

APR 05 2005

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OF THE NINTH CIRCUIT**

NOT FOR PUBLICATION

**UNITED STATES BANKRUPTCY APPELLATE PANEL
OF THE NINTH CIRCUIT**

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In re:)	BAP No. WW-04-1328-PST
)	
X10 WIRELESS TECHNOLOGY, INC.,)	Bk. No. 03-23561
)	
Debtor.)	
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OFFICIAL CREDITORS' COMMITTEE,)	
)	
Appellant,)	
)	
v.)	
)	MEMORANDUM¹
X10 WIRELESS TECHNOLOGY, INC.;)	
196TH CORRIDOR, LLC,)	
)	
Appellees.)	
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Argued and Submitted on
February 25, 2005 at Seattle, Washington

Filed - April 5, 2005

Appeal from the United States Bankruptcy Court
for the Western District of Washington

Honorable Samuel J. Steiner, Bankruptcy Judge, Presiding

Before: PERRIS, SMITH and TIGHE,² Bankruptcy Judges.

¹ This disposition is not appropriate for publication and may not be cited to or by the courts of this circuit except when relevant under the doctrines of law of the case, res judicata, or collateral estoppel. See 9th Cir. BAP Rule 8013-1.

² Hon. Maureen Tighe, U.S. Bankruptcy Judge for the Central District of California, sitting by designation.

1 This is an appeal of an order allowing a chapter 11³ debtor in
2 possession to assume three unexpired leases of nonresidential real
3 property. Because there was insufficient evidence that assumption
4 would be beneficial to the estate, we REVERSE and REMAND for the
5 court to conduct an evidentiary hearing.

6 FACTS

7 X10 Wireless Technology, Inc. ("debtor") develops, markets and
8 sells wireless networking products for homes and small businesses.
9 Debtor filed a chapter 11 petition in October 2003.

10 Shortly after the petition date, debtor filed a Motion for
11 Order Extending Deadline to Assume or Reject Non-Residential Real
12 Property Leases ("the first extension motion"). Debtor requested an
13 extension with regard to the following three nonresidential real
14 property leases:

- 15 1. Kent, Washington office space (lease expires 2/28/2007);
- 16 2. Nevada warehouse (lease expires 3/31/2007); and
- 17 3. New Jersey warehouse (lease expires 8/1/2006).⁴

18 Debtor was not in default on the petition date, and has remained
19 current on all postpetition obligations associated with these
20 leases.

21 Debtor's chief financial officer stated as follows in his
22 declaration in support of the first extension motion:

23
24 _____
25 ³ Unless otherwise indicated, all chapter and section
26 references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1330.

⁴ The parties did not analyze the three leases separately
before the bankruptcy court, and do not do so on appeal.

1 2. [Debtor] has approximately 100 employees and our
2 business entails marketing and distributing innovative and
3 affordable wireless home automation and security products to
4 home and small business customers. We reach these customers
5 primarily through direct advertising conducted on the Internet
6 and generally receive and process thousands of customer orders
7 each week. Our primary offices are located in Kent, Washington
8 and we maintain two warehouses located in Nevada and New
9 Jersey.

10

11 4. The real properties subject to these three leases are
12 [sic] among the [debtor's] primary assets. Because our sole
13 business is the operation of a retail sales business from
14 leases [sic] offices in [the] Kent, Washington location with
15 two leased large warehouse facilities located in Nevada and New
16 Jersey, until we can negotiate a confirmable Plan of
17 Reorganization we are not in a position to fairly consider
18 whether to assume or reject these leases. [Debtor's] analysis
19 of these leases is directly related to our ability to
20 successfully reorganize under a Plan of Reorganization. For
21 these reasons, [debtor] requires additional time to negotiate a
22 Plan before we decide whether to assume or reject real property
23 leases.

24 Declaration of Wade Pfeiffer in Support of Debtor's First Extension
25 Motion, at 1-2.

26 The owner of the Kent property objected to the length of the
extension requested by debtor. The court entered an order extending
the deadline for debtor to assume or reject the leases until March
24, 2004, "unless extended by subsequent motion." Order Granting
Debtor's Motion for Order Extending Deadline to Assume or Reject
Non-Residential Real Property Leases, at 1-3.

 Before the extended date for assumption or rejection, debtor
filed a Motion to Extend Time to Accept or Reject Leases ("the
second extension motion"), requesting an additional 120 days. The
second extension motion was supported by a declaration of debtor's

1 president, Alex Peder ("Peder"). Peder ratified Pfeiffer's
2 declaration and stated that debtor

3 requires additional time to negotiate a Plan before deciding
4 whether to assume or reject its real property leases. This is
5 due in part to the fact that [debtor] has recently retained new
6 counsel to represent the corporation in this chapter 11
7 proceeding, and [debtor's] new counsel will require additional
8 time to come "up to speed" in this case before a Plan can be
9 negotiated and proposed.

10 Declaration of Peder in Support of Second Extension Motion, at 1-2.

11 The owner of the Kent property opposed the second extension
12 motion, arguing, inter alia, that there was no cause for an
13 extension, because debtor had had adequate time to formulate a plan.
14 The court entered an order extending the time to accept or reject
15 the leases to May 14, 2004. The court rejected language in the
16 proposed order indicating that a further extension was possible, and
17 stated on the record that May 14 was "a drop dead deadline."
18 Transcript of April 9, 2004 Hearing, at 10.

19 Debtor timely filed a motion to assume the three leases
20 pursuant to § 365(a). The motion to assume was supported by a
21 declaration of Peder, stating, in substantive part, as follows:

22 [Debtor] has determined that it is in the best interest of the
23 debtor to continue to lease these properties in order to
24 continue its business operations uninterrupted during the
25 pendency of this chapter 11 case, and therefore wishes to
26 assume the leases. [Debtor] is current on its payments due
under the Lease and will be able to continue to perform under
the leases post assumption.

27 Declaration of Peder in Support of Motion to Assume, at 2.

28 The creditors' committee ("the committee") filed an Objection
29 to Assumption of Leases and Motion to Extend Time to Assume to
30 Confirmation, requesting that the court deny the motion and extend

1 the time to assume the leases to "August 31, 2004, on the condition
2 that the Debtor file a Plan providing for assumption or rejection of
3 its leases no later than June 18, 2004." Objection to Assumption
4 and Motion to Extend Time to Assume to Confirmation, at 4.

5 After a hearing, the court entered an order granting the motion
6 to assume. The committee timely appealed.

7 ISSUE

8 Whether the bankruptcy court erred in granting debtor's motion
9 to assume the leases.⁵

10 STANDARD OF REVIEW

11 A bankruptcy court's decision that assumption is warranted
12 under the business judgment rule is reviewed for clear error.⁶ In
13 re Crystalin, L.L.C., 293 B.R. 455, 463 (8th Cir. BAP 2003). See
14 also Lubrizol Enters., Inc. v. Richmond Metal Finishers, Inc., 756
15 F.2d 1043, 1047 (4th Cir. 1985), superseded by statute on other
16 grounds as stated in, In re A.J. Lane & Co., Inc., 107 B.R. 435, 440
17 (Bankr. D. Mass. 1989).

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20 ⁵ While the committee also sought an extension of time for
21 debtor to assume or reject the leases, it does not argue on appeal
22 that the bankruptcy court erred in denying an extension.

23 ⁶ The committee cites In re Sun Runner Marine, Inc., 116
24 B.R. 712 (9th Cir. BAP 1990), vacated in part on other grounds, 945
25 F.2d 1089 (9th Cir. 1991), in support of its position that a *de novo*
26 standard of review applies. Sun Runner is not instructive as to the
applicable standard of review in this case. In Sun Runner, this
Panel applied a *de novo* standard of review in deciding, among other
things, that the bankruptcy court erred in finding that the contract
at issue was an executory contract. There is no dispute that the
leases at issue in this appeal qualify as unexpired leases under
§ 365(a).

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DISCUSSION

Section 365(a) states that "the trustee, subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor." As a chapter 11 debtor in possession, debtor is authorized to exercise most of the powers of a trustee, including the power to assume or reject unexpired leases under § 365(a). See §§ 1101; 1107.

If a debtor assumes a lease, it accepts both the burdens and the benefits of the bargain, and any liabilities incurred in the lease's postpetition performance will be treated as administrative expenses with priority status. See In re Barakat, 99 F.3d 1520, 1528 (9th Cir. 1996). Moreover, damages associated with leases that are rejected after they have been assumed are not subject to the § 502(b)(6) cap.⁷ In re Klein Sleep Products, Inc., 78 F.3d 18,

⁷ With certain exceptions not relevant here, § 502(b) provides that, upon objection to a claim, a court shall allow the claim in the amount stated, except to the extent that

(6) 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[.]

1 28-29 (2d Cir. 1996). As a result, “[a]ssumption . . . may
2 ultimately result in a detriment to the holders of unsecured
3 claims.” In re Gateway Apparel, Inc., 210 B.R. 567, 570 (Bankr.
4 E.D. Mo. 1997) (citing Klein). For these reasons, we have held that
5 the interests of the general unsecured creditors are of paramount
6 importance when considering a motion to assume or reject, and that a
7 “balancing of interests” of all parties may be required. In re Chi-
8 Feng Huang, 23 B.R. 798, 801 (9th Cir. BAP 1982).

9 Whether to assume or reject an executory contract is left to
10 the business judgment of the trustee or debtor in possession. In re
11 G.I. Indus., Inc., 204 F.3d 1276, 1282 (9th Cir. 2000); Chi-Feng
12 Huang, 23 B.R. at 800. In exercising that business judgment, the
13 trustee or debtor in possession must demonstrate that assumption
14 will benefit the estate. In re Crystalin, L.L.C., 293 B.R. 455, 464
15 (8th Cir. BAP 2003); In re Kirkpatrick, 34 B.R. 767, 769 (9th Cir.
16 BAP 1983). “‘As long as assumption of a lease appears to enhance a
17 debtor’s estate,’” a bankruptcy court should normally grant its
18 approval, unless the debtor in possession’s “‘judgment is clearly
19 erroneous, too speculative, or contrary to the provisions of the
20 Bankruptcy Code’” Richmond Leasing Co. v. Capital Bank,
21 N.A., 762 F.2d 1303, 1309 (5th Cir. 1985) (quoting Allied Tech., Inc.
22 v. R.B. Brunemann & Sons, 25 B.R. 484, 495 (Bankr. S.D. Ohio 1982)).

23 The committee does not argue on appeal that debtor’s decision
24 to assume the leases was clearly erroneous, too speculative, or
25 contrary to the Code. Instead, the committee’s main argument is
26 that the bankruptcy court erred in approving the motion to assume,

1 because there is insufficient evidence upon which the court could
2 have concluded that assumption was beneficial to the estate.⁸ We
3 agree.

4 The court will approve assumption of a lease if the debtor, in
5 the exercise of its business judgment, establishes that assumption
6 will benefit the estate. In order to determine whether assumption
7 is appropriate under this standard, the debtor must provide evidence
8 to support its business judgment that the estate will be benefitted.

9 In this case, the leases were never made part of the record in
10 connection with the extension or assumption motions. In addition,
11 there was no evidence that the leased property was uniquely suited
12 to debtor's needs, of the availability of alternative space, or of
13 the cost of moving debtor's business operations. In fact, there is
14 evidence in the record that could support a conclusion that
15 assumption was not beneficial to the estate. The president of the

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17 ⁸ The committee argues that the bankruptcy court also erred,
18 because debtor did not provide adequate assurance of future
performance. We reject this argument.

19 A debtor in possession must provide adequate assurance of
20 future performance only "[i]f there has been a default in an
21 executory contract or unexpired lease" § 365(b)(1)(C).
22 There was no default in this case. Even if the adequate assurance
23 of future performance requirement applied, debtor satisfied that
24 requirement in this case. The necessary degree of assurance "'falls
25 considerably short of an absolute guaranty.'" In re Tex. Health
26 Enters., Inc., 246 B.R. 832, 835 (Bankr. E.D. Tex. 2000) (quoting In
re PRK Enters., Inc., 235 B.R. 597, 603 (Bankr. E.D. Tex. 1999)).
Debtor's president stated in his declaration filed in support of the
motion to assume, that debtor "will be able to continue to perform
under the leases post assumption." Declaration of Alex Peder, 2:15-
16. In addition, the court inquired as to debtor's future prospects
at the hearing on the motion to assume. See Transcript of June 4,
2004 Hearing, 13:6-19.

1 lessor of the Kent, Washington property submitted a declaration
2 stating that "[t]he market for similar commercial space in the
3 surrounding area is poor." Declaration of Joann Lee in Support of
4 196th Corridor LLC's Opposition to Debtor's Motion for Order
5 Extending Deadline to Assume or Reject Non-Residential Leases, at 2.
6 This suggests that debtor might have been able to lease replacement
7 property at a net savings to the estate.

8 Debtor's attorney admitted at the hearing on the assumption
9 motion that debtor's decision to assume was driven by the fact that
10 rejection was the only other option, not by debtor's informed
11 analysis that assumption would benefit the estate. See Transcript
12 of June 4, 2004 Hearing, 3:23-25; 11:7-12:10.

13 The bankruptcy court in this case did not make a finding that
14 debtor had established that assumption is likely to benefit the
15 estate, nor did debtor submit evidence from which such a finding
16 could have been made. In fact, the court's decision to approve
17 assumption resulted from the same type of analysis as was applied by
18 the debtor. At the end of the hearing on the motion to assume, the
19 court announced that it would grant the motion to assume, ruling as
20 follows:

21 THE COURT: Well, I did make an order as a result of a
22 contested hearing, setting a final date for the debtor to
23 assume or reject these leases. It's my understanding that that
24 date has come and gone. Now both the debtor and the committee
25 are saying that we ought to have some kind of an evidentiary
26 hearing to establish the economic viability of these leases.

In my opinion, that approach is nothing more than a
subterfuge to, in effect, give the debtor a further extension.
I made the order. I have to stand by my orders. Therefore,
I'm going to grant the debtor's motion to assume. I don't see
where I have room to do anything else.

