges. Addressing a so-called triple-net or net-net lease, the Second Circuit in 1936 held that "the estimated cost of repairs and maintenance" was properly included in calculating the three years of "rent reserved" a landlord could rightly claim under the 1934 statute. See In re United Cigar Stores of Am. Inc., 86 F.2d 629, 631, 633 (2d Cir. 1936) (holding that such variable charges are properly considered "rent" though not denominated as such).

It would have been inconsistent with that ruling for courts to allow estimated costs of repair and maintenance in calculating prospective damages but not allow actual costs of repair and maintenance in calculating non-prospective rent accrued prior to bankruptcy, which has never been capped. See infra notes 184-185 and accompanying text. A tenant's agreement to pay for routine maintenance and repair — as opposed to capital improvements — benefits both parties, because the base rental charge is better calibrated to what the landlord requires as a margin. These variable costs are borne by the tenant to ensure the landlord does not collect, and the tenant does not pay, too much or too little "rent."

This distinction was recognized in C. D. Simon Co. v. Potter (In re Save-Rite Drug Stores), 195 F.2d 410 (10th Cir. 1952), where the Tenth Circuit disallowed a claim for capital improvements redounding to the benefit of the landlord, but would have allowed damages for mitigation and the tenant's failure to return the premises in good condition had the lessor not "failed to prove the extent or amount of the damage resulting from such breach." Id. at 414 ("Undoubtedly, the expenses reasonably necessary in order to obtain a tenant and mitigate damages under the lease should be assessed against the lessee. But, changes like these, of such substantial and permanent character, redounding as they do to the benefit of the lessor, are not proper items of damages."). See also Ten-Six Olive, Inc. v. Kirby, 208 F.2d 117, 123-24 (8th Cir. 1953) (disallowing a landlord's claims for rent, repairs, and restoration only because the trustee had not assumed or rejected the lease, and applicable nonbankruptcy law rendered the tenant not liable for those damages); Mauer v. Corondolet Realty Trust (In re Parkview-Gem, Inc.), 465 F. Supp. 629, 634, 638 (W.D. Mo. 1979) (applying the 1938 cap provision and allowing recovery of (properly capped) reasonable postrejection mitigation expenses, disallowing capital improvement expenses, and agreeing with the trustee, who conceded that "items of expense incurred by a lessor for repairs which were intended to be included as rental under a 'net-net' lease are properly chargeable to the lessee"). From the 1950s through the 1970s, courts analyzed individual claims, distinguishing capital improvements (not allowed) from repair expenditures (allowed as rent-like charges) and remodeling charges (allowed as reletting damages).
decisions under its predecessors. In 1982, a bankruptcy court allowed damages in excess of the capped future rent claim for intentional destruction of property, noting that "a claim for damages to the premises is not included" in the § 502(b)(6) cap. In 1986, a bankruptcy court, though not addressing precisely what the cap’s "termination" damages encompassed, held that common-area maintenance charges were part of the calculation of "rent reserved." The court thus allowed the portion of those charges accrued and due as prepetition, uncapped amounts and included those charges in the calculation of the cap based on "rent reserved." In 1985, a bankruptcy court analyzed the distinctions between rejection and termination, and concluded that § 502(b)(6) does not make rejection of a lease synonymous with termination: "Use of the word ‘termination’ simply limits the type of claims to which the subsection applies." In a 1986 opinion in the same case, another judge applied this holding to conclude that nonrenewal penalties under a "residual guarantee" clause in a lease were termination damages and therefore were capped.

Finally, in 1991, the court in *In re Atlantic Container Corp.* addressed whether § 502(b)(6) capped a landlord’s claim for repair and maintenance expenses. It was alleged that the landlord suffered prepetition damage to the leased premises resulting from the debtor’s breach of repair and maintenance obligations and intentional infliction of injury. The landlord argued that these damages, unlike other routine termination damages, were not subject to the § 502(b)(6) cap because they did not result from termination. The trustee argued that § 502(b)(6) should be read as broadly as its predecessors.

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173 See id. The parties stipulated that the cap applied to a long list of other charges, see id. at 340, some of which were captioned "repair" but which appeared to be more akin to costs of reletting, i.e., site preparation for new tenants, see id. at 341. The precise issue in Goldblatt was whether the calculation of "rent reserved" should include taxes and common area maintenance charges assessed under the lease, which the court held were included in "rent reserved." See id. at 339, 345.
176 Id. at 981-84.
177 Id. at 987-88 (detailing the parties’ arguments). The trustee argued that the damages were either breaches of the duty to restore premises, which arose only upon termination of the lease, or effective claims for future rent since the lease would have permitted the landlords to make the repairs and charge the tenants “additional rent.” Id. at 985. The landlords argued in the alternative that the prepetition obligations were essentially unpaid rent due on the petition date and thus allowable in full under § 502(b)(6)(B); that the failure to perform the breached covenants "existed before the termination" and thus did not result from termination; or that the damages could be viewed as damages to the landlords’ reversionary interests, "independent of the damage the Landlords suffered from the termination of the Leases." Id. at 986.
sor in the 1938 statute. To support this argument, the trustee relied on two excerpts from the legislative history: statements that the 1978 provision was “derived from current law” and that a landlord’s allowed claim “is for his total damages, as limited by” the cap provision.180

The court rejected the trustee’s argument:

Common sense, as well as traditional methods of statutory construction, however, suggest that Congress must have had some reason for omitting the reference to damages for breaches of lease covenants when it enacted § 502(b)(6). At best, it can be said that the text of § 502(b)(6) is unclear with regard to its application to breaches of lease covenants not caused by or causing the termination.181

Observing that the statutory phrase “damages resulting from the termination of a lease” suggests that the cap “is intended to limit only those damages which the lessor would have avoided but for the lease termination,” the court stated that damages caused by the tenant’s “failure to fulfill its repair and maintenance obligations are unrelated to the termination of the lease.”182 The court reasoned that “the formula for calculating the maximum allowable claim for termination damages under § 502(b)(6) suggests that the primary purpose of the section is to limit claims for prospective damages resulting from the lease termination.”183

The Atlantic Container court addressed the trustee’s argument that repair and maintenance charges should be treated as “future rent” because the parties’ lease designated any charges the landlord may have to incur to maintain and repair the premises as “additional rent” chargeable to the tenant.184

181Atlantic Container, 133 B.R. at 987. The latter is something of an overstatement. The 1970s-era legislative history may be unclear about the application to breaches of lease covenants, but the statute itself does not mention covenants, indemnity, breaches, lease provisions, or anything other than “termination.” See 11 U.S.C. § 502(b)(6); supra Part II.G (detailing 1970s legislative history).
182Atlantic Container, 133 B.R. at 987.
183Id. The court noted the “history of the development of § 502(b)(6) also suggests that the drafters’ primary concern was with limiting prospective damage claims.” Id. at 987–88 (“The repair damages sought here have nothing to do with the long-term nature of the leases. Subjecting these claims to the § 502(b)(6) limitation would deviate severely from the real and reasonable expectations of the parties to the Leases. This court declines to impose such a result absent a clear and unambiguous direction from Congress, especially where, as here, it is alleged that at least some of the damage to the Premises was intentional.”).
184See id. at 985, 988. The trustee cited as support Picker v. Irving Trust Co. (In re United Cigar Stores Co. of America), 86 F.2d 629 (2d Cir. 1936), in which repair and maintenance charges were designated “additional rent” in the lease contract. See id. at 631. The trustee’s citation of United Cigar was unusual, because the Second Circuit permitted these rent-like charges to be included in any calculation of “rent” allowed in future rent claims. See id. at 633.
The court distinguished future repair and maintenance charges that landlords might try to claim as part of termination damages from repair and maintenance costs incurred to remedy the tenant’s past failure to perform its lease obligations:

[W]hether they are considered damages for breaches of covenants to repair and maintain or unpaid past-due rent, the Landlords’ claims for expenses incurred to remedy damage to the leased Premises are not subject to the § 502(b)(6) statutory cap.\(^\text{185}\)

In other words, even if repair and maintenance charges are considered rent-like charges — under the lease or under applicable law — damages accruing from untended repair and maintenance as of the petition date are not capped by § 502(b)(6). Either those damages are unrelated to “termination” and therefore are not capped by § 502(b)(6), or they are properly categorized as uncapped § 502(b)(6)(B) charges for “unpaid rent due under such lease, without acceleration,” as of the petition date or date of repossession or surrender.\(^\text{186}\)

In the two years following Atlantic Container, three other bankruptcy courts followed the same analysis.\(^\text{187}\) In sum, the plain meaning of § 502(b)(6) prevailed in the case law — that is, until Mr. Gatti’s.

B. Enter Mr. Gatti’s

In Mr. Gatti’s, the debtor-tenant had breached its covenant to maintain the premises, abandoning the leased premises four years before filing bankruptcy.\(^\text{188}\) The issue was whether the repair and maintenance damages were within the scope of the § 502(b)(6) cap.\(^\text{190}\) The court ruled that because “rejection is equated to termination . . . § 502(b)(6) is therefore effectively

\(^{185}\) See Atlantic Container, 133 B.R. at 988.


\(^{187}\) Shortly after Atlantic Container, another court added to a landlord’s capped future rent claim an uncapped $90,000 claim for “property damage to the premises resulting from the removal of equipment and vandalism.” In re Q-Masters, Inc., 135 B.R. 157, 160–61 (Bankr. S.D. Fla. 1991). Within the following two years, two other courts similarly did not cap damages for “failure to properly repair and maintain the premises,” In re Bob’s Sea Ray Boats, Inc., 143 B.R. 229, 232 (Bankr. D.N.D. 1992), and damages for the wrongful removal of the landlord’s personal property, In re Farley, Inc., 146 B.R. 739, 746 (Bankr. N.D. Ill. 1992) (describing tenant’s “act of conversion”).


\(^{190}\) See In re Mr. Gatti’s, Inc., 162 B.R. 1004, 1007 (Bankr. W.D. Tex. 1994).
synonymous with its predecessor, § 63a(9). This conclusion sparked a series of misguided applications of the § 502(b)(6) cap in bankruptcy courts across the country.

One flaw in Mr. Gatti's was its inaccurate and misleading conclusion that "[i]t is only where the bankruptcy estate rejects its obligation to perform any further under an unexpired lease of real property that the landlord becomes entitled to file a proof of claim." In fact, a landlord may file a claim for damages resulting from a lease termination that occurred before the bankruptcy filing — i.e., before the power of rejection even arises — and § 502(b)(6) certainly caps that claim. However, the faulty premise that rejection must precede any landlord's claim essentially led the court to conclude that, since rejection damages are all a landlord can claim, § 502(b)(6) must cap all landlord claims.

But the fatal flaw in Mr. Gatti’s was its conflation of rejection and termination: “Rejection by the debtor is a breach of each and every provision of the lease and is, for all practical purposes, a 'termination' by the debtor of the estate’s obligation to perform.” The court observed that “[w]hether the debtor’s rejection is a 'termination' for all legal purposes under the Code is not what § 502 is specifically dealing with. Section 502 deals only with allowance by a landlord of a claim, if presented, against the bankruptcy estate.” Citing numerous cases for the proposition that rejection “results in actual termination of the lease,” the court nonetheless failed to distinguish between the practical fact that rejection usually results in termination — i.e., that most landlords treat rejection as termination — and the quite different

191Id. at 1013.
192Id. at 1011.
193E.g., Solow v. PPI Enters. (U.S.), Inc. (In re PPI Enters. (U.S.), Inc.), 324 F.3d 197, 207-10 (3d Cir. 2003); see supra notes 18-24 and accompanying text. It is surprising that the Mr. Gatti’s court disregarded this possibility in view of the facts of the case: the “[d]ebtor ceased operations and vacated the leased premises about four years prior to filing the[e] bankruptcy case.” Mr. Gatti’s, 162 B.R. at 1007. Upon the tenant’s vacating, the lessor had not exercised its right to terminate the lease, so the debtor did formally reject the unexpired lease upon filing bankruptcy. See id. at 1006. If the lessor had terminated the lease before bankruptcy, however, nothing in § 502(b)(6) would have prevented the capping of damages under the premature termination of the unexpired lease, even though there had been no rejection.
194Mr. Gatti’s, 162 B.R. at 1011. Similarly, the court concluded:

When a debtor “rejects” a lease, the debtor is rejecting its future performance of all of the covenants contained within the lease. This rejection includes its obligation to pay rent, common area maintenance, expenses, taxes, utility charges or to perform services such as maintenance and repair obligations. In a very real and practical sense, rejection is a "termination" by the debtor of the lease.

195Id. at 1012.
196Id. at 1011. The court was correct that § 502 is not concerned with whether rejection constitutes termination “for all legal purposes.” But the observation was beside the point. Section 502(b)(6) is concerned with capping damages “resulting from . . . termination,” language of causation the court disregarded.
197Id. at 1011-12 (citing cases).
legal conclusion that, at least for purposes of statutory interpretation, rejection equals termination in all cases.

The court chose not to examine the distinction between rejection and termination — or even the meaning of the word termination — in interpreting and applying § 502(b)(6). Against the weight of available evidence, the court instead determined that § 502(b)(6) was not concerned with the distinction between termination and rejection. The court held that it capped any damages a landlord may claim following rejection. Rather than analyze the statute to support this conclusion, the court reasoned backward from apparently preconceived conclusions and purported "common sense."197

Moreover, the precedents on which Mr. Gatti’s relied contradicted rather than supported its conclusion. Although many cases from 1985 to 1992 had considered the specific § 502(b)(6) issue and all had reached the same conclusion,198 Mr. Gatti’s cited five cases as "substantial case authority"199 supporting the debtor-tenant’s argument that § 502(b)(6) capped the landlord’s reasonable cost of repairs from the debtor’s failure to maintain and repair the leased premises.200 None of the cases supported Mr. Gatti’s ultimate conclusion.

Weeks v. Kinslow (In re Weeks)201 was an application of the § 502(b)(6) cap to a “claim for contractual rent.”202 Weeks repeatedly referred to the claims resulting from the debtor’s “termination” of the lease.203 That was because Weeks involved a prepetition claim based on a state court judgment for prepetition termination.204 This turns on its head the Mr. Gatti’s generalization that the cap only applies after rejection.205 Weeks contradicted rather than supported Mr. Gatti’s.

Schwartz v. C.M.C., Inc. (In re Communicall Central, Inc.)206 involved an application of the cap to a claim for unrealized future rent.207 The trustee did not dispute the landlord’s claim, and the landlord conceded the cap’s applica-

197 For example, the court said: “Common sense also tells this court that a lessor’s ‘damages’ are not ‘caused’ by technical termination of a lease in any event. Damages are ‘caused’ by a tenant’s actual non-performance of its obligations.” Id. at 1012. By this logic, however, rejection, too, causes no damages.
198 See supra note 188.
200 See Mr. Gatti’s, 162 B.R. at 1006, 1013–14.
202 Id. at 960.
203 See id. at 959, 961.
204 See id. at 959.
205 See Mr. Gatti’s, 162 B.R. at 1011.
207 Id. at 542.
tion.\textsuperscript{208} Because the rejection-termination distinction was not at issue, the court referred to the damages variously as "resulting from rejection,"\textsuperscript{209} "resulting from termination,"\textsuperscript{210} and "flowing from the rejection of the lease."\textsuperscript{211} But the court was not distinguishing between damages arising from rejection and damages resulting from termination. No distinction was necessary because in \textit{Schwartz} they were one and the same, namely a claim for \textit{future} rent. \textit{Schwartz} provided no support for the conclusion in \textit{Mr. Gatti's}.

\textit{Bel-Ken Associates L.P. v. Clark}\textsuperscript{212} refused to apply the cap to a landlord's claim against the guarantors of a rejected lease.\textsuperscript{213} In support of its holding that the cap protects the bankruptcy estate and not third-party guarantors, the court observed that the cap "comes into play once the bankruptcy trustee rejects the lease under 11 U.S.C. § 365(a)."\textsuperscript{214} That observation, which \textit{Mr. Gatti's} quoted in isolation,\textsuperscript{215} did not support the conclusions in \textit{Mr. Gatti's} that rejection equals termination or that the cap applies to all damages asserted after rejection regardless of their cause or date of accrual.

\textit{In re Storage Technology Corp.}\textsuperscript{216} involved an application of the cap to a "residual guarantee," a financial covenant that required a payment of $4.35 million if the tenant failed to renew the lease at expiration.\textsuperscript{217} The landlord argued the cap should not apply to the covenant. After quoting § 502(b)(6)'s language regarding "damages resulting from the termination of a lease,"\textsuperscript{218} the court observed: "This language does not qualify or in any way limit the type of damages involved. The damage cap applies to all damages, which are then arbitrarily capped and measured by rent reserved."\textsuperscript{219} Although this conclusion was imprecise, read in context it was correct, because the court's phrase "all damages" referred to "damages resulting from the termination of a lease." All damages are indeed included — if they result from termination, as nonrenewal penalties do.\textsuperscript{220} The quoted statement does not suggest that the cap extends beyond "damages resulting from the termination of a lease," i.e., to

\textsuperscript{208}See id. at 543.
\textsuperscript{209}Id.
\textsuperscript{210}Id.
\textsuperscript{211}Id. at 544.
\textsuperscript{213}See id. at 358.
\textsuperscript{214}Id. Although the cap can apply regardless of rejection, the Bel-Ken court correctly observed that the cap is a factor in the parties' decision-making following rejection. The observation, however, did not support the Mr. Gatti's court's conclusions.
\textsuperscript{215}See In re Mr. Gatti's, Inc., 162 B.R. 1004, 1010 (Bankr. W.D. Tex. 1994).
\textsuperscript{216}In re Storage Tech. Corp. (\textit{Storage Tech. II}), 77 B.R. 824 (Bankr. D. Colo. 1986).
\textsuperscript{217}Id. at 824–25; see also In re Farley, Inc., 146 B.R. 739, 746 (Bankr. N.D. Ill. 1992) ($10 million residual guarantee for failure to renew lease for seven more years).
\textsuperscript{218}Storage Tech. II, 77 B.R. at 825 (emphasis added).
\textsuperscript{219}Id.
\textsuperscript{220}See infra note 273 (discussing nonrenewal penalties).
rejection damages generally or damages resulting from breaches preceding termination. This case, too, did not support Mr. Gatti's.  

In re Emple Knitting Mills, Inc. provided authority contrary to Mr. Gatti's conclusion. Emple Knitting involved a claim for several years' rent when a trustee rejected a lease and the landlord then chose not to terminate the lease. The landlord insisted that it could treat the lease as not terminated and still claim full future rent from the estate (as opposed to the debtor). The Emple Knitting court made clear that, although the landlord's future rent claim against the tenants might exceed $1 million, the landlord would be limited to the capped amount if it wished to assert a claim in the bankruptcy. Given the landlord's attempted uncapped claim for an unterminated lease, the court concluded: "[T]he lessor retains the option, under state law and according to the terms of the lease, of not terminating the lease and rendering the tenant liable for future rents — but such a claim is not enforceable against the bankruptcy estate."  

Despite Emple Knitting's distinction between "rejection" and "termination," Mr. Gatti quoted extensively from the decision and then concluded: "Thus, if the vast majority of reported opinions are correct, rejection is equated to termination and § 502(b)(6) is therefore effectively synonymous with its predecessor, § 63a(9)." But even if rejection equals termination, this does not purge from § 502(b)(6) the words "resulting from" and their causal requirement. Even assuming arguendo the equivalence of the two words, it does not re-import into § 502(b)(6) the sweeping covenant-or-indemnity language of the statute's predecessor. Moreover, Emple Knitting did not address non-rent damages like the repair damages at issue in Mr. Gatti's. Emple Knitting does not stand for the proposition that § 502(b)(6) caps damages of any kind whatsoever that a landlord may assert against a debtor-tenant (or its estate).  

In sum, the conclusion in Mr. Gatti's that "rejection is equated to termi-
nation and § 502(b)(6) is therefore effectively synonymous with its predecessor, § 63a(9).229 was based upon flawed reasoning, was not supported by the precedents cited for it, and did not "comport with Congressional intent" as the opinion claimed.230

C. Between Mr. Gatti’s and El Toro

The next year, the Ninth Circuit Bankruptcy Appellate Panel in Kuske v. McSheridan (In re McSheridan) followed Mr. Gatti’s essential reasoning.231 In McSheridan, the tenants had already surrendered the premises by the time the trustee rejected the lease, and all rents were current.232 One year later, the landlord filed a claim in the bankruptcy for building improvements, repair and maintenance damages, insurance, utilities, and other expenses incurred

F.2d 1077, 1080-81 (9th Cir. 1989) (emphasis added). The court was not analyzing the ramifications of rejection, breach, and termination of leases, but was addressing their effect on enterprises as going concerns.

Mr. Gatti’s cited a Second Circuit case for the unexceptional proposition that "§§ 365(d)(3), 365(d)(4) and 502(b)(6) when ‘read together’, are part of a total scheme designed to set forth the rights and obligations of landlords and tenants involved in bankruptcy proceedings." Mr. Gatti’s, 162 B.R. at 1011. First, the full quotation reveals that the court of appeals was referring specifically to the bona fide lease provision of § 502(b)(6) and not its treatment of lease termination damages. See Liona Corp., N.V. v. PCH Assocs. (In re PCH Assocs.), 804 F.2d 193, 199 (2d Cir. 1986) ("We have no difficulty applying the section 502(b)(6) requirement of a bona fide lease to section 365(d)(3), (4) because these sections, read together, are part of a total scheme designed to set forth the rights and obligations of landlords and tenants involved in bankruptcy proceedings."). Second, the court’s next two sentences set forth the very rejection analysis that Mr. Gatti’s refused to apply: "When a debtor-tenant rejects a lease . . . that rejection constitutes a breach of the lease under section 365(g), and brings section 502(b)(6) into effect. Section 502(b)(6) limits a landlord’s claim for unpaid rent to three years of future rent, plus any unpaid rent, upon breach of the lease." Id. at 200 (emphasis added) (citation omitted).

229Mr. Gatti’s, 162 B.R. at 1013.
230See id.
231Kuske v. McSheridan (In re McSheridan), 184 B.R. 91 (B.A.P. 9th Cir. 1993), overruled in part by Saddleback Valley Cnty. Church v. El Toro Materials Co. (In re El Toro Materials Co.), 504 F.3d 978, 982 (9th Cir. 2007). The primary issue before the McSheridan court was the proper interpretation of “rent reserved” in § 502(b)(6)(A). See id. at 99–100 (setting forth three-part test for “rent reserved”). The court acknowledged that the scope of the cap had not been raised in the bankruptcy court, the parties had raised the issue on appeal, and the court was empowered to rule on it. See id. at 96 n.5. The opinion is unclear as to which damages, if any, the parties agreed to be capped and which were disputed. See id. at 95 (noting that all rents were current on the date the lessee-debtor abandoned the premises, which was before rejection, and noting damages for building improvements, utilities, repair and maintenance, etc., without reference to whether the charges were properly applicable to the time before the tenant’s surrender). In the end, the court’s conclusion on the issue rendered the question irrelevant, because the court held all damages were capped in toto.

One commentator after El Toro suggested that thirteen courts followed McSheridan’s handling of the cap issue, likely because thirteen is the number of courts Lexis indicates “followed” McSheridan. See Ralph R. Mahey, The Ninth Circuit Effectively Overrules McSheridan and Holds That Bankruptcy Code Section 502(b)(6) Does Not Cap Damages Against Debtor Lessees for Waste, Nuisance, and Trespass, LexisNexis Expert Commentaries (Nov. 2007) (“McSheridan was followed by over thirteen other courts in published opinions, and was relied upon by practitioners within the Ninth Circuit for over a decade.”). In reality, only four of those courts followed McSheridan’s ruling on the § 502(b)(6) cap issue; the others followed McSheridan’s three-part test for “rent reserved.”

232See McSheridan, 184 B.R. at 95.
after rejection. It is unclear from the facts whether these expenses were necessary to remedy past failures to repair and maintain, or whether the landlord was claiming much of the damages essentially as prospective damages. There should be little doubt that a landlord’s future repair and maintenance charges are capped under § 502(b)(6), if allowed at all. The key question is whether past accrued damages for failure to repair and maintain the leased premises are capped.

The court’s resolution rendered the past-future distinction moot. McSheridan concluded that a “claim arising from breach of the lease conceptually encompasses all time intervals and treats the claim as if the breach occurred immediately prior to the filing of the bankruptcy case.” After a statutory analysis in which the court effectively equated rejection with termination, the court held that § 502(b)(6) capped all damages from the breach of any lease provision:

[R]ejection of the lease results in the breach of each and every provision of the lease, including covenants, and § 502(b)(6) is intended to limit the lessor’s damages resulting from that rejection. The damages are those resulting from nonperformance of the debtor’s obligations under the lease. The distinction between past obligations under the lease and damages “caused” by the termination is incorrect because all damages due to nonperformance are encompassed by the statute.

McSheridan’s conclusion that rejection breaches “each and every provision of the lease” was wrong — and entirely unnecessary. Assume, for example, a lease containing three basic covenants: a covenant to pay future rent, a covenant not to damage the leased premises, and a covenant not to manufac-

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233 See id.
234 See id. Only one charge for building improvements is clearly attributed to wear and tear on the building’s roof and air conditioning system during the debtor’s tenancy. See id. It is unclear whether the landlord specifically attributed all other damages to the pre-rejection or pre-surrender period. See id. The past-future distinction is made relevant by a footnote in El Toro. See infra note 261.
235 E.g., Picker v. Irving Trust Co. (In re United Cigar Stores Co. of Am.), 86 F.2d 629, 631 (2d Cir. 1936) (allowing three years of estimated repair and maintenance costs as “rent reserved” in calculating cap).
236 McSheridan, 184 B.R. at 101.
237 Id. at 102.
238 Id. (citing Mr. Gatti’s, 162 B.R. at 1011). The court may have engaged in this circular reasoning because the court considered the cap issue subsidiary to the “rent reserved” issue, without full briefing or even a delineation of the damages attributable to the tenant’s actions before abandonment of the premises which itself preceded the lease’s rejection. The court provided no authority or extended analysis for its conclusion that “rejection of the lease results in the breach of each and every provision of the lease, including covenants.” See id.
ture products outside the tenant’s core business. Assume further that the
tenant manufactures only core products, damages the property prior to bank-
ruptcy, and then rejects the lease in bankruptcy. The debtor does not breach
the covenant not to manufacture noncore products, does breach the covenant
not to damage the property, and anticipatorily breaches the obligation to pay
future rent at the time of rejection.

There is no bankruptcy-related reason to conclude in this situation that
the debtor breached the covenant not to manufacture noncore products at
the time of rejection. Rejection constitutes breach of a contract for purposes
of providing a mechanical petitioning "relation back." As the legislative
history of the predecessor statute makes clear, this breach is understood as an
anticipatory breach giving the nonbreaching party the right to participate in
the bankruptcy distribution, not as a literal breach in toto. Rejection con-
istitutes a breach of provisions the debtor will fail to satisfy because of the
rejection and whatever flows from the rejection — most notably, termination
under nonbankruptcy law. The breach presumed from rejection, however, is
not and need not be a breach of each and every provision of the lease.

McSheridan drew criticism from the next court to consider the
§ 502(b)(6) cap. In In re Best Products Co., the court noted that McSheridan
"relied heavily on Mr. Gatti’s to reach a rather broad, if not startling, conclu-
sion." The Best Products court observed that both cases "rest[ed] upon a
somewhat tortured analysis of the relevant code sections" and concluded that
nothing "in the legislative history of the Bankruptcy Act or current code . . .
overly suggests Congress intended to do more than change common law
rules of law so as to allow landlords to receive a limited portion of future
rents in bankruptcy." The court noted that the majority of cases did not
follow the Mr. Gatti’s and McSheridan rationale. Nonetheless, after Best
Products, a district court in 2000 and a bankruptcy court in 2007 followed
McSheridan, applying § 502(b)(6) to cap all damages a landlord may claim.

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239 See supra note 60.
240 See S. Rep. No. 78-1916, at 6 (1938) ("While this is a fictional relation back, it is necessary as a
mechanical device."); 83 Cong. Rec. 9107 (1938) (House Report with identical statement); supra text
accompanying notes 116, 141 (referring specifically to claims for "anticipatory breach"); see generally supra
Part I.A.
242 Id. at 677–78.
243 See id. at 678.
244 See New Valley Corp. v. Corporate Prop. Assocs. (In re New Valley Corp.), No. Civ. A. 98-982,
(Bankr. D. Del. 2007).

Since El Toro, some commentators have described the McSheridan application of § 502(b)(6) as having
represented the majority rule, while others have described it as the minority rule. Compare Alan J. Lipkin
& Andrew D. Sorkin, Recent Developments in Bankruptcy Cases Affecting Landlords’ Lease Rejection
Damages Claims, 4 PRATT’S J. BANKR. L. 533, 557 & n.8, 558 (2008) (citing McSheridan alone for the
The inherent weakness in giving § 502(b)(6) the sweeping application of Mr. Gatti's and McSheridan becomes evident from an analysis of the steps courts follow in using this approach. These courts proceed by "reverse logic," defining the boundaries of the 1978 cap by reference to the 1938 cap. First, they equate "termination" with "rejection," providing a textual bridge to § 502(b)(6)'s predecessor. Second, they conclude that, because these two terms are synonymous and appear in respective versions of the cap provision, the 1938 and 1978 cap provisions operate identically. Third, they conclude (for reasons not explained) that rejection necessarily constitutes a breach of all provisions of the lease, and thus that the breach of any lease provision should be treated, for purposes of the cap's application, identically to the breach presumed from rejection. Fourth, observing that the 1938 provision was categorical, these courts cap all damages arising from the proposition that "[i]n most previous cases, courts had found the statutory cap covered all damages under a lease because rejection results in a comprehensive breach of a lease," and arguing that "[t]here will be a new level of uncertainty regarding calculation of lease-rejection damages because El Toro is inconsistent with many prior cases," and Mabey, supra note 231 ("McSheridan was followed by over thirteen other courts in published opinions, and was relied upon by practitioners within the Ninth Circuit for over a decade."); and John J. Rapisardi, 'El Toro': A Red Flag on Lease Rejection Damages, N.Y.L.J., Nov. 15, 2007, at 3, 3 (arguing that "McSheridan has been widely followed by other courts, including, for example, the U.S. Bankruptcy Court for the District of Delaware as recently as May 2007," and that El Toro "unsettled existing law", with Michael Buschell, Does § 502(b)(6) Cap Repair and Maintenance Damages?, Am. BANKER. INST. J., Nov. 26, 2007, at 34, 64 & n.15 (collecting citations in support of the assertion that McSheridan represents the minority approach). Based on published cases since 1978, not just since 1994, the position of Mr. Gatti's and McSheridan is the minority, although McSheridan's separate holding regarding the "rent reserved" test has been widely followed. See supra note 231. Characterizing El Toro as "unsettling existing law" ignores the fact that Mr. Gatti's and McSheridan themselves unsettled the law regarding non-prospective damages that had prevailed since the 1930s.

21See id. at 1013 ([R]ejection is equated to termination and § 502(b)(6) is therefore effectively synonymous with its predecessor, § 63a(9)).
22Kuske v. McSheridan (In re McSheridan), 184 B.R. 91, 102 (B.A.P. 9th Cir. 1995); Mr. Gatti’s, 162 B.R. at 1011.
23McSheridan, 184 B.R. at 102 (“Reading these provisions as a whole, therefore, rejection of the lease results in the breach of each and every provision of the lease, including covenants, and § 502(b)(6) is intended to limit the lessor’s damages resulting from that rejection. The damages are those resulting from nonperformance of the debtor’s obligations under the lease. The distinction between past obligations under the lease and damages ‘caused’ by the termination is incorrect because all damages due to nonperformance are encompassed by the statute.”); Mr. Gatti’s, 162 B.R. at 1012 (“In a very real and practical sense, rejection is a ‘termination’ by the debtor of the lease. This rejection effectuates a breach of each of the lease covenants as shown by § 365(g) and that breach is what authorizes a landlord to file a proof of claim for damages. When one considers the context in which termination of the lease is being used, and the fact that structurally it is being used in a Code section that defines the landlord’s rights only when the landlord is filing a proof of claim against the bankruptcy estate because of the rejection of a previously unexpired lease of real property, ‘termination’ is not incompatible with the prior effect of rejection under § 63a(9). In a very real sense, the ‘plain meaning,’ taken structurally and in context, is that the lease is being terminated for the purpose of affording the landlord a breach-of-contract claim for damages suffered because of the future non-performance by the tenant-debtor of the covenants in the lease.”).
24See McSheridan, 184 B.R. at 101.
breach of any provision of the lease, whether the breach was prepetition or postpetition. In sum, these courts conclude that because the 1938 and 1978 cap provisions operate identically, the 1978 provision caps all damages under any covenant of the lease, just as the 1938 provision supposedly did.

This logic pays little respect to the language of the statute and disregards the substantial revision of the cap in 1978. Although these courts generally invoke legislative history to support their interpretation, they rely only on the 1978 legislative history, disregarding the more illuminating legislative history surrounding the cap’s original adoption in the 1930s, none of which the 1978 legislative history repudiates.254

D. ENTER EL TORO

In 2007, the Ninth Circuit Court of Appeals overruled McSheridan’s holding on the scope of § 502(b)(6). The facts of Saddleback Valley Community Church v. El Toro Materials Co. (In re El Toro Materials Co.) illustrate the fundamental illogic of the McSheridan and Mr. Gatti’s reasoning. In El Toro, the debtor-tenant filed a chapter 11 bankruptcy to avoid an estimated $23-million liability for removal of mining waste left on the leased premises in violation of a lease covenant. The monthly rent was $28,000. The three-year cap amounted to just over $1 million, a small fraction of the $23 million in removal expenses the landlord was forced to incur.

As the El Toro court noted, capping these damages at a number of months of rent made no sense, because “collateral damages are likely to bear only a weak correlation to the amount of rent: A tenant may cause a lot of damage to a premises leased cheaply, or cause little damage to premises underlying an expensive leasehold.” The court held that § 502(b)(6) in no way

250 Id. (observing vaguely that a “claim arising from breach of the lease conceptually encompasses all time intervals and treats the claim as if the breach occurred immediately prior to the filing of the bankruptcy case”); id. at 102 (“The distinction between past obligations under the lease and damages caused by the termination is incorrect because all damages due to nonperformance are encompassed by the statute”); see also In re Framex Int’l, Inc., 368 B.R. 383, 393 (Bankr. D. Del. 2007) (quoting McSheridan, 184 B.R. at 101-02).
251 See McSheridan, 184 B.R. at 102; Framex, 368 B.R. at 394; Mr. Gatti’s, 162 B.R. at 1013-14.
252 Mr. Gatti’s, 162 B.R. at 1013 (concluding — without any citation, example, or authority — that, with regard to “other damages, not caused by termination,” “to ignore the cap would be a drastic change from well established bankruptcy law as it existed prior to the enactment of § 502(b)(6)”).
253 See McSheridan, 184 B.R. at 101; Framex, 368 B.R. at 394; Mr. Gatti’s, 162 B.R. at 1009 n.4, 1013.
254 See supra Part II.
256 See id. at 979.
257 Id. at 980 n.2.
258 Id. at 980.
required capping tort-like damages entirely unrelated to termination.\textsuperscript{259} The court reversed the Bankruptcy Appellate Panel, which had believed itself bound by McSheridan,\textsuperscript{260} and overruled McSheridan “[t]o the extent that McSheridan holds section 502(b)(6) to be a limit on tort claims other than those based on lost rent, rent-like payments or other damages directly arising from a tenant’s failure to complete a lease term.”\textsuperscript{261}

Unfortunately, the \textit{El Toro} court was less careful in its use of the statutory terms, referring alternately to “rejection” and “termination” without

\begin{footnotesize}
\begin{enumerate}
\item See id. at 981. A subsidiary issue in \textit{El Toro}, more fully developed in the Bankruptcy Appellate Panel, was whether Saddleback’s claims, which originally sounded in tort, should be analyzed as breaches of lease covenants. See \textit{El Toro Materials Co. v. Saddleback Valley Cnty. Church (In re El Toro Materials Co.)}, No. CC-04-1287, slip op. at 10–22 (B.A.P. 9th Cir. July 8, 2005). As the Bankruptcy Appellate Panel concluded, the tort-versus-contract issue is a distraction, a result of focusing on the wrong statutory terms. Nothing in \S\ 502(b)(6) limits its application to lease breaches. See id. at 22. The cap limits “damages resulting from the termination,” whatever those damages might be. The analysis should depend upon whether the damages resulted from termination.

Because the Ninth Circuit seemed to focus on the tort-like nature of Saddleback’s claim, see \textit{El Toro}, 504 F.3d at 981–82, practitioners’ commentary after \textit{El Toro} has focused upon this aspect of the decision. See, e.g., Lipkin & Sorkin, supra note 244, at 558 (“A key battle line will be drawn over whether or not ‘tort-like’ damages are deemed to arise from rejection of a lease because the claims duplicate a claim based on a breached lease covenant.”); Mabey, supra note 231, at 2 (“In the Ninth Circuit, debtors are now unable to limit landlords’ claims against them for damages arising from tortious [sic] conduct that is unrelated to the lease.”); Rapoza, supra note 244, at 13 (arguing that “\textit{El Toro}’s bifurcation of potential lease-rejection damages into ‘rent-like’ damages and ‘collateral,’ ‘tort-like’ damages injects an element of uncertainty into a debtor’s lease assumption/rejection decision and may adversely affect the feasibility of a debtor’s plan of reorganization” and suggesting that “[i]f these courts may limit the decision . . . by holding that a landlord is precluded from recovering damages in tort for conduct governed by a lease and that the limitation of \S\ 502(b)(6) operates to cap these contract damages.”). The case law risks further confusion from this artificial tort-contract distinction. The focus should be on the only dispositive issue in \textit{El Toro}: whether violation of the stockpiling covenant in the lease gave rise to damages resulting from termination of the lease. See \textit{El Toro}, 504 F.3d at 981.

\item See \textit{El Toro}, 504 F.3d at 982 n.7 (noting that two of the three members of the Bankruptcy Appellate Panel expressed reservations about the McSheridan holding and suggesting that it might be appropriate for the Bankruptcy Panel to adopt an en banc procedure).

\item Id. at 981–82. In a footnote, the court noted:

\begin{quote}
McSheridan also holds that damages flowing from the failure of a party that has rejected a lease to perform future routine repairs or pay utility bills are capped. As the tort claims at issue here are not based on a failure to perform routine maintenance, we do not address the propriety of that holding.
\end{quote}

\end{enumerate}
\end{footnotesize}
drawing any distinction. Nonetheless, El Toro's major contribution to the § 502(b)(6) debate was to focus upon causation, i.e., the statute's often-neglected phrase “resulting from.” The court's reasoning and proposed “test” for the application of the § 502(b)(6) cap demonstrated both the focus on causation and the imprecision in terminology:

The cap applies to damages “resulting from” the rejection of the lease. Saddleback's claims for waste, nuisance and trespass do not result from the rejection of the lease — they result from the pile of dirt allegedly left on the property. . . . A simple test reveals whether the damages result from the rejection of the lease: 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?263

Thus, although El Toro properly stressed causation of the damages claimed, the opinion ignored the word that follows the critical phrase “resulting from”: “termination.”264

Commentary after El Toro has predicted that landlords will frame their termination damages as tort-like claims to avoid the § 502(b)(6) cap.265 But this prediction is short-sighted: the El Toro court did not limit its reasoning, its holding, or even its overruling of McSheridan to tort or tort-like claims.266 The court only mentioned the tort-like nature of the landlord's damages in El Toro to demonstrate that the contested damages did not “result from” termination or rejection or “arise from” the tenant's failure to complete the lease term. The court did not overrule McSheridan's handling of tort claims; rather, the court overruled McSheridan's failure to analyze causation: “To the

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262 The court used the word “termination” only twice, both times in quoting the statute's text, see id. at 979-80, and used the word “terminated” once, see id. at 981 n.4 (“We need not, and do not, decide whether Saddleback could have brought its claims before the lease terminated.”). The court used forms of “reject” throughout, most notably in the statement: “The cap applies to damages 'resulting from' the rejection of the lease.” Id. at 980.

263 Id. at 980-81 (citation omitted).

264 The reluctance to focus on rejection versus termination is unsurprising considering the court's past statements, which have essentially conflated termination and rejection when the distinction was neither dispositive nor closely analyzed. See e.g., K-A, Inc. v. Midway Engineered Wood Prods., Inc. (In re TreeSource Indus., Inc.), 363 F.3d 994, 998 (9th Cir. 2004) (holding that lease contract damages accruing upon termination of lease are not subject to administrative expense priority as pre-rejection damages but rather as prepetition rejection damages, and noting that “[t]he termination or expiration of the lease occurred when Midway rejected the lease”); Cukierman v. Uecker (In re Cukierman), 265 F.3d 846, 849 (9th Cir. 2001) (holding all lease obligations entitled to administrative priority until rejection by trustee and observing, without analysis, that the bankruptcy court's denial of a motion to assume a lease “amounted to a rejection of the lease, so the debtor's obligations under the lease ceased at that point”).

265 See supra note 259.

266 See text accompanying supra note 263 (setting forth El Toro's test for application of § 502(b)(6)).
extent that McSheridan holds section 502(b)(6) to be a limit on tort claims other than those based on lost rent, rent-like payments or other damages directly arising from a tenant’s failure to complete a lease term, it is overruled. Based upon this statement — and the discussion throughout El Toro — any claim fashioned in tort but resulting from termination or “directly arising from a tenant’s failure to complete a lease term” will be capped under El Toro’s reading of § 502(b)(6). Focusing on tort versus contract, if divorced from a causation analysis, is likely a futile strategy, serving only to distort the law of § 502(b)(6) still further.

E. After El Toro

El Toro returned the application of § 502(b)(6) to the key inquiry, causation. A causation analysis will lead to the correct result in most cases, regardless whether the damages resulted from rejection or termination. In most cases, the damages resulting from either one will be the same. Neither will include damages accrued before termination or rejection. Nonetheless, courts should refine the analysis of § 502(b)(6) to recognize that the cap turns upon “termination,” not “rejection.” A proper application of § 502(b)(6) should address each item of damages asserted by a landlord and apply the following analysis.

First, the court should determine whether the item of damages is permitted under applicable nonbankruptcy law, typically the lease or state law, without regard to the cap.

Second, for each item of damages applicable nonbankruptcy law permits, the court should place the item into one of three categories: (1) “unpaid rent due” according to § 502(b)(6)(B) (as of the applicable date under § 502(b)(6)(A)(i)-(ii)); (2) damages “resulting from” the lease’s termination, whether termination occurs before bankruptcy or after rejection in bankruptcy; and (3) damages not “resulting from” the lease’s termination, i.e., damages the landlord was entitled to assert whether or not the lease was terminated. That a lease permits a landlord to claim an item of damages upon termination of the lease does not necessarily mean the damages “result from”

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267El Toro, 504 F.3d at 981–82.

268Judge Klein noted as much in his concurrence to the Bankruptcy Appellate Panel’s opinion. See El Toro Materials Co. v. Saddleback Valley Cmtv. Church (In re El Toro Materials Co.), No. CC-04-1287, slip op. at 30 (B.A.P. 9th Cir. July 8, 2005) (Klein, J., concurring in result) (noting that “re-branding contractual obligations as ‘torts’ is not a promising strategy for eluding the § 502(b)(6) cap”). Of course, framing damages as tort damages, when appropriate, may highlight their non-routine nature and signal to the court that the tort-like damages are not typical termination damages subject to the cap. But El Toro will require a causation analysis nonetheless.

269See Unsecured Creditors’ Comm. of Highland Superstores, Inc. v. Strobeck Real Estate, Inc. (In re Highland Superstores, Inc.), 154 F.3d 573, 581 (6th Cir. 1998) (adopting “the widely accepted rule that a lessor’s damages arising out of a debtor’s lease rejection are determined in accordance with the terms of the debtor’s lease and applicable state law, and then are limited by application of section 502(b)(6)”).
Non-prospective damages claimed for untended repairs, affirmative waste, and the like would normally be categorized as damages not resulting from termination. Reasonable reletting damages incurred after premature lease termination, on the other hand, normally would be categorized as prospective termination damages. And damages claimed for capital improvements normally would not be allowed under any category, because those damages usually will not be permitted by applicable nonbankruptcy law.

Third, each of these three categories should be capped or not pursuant to § 502(b)(6). Damages for items categorized as "unpaid rent due" should be allowed in full. Likewise, damages not resulting from termination, i.e., damages the landlord was entitled to claim regardless of whether the lease was terminated, should be allowed in full. If any damages did result from termination, the amount calculated under § 502(b)(6)(A) should be applied to these damages alone. In sum, each properly asserted item of a landlord's damages should be allowed in full (subject, of course, to Code provisions other than § 502(b)(6)) unless the item of damages: (a) is not for "unpaid rent due," and (b) results from a lease's termination, regardless of whether that termination occurs before bankruptcy or after rejection in bankruptcy.

Where termination occurs before bankruptcy, rejection generally should not be relevant to the § 502(b)(6) analysis. The cap's plain terms limit damages from termination regardless when it occurs, rejection aside. Where termination occurs after rejection, the rejection should be analyzed pursuant to § 365(g) as a prepetition breach of the unexpired lease, giving rise to the landlord's right to treat the lease as terminated. In appropriate cases, the court should resort to the lease or state law to determine if the landlord's actions following rejection amounted to termination of the lease, acceptance

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272 See In re Toms, 994 F.3d at 989-94 ("Rejection of the lease may or may not have triggered Saddlesack's ability to sue for the alleged damages. But the harm to Saddlesack's property existed whether or not the lease was rejected." Footnote omitted).


275 In addition, § 365(g) makes plain that only "unexpired" leases may be rejected. An expired lease may not be rejected, and claims for damages accrued under the expired lease generally must be allowed in full, with some notable exceptions. For example, nonrenewal penalties under a "residual guarantee," even those accruing prepetition, are damages that result from the tenant's choice not to renew — that is, to terminate — the lease. Accordingly, penalties under residual guarantees would properly be capped under § 502(b)(6) even where the lease expired prepetition.

Even if one did not agree that nonrenewal penalties were properly designated "termination" damages, the debate would concern the proper interpretation of the word "termination" under the Code, a more appropriate debate than one where the word is either ignored or read to mean rejection, recasting § 502(b)(6) as the equivalent of its 1938 predecessor.
of surrender, or other actions amounting to termination. In general, if the landlord is attempting to assert a prospective damages claim against the estate, the landlord should be treated as having terminated the lease.

CONCLUSION

Section 502(b)(6) caps a landlord's damages that result from the termination of its lease. The cap does not limit claims for non-prospective damages bearing no relationship to the rental value of the leased premises. Nor does it limit damages for repair and maintenance and other injuries that are not the result of the termination of the lease. This conclusion follows naturally from the plain meaning of § 502(b)(6). The statute requires a causation analysis to cap only those claims occurring after and because of the tenant’s termination of the lease, whenever that termination may occur. The statute does not purport to cap damages resulting from “rejection,” only damages resulting from “termination.” Rejection does not equal termination. The application of the cap will be misguided if the language of the section is ignored and these two distinct concepts are treated improperly as equivalent.

The legislative history of § 502(b)(6), and especially the legislative history of its predecessors, illuminates Congress's intention in enacting and later amending the cap. The genesis of § 502(b)(6) lay in an effort by Congress to allow a landlord's future rent claims, which before the enactment of the original provision were not provable claims in bankruptcy. The evolution of the cap's statutory language from 1933 to 1978 demonstrates that the current § 502(b)(6), by its own terms, is more limited in scope than its predecessor. To read § 502(b)(6) as if it contained the broader language of its predecessor is a mistake.