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U.S. BKCY. APP. PANEL
OF THE NINTH CIRCUIT

NOT FOR PUBLICATION

UNITED STATES BANKRUPTCY APPELLATE PANEL
OF THE NINTH CIRCUIT

In re:) BAP No. CC-04-1287-PaBK
) BAP No. CC-04-1300-PaBK
 EL TORO MATERIALS COMPANY, INC.,) (cross appeals)
)
 Debtor.) Bk. No. SA 02-18913-RA
)
) Adv. No. SA 03-01486-RA
 EL TORO MATERIALS COMPANY, INC.,)
)
 Appellant,)
)
 v.) **MEMORANDUM¹**
)
 SADDLEBACK VALLEY COMMUNITY)
 CHURCH; UNITED STATES TRUSTEE;)
 KAREN SUE NAYLOR, Trustee,)
)
 Appellees.)

Argued and Submitted on February 23, 2005
at Los Angeles, California

Filed - July 8, 2005

Appeal from the United States Bankruptcy Court
for the Central District of California

Honorable Robert W. Alberts, Bankruptcy Judge, Presiding

Before: PAPPAS,² BRANDT and KLEIN, 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. Jim D. Pappas, Bankruptcy Judge for the District of Idaho, sitting by designation.

1 Debtor rejected a real property lease in its chapter 11
2 case.³ The lessor filed a proof of claim for \$23 million in
3 damages. Through an adversary proceeding, Debtor objected to the
4 lessor's claim and sought to recover money damages from the
5 lessor for its alleged prepetition breach of the lease. The
6 lessor asserted counterclaims under several different theories,
7 including nuisance, waste, and trespass, all premised upon the
8 same conduct by Debtor.

9 On Debtor's motion for partial summary judgment, the
10 bankruptcy court decided that the lessor's claims for nuisance
11 and waste were not subject to the cap on a lessor's claim for
12 breach damages under 11 U.S.C. § 502(b)(6). It also dismissed
13 the lessor's trespass claim. Debtor timely appealed the
14 bankruptcy court's application of § 502(b)(6), and the lessor
15 cross-appealed dismissal of its trespass counterclaim.

16 We REVERSE the decisions of the bankruptcy court and REMAND.

17 I. FACTS

18 As early as the 1960s, the predecessor-in-interest to Debtor
19 El Toro Materials Co., Inc. ("El Toro") conducted sand and gravel
20 mining operations on leased property in Orange County,
21 California. By the late 1970s, El Toro took over control of the
22 operation.

23 The leased property was owned, at least as of the 1980s, by
24 Baker Ranch Properties ("Baker Ranch"). On November 1, 1988,

25
26 ³ Absent contrary indication, all section and chapter
27 references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1330.
28 "Rule" references are to the Federal Rules of Bankruptcy
Procedure, and "FRCP" references are to the Federal Rules of
Civil Procedure.

1 Baker Ranch and El Toro executed a lease agreement with a term of
2 ten years and seven months. This lengthy document
3 comprehensively detailed El Toro's rights and duties as to the
4 leased property. Among the terms relevant to this appeal, the
5 lease provided:

6 [ARTICLE] 9.01 Throughout the term of this Lease, El
7 Toro, at its sole cost and expense, shall promptly
8 comply with all present and future laws, ordinances,
9 orders, rules, regulations and requirements of all
10 federal, state, county and municipal governments,
11 departments, commissions, boards and offices,
12 including, but not limited to the conditions set forth
13 in all existing permits.

14

15 [ARTICLE] 10.01 El Toro shall have the right to use the
16 Premises only for the following:

17 (a) Subject to the conditions set forth in all applicable
18 government permits, the removal from the Premises of rock,
19 sand, gravel, and fill materials

20

21 (e) The storage of materials procured from or off the
22 Premises which are used in conjunction with [the permitted
23 mining operations described in the lease].

24

25 [ARTICLE] 10.05 As additional consideration for [Baker
26 Ranch] entering into this Lease, El Toro shall conduct all
27 of its operations in a workmanlike manner in accordance with
28 sound engineering and mining principals and practice, though
Lessor hereby acknowledges that El Toro does not have an
engineer on the Premises at all times, and consistent with
the reshaping of the Premises as follows:

(a) The Premises shall be restored to as near as practical
with the grade as outlined in El Toro's Reclamation Plan
granted by the County of Orange . . . and the finished grade
as set forth in El Toro's Grading Permit . . . or as said
Grading Permit is later amended with the written consent of
Lessor.

. . . .

(c) All settlement ponds and debris deposits will be
removed from the Premises prior to the termination of the

1 term, except as same are necessary to complete El Toro's
2 operations within the term of the Lease, which remaining
3 ponds and deposits shall be removed no later than four (4)
4 months following the date of termination.

5

6 ARTICLE 23 SURRENDER - END OF THE TERM

7 On the expiration or other termination of the term
8 of this Lease . . . El Toro shall quit and surrender
9 the Premises to Lessor, in good order and condition, as
10 set forth in Section 10.05 hereinabove, free and clear
11 of lettings, subtenancies and occupancies and of all
12 liens and encumbrances other than those if any, created
13 by lessor.

14 El Toro and Baker Ranch executed an amendment to the lease
15 on the same day they executed the lease. This amendment provided
16 Baker Ranch with the right to bifurcate the lease into two
17 separate leases in connection with a division of the property
18 into two separate lots and a sale or transfer of either lot. The
19 amendment further specified that, upon bifurcation of the
20 property into Plots 1 and 2, the lease would continue in effect
21 with the fee owners of either plot.

22 On June 20, 1997, appellee Saddleback Valley Community
23 Church ("SVCC") and El Toro executed a conditional amendment to
24 El Toro's 1988 lease with Baker Ranch in anticipation of SVCC's
25 purchase of Plot 1. At the time, SVCC owned other property
26 adjoining the Baker Ranch property. One of the proposed
27 modifications between SVCC and El Toro extended El Toro's lease
28 term indefinitely, subject to termination by either party upon
two years' notice. SVCC purchased Plot 1 (approximately forty
acres) from Baker Ranch in 1999, and in December 2001 it gave El
Toro notice of its intent to terminate the lease.

Prior to the lease expiring under the two-year notice

1 provision of the modification agreement, on October 18, 2002,
2 SVCC gave El Toro a "Thirty (30) Day Notice to Perform or Quit."
3 This notice alleges that El Toro had violated Articles 9.01 and
4 23 of the 1988 lease by stockpiling waste material generated in
5 its sand mining operation. SVCC demanded that El Toro remove or
6 dispose of the waste material within thirty days, vacate Plot 1,
7 or face legal action.

8 El Toro filed for protection under chapter 11 of the
9 Bankruptcy Code on November 18, 2002.⁴ SVCC filed a proof of
10 claim for \$23 million in El Toro's bankruptcy case. According to
11 the proof of claim, the basis for SVCC's claim is that El Toro
12 stockpiled approximately 650,000 cubic yards of mining byproducts
13 on its property; the amount of the claim was derived from cost
14 estimates SVCC received to remove the waste material.⁵ SVCC's
15 claim also references unspecified future damage it may incur due
16

17 ⁴ A chapter 11 trustee was appointed in the Chapter 11
18 case on October 1, 2003. However, the record does not disclose
19 the circumstances precipitating this event, nor do the parties
20 suggest they are relevant to the appeal or cross-appeal.

21 ⁵ At oral argument, counsel for El Toro represented that
22 the waste material at issue is not a "hazardous material." It
23 is, counsel suggests, "fill" material. While SVCC refers to the
24 stockpile in its briefing as "goo," or more specifically, as
25 water-saturated clay resulting from El Toro's sand-washing
26 operation, rubble and debris, we presume the nature of the
27 material is not particularly pertinent to the issues on appeal,
28 but rather, it is the existence of and amount in the stockpile
that concern SVCC.

25 In addition, we note SVCC's dispute with El Toro also
26 involved, at least initially, certain equipment and other
27 personal property El Toro left behind on Plot 1. Counsel for El
28 Toro informed the Panel that the trustee had sold these items
prior to oral argument. Presumably, that sale effectively
settled any dispute regarding the equipment, and so the Panel
will focus only on the stockpiled material, as have the parties.

1 to delays in its ability to develop Plot 1, and the possibility
2 of subsequently amending its proof of claim to assert an
3 administrative claim for El Toro's postpetition "unauthorized
4 operations . . . and the delay in the development" of Plot 1.

5 On January 24, 2003, El Toro and SVCC filed a stipulation in
6 the bankruptcy case. This stipulation provided El Toro would
7 reject the lease, effective upon the bankruptcy court's order
8 approving the stipulation, but remain in possession of Plot 1
9 until April 30, 2003. El Toro was required to pay rent during
10 this extension, which allowed it to make a more orderly
11 departure. The bankruptcy court entered an order approving the
12 stipulation on January 27, 2003. El Toro vacated the premises on
13 the designated date but did not remove the residue.

14 El Toro objected to SVCC's claim, and it filed a complaint
15 against SVCC on April 25, 2003, initiating the adversary
16 proceeding from which this appeal and cross-appeal arise. The
17 bankruptcy court consolidated El Toro's objection to SVCC's proof
18 of claim and the adversary proceeding in an order dated October
19 24, 2003.

20 In its complaint, El Toro alleged, inter alia, that SVCC
21 breached the lease agreement and interfered with El Toro's
22 relationship with its subtenants and with its plan to shift its
23 operation to Plot 2. SVCC answered and asserted counterclaims
24 against El Toro for, as relevant to this appeal, breach of the
25 lease, and state law claims for waste, nuisance, and trespass.

26 All four of SVCC's counterclaims were premised, in whole or
27 in part, on El Toro's stockpiling of mining byproducts on Plot 1.
28 In particular, the trespass claim focused on El Toro's

1 postpetition, post-rejection failure to remove the stockpiled
2 mining waste. Specific to this claim, SVCC identified its
3 damages as including the cost of removing the stockpiled material
4 and restoring Plot 1 as detailed in a reclamation plan. In its
5 prayer for relief, SVCC also requested that the bankruptcy court
6 issue an injunction requiring El Toro to remove the mining waste
7 and any other property it had left behind on the leased property.

8 On November 3, 2004, El Toro filed a motion for partial
9 summary adjudication in which it asked the bankruptcy court to
10 apply the § 502(b)(6)⁶ cap on claims of a lessor for damages to
11 both SVCC's proof of claim and to its counterclaims in the
12 adversary proceeding; to dismiss SVCC's counterclaim for
13 interference with prospective economic advantage; and to dismiss
14 SVCC's request for injunctive relief requiring it to remove the
15 mining waste.

16
17 ⁶ This Code provision states that, upon objection to a
claim, the bankruptcy court

18 shall determine the amount of such claim as of the date
19 of the filing of the petition, and shall allow such
20 claim in lawful currency of the United States in such
amount, except to the extent that—

21

22 (6) if such claim is the claim of a lessor for damages
23 resulting from the termination of a lease of real
property, such claim exceeds—

24 (A) the rent reserved by such lease, without
25 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—

26 (i) the date of the filing of the petition; and
27 (ii) the date on which such lessor repossessed,
or the lessee surrendered, the leased property; plus

28 (B) any unpaid rent due under such lease, without
acceleration, on the earlier of such dates[.]

1 In its opposition papers, SVCC made a number of arguments,
2 including one urging that its trespass claim should not be
3 dismissed. El Toro filed a reply brief, and in a footnote, it
4 argued that since El Toro was in rightful possession of Plot 1
5 prior to lease rejection, it could not be liable for trespass.

6 The bankruptcy court granted El Toro's motion in part. It
7 held:

8 (1) All of SVCC's claims for damage due to the Debtor's
9 nonperformance under the lease, including damages for
10 breach of the lease covenants, are limited by the cap
11 in § 502(b)(6) of the bankruptcy Code as damages
12 resulting from "termination" of the subject lease.

13 (2) However, SVCC's claims for damages arising from
14 "tortious illegal acts (specifically, those for
15 nuisance and waste)" are not limited by the cap.

16 (3) Debtor's motion for partial summary judgment was granted
17 as to SVCC's counterclaim for trespass.

18 (4) Debtor's motion for partial summary judgment was granted
19 as to SVCC's claim for injunctive relief.

20 Although the judgment did not dispose of all of the claims raised
21 in the adversary proceeding, the bankruptcy court certified it as
22 a final order pursuant to FRCP 54(b), applicable via Rule 7054.

23 After the bankruptcy court denied their respective motions
24 for reconsideration, El Toro and SVCC each timely appealed the
25 judgment. El Toro seeks review of the bankruptcy court's
26 decision concerning application of the § 502(b)(6) cap; SVCC
27 appeals dismissal of its trespass claim.⁷

28 ⁷ As the two appeals were identified as cross-appeals,
the BAP clerk issued a cross-appeal briefing schedule, with which
the parties have complied. On January 31, 2005, El Toro filed an
"Additional Citation of a Relevant Decision" with a cite to K-4,
Inc. v. Midway Engineered Wood Prods., Inc. (In re Treesource
Indus., Inc.), 363 F.3d 994 (9th Cir. 2004).

1 **V. DISCUSSION**

2 A. Does the § 502(b)(6) cap limit damages resulting from a
3 debtor's conduct that violates the terms of the lease, but
4 is also actionable under state tort law?

5 Because SVCC's nuisance and waste claims are based upon El
6 Toro's failure to remove the mining residue from the leased
7 property, conduct that SVCC in its proof of claim concedes
8 constitutes a violation of the lease, we conclude that the
9 § 502(b)(6) cap on a lessor's damages applies. Our conclusion is
10 based upon the language of the Bankruptcy Code, the
11 interpretations previously given this provision by this Panel,
12 and, importantly, is required by the critical undisputed facts of
13 this case.

14 1. The Language of the Code.

15 As always, our examination of the scope of the statutory cap
16 on damage claims begins with the words of the statute. The
17 critical language here is that part of § 502(b)(6) that applies a
18 cap to "the claim of a lessor for damages resulting from the
19 termination of a lease of real property"

20 This language is simple enough and is not ambiguous. The
21 Code applies the cap to a lessor's claim for "damages." The
22 words in the statute do not distinguish between a lessor's claims
23 founded upon contract, tort, statute or some other legal basis.
24 If the lessor holds a claim for "damages," the claim is capped.
25 All kinds of damages claims are logically included within the
26 reach of the cap. As a result, under a plain reading of the
27 statute, there is no reason to infer a limitation on the type of
28 damages a lessor may recover under the statute.

It is also significant that later, in the same subsection of

1 the Code, in constructing the formula for calculating the amount
2 of the cap in each case, Congress refers to "the rent reserved"
3 and to "any unpaid rent." 11 U.S.C. § 502(b)(6)(A), (B). See
4 Koons Buick Pontiac GMC, Inc. v. Nigh, 125 S. Ct. 460, 466-67
5 (2004) (instructing that statutory construction is a "holistic
6 endeavor" and that perceived ambiguity may be clarified by
7 reading one statute in the light of the remainder of the
8 statutory scheme). By using these more specific terms,
9 presumably Congress intended there be a difference between
10 rendering all the lessor's "damages," which are subject to the
11 cap, and those kinds of damages used to calculate the actual
12 amount of the cap in each case, using a formula based on "rent."
13 See Kuske v. McSheridan (In re McSheridan), 184 B.R. 91, 96-100
14 (9th Cir. BAP 1995) (establishing a three-part test for
15 determining which components of a lessor's claim constitute "rent
16 reserved" for purposes of § 502(b)(6)(A)). We must assume that
17 if Congress intended that the reach of the cap be limited solely
18 to claims for "rent," or that the nature of the damage claim be
19 limited at all, Congress would have expressly said so in the
20 statute.

21 Instead, the only limitation in the damage cap is that the
22 lessor's claim be one "resulting from the termination of a
23 lease." In other words, to come within the cap, the lessee's
24 failure to perform the lease must be the "cause in fact" of the
25 lessor's damages. This language requiring a causal connection
26 between the lessee's conduct and the lessor's damages does not
27 require that the damages be based on breach of the lease, nor
28 does it exclude damages claimed for state common law torts based

1 upon the debtor's conduct in violating the lease, if that conduct
2 in fact caused the damages.

3 A broad reading of the scope of the cap on lessor damages is
4 consistent with its purpose. As the Panel has previously
5 observed, the statutory limit on a lessor's claim was intended by
6 Congress to "[prevent] landlords from receiving a windfall as a
7 result of the filing of the bankruptcy petition [by the lessee]."
8 McSheridan, 184 B.R. at 97. Indeed, the cap reflects a balancing
9 of interests struck by Congress by allowing a lessor "to be paid
10 a reasonable sum without unfairly diluting or squeezing out other
11 creditors." Redback Networks, Inc. v. Mayan Networks Corp. (In
12 re Mayan Networks Corp.), 306 B.R. 295, 306 (9th Cir. BAP 2004)
13 (Klein, J., concurring).

14 Obviously, the cap becomes important only when a lessor's
15 damages recoverable under state law exceed the amount of the cap
16 as calculated under the statute.⁸ When it operates, the cap
17 effectively denies a landlord payment of a claim otherwise

18
19 ⁸ Given the procedural status of this action, it would be
20 speculative for the Panel to assume SVCC will prevail on the
21 merits of its claims against El Toro. The issue here is,
22 assuming SVCC holds valid claims against El Toro under its
23 different theories, whether the amount of those claims would be
24 capped. We are somewhat concerned that we are asked to decide an
25 issue of law that may, or may not, be implicated in the final
26 analysis. We acknowledge, though, SVCC's proof of claim alleges
27 El Toro owes it "in excess of \$23 million," an amount that would
28 clearly exceed any cap calculated under § 502(b)(6). Therefore,
resolving the legal question as to the applicability of
§ 502(b)(6) to SVCC's counterclaims will materially aid the
bankruptcy court on remand. In addition, we understand the
bankruptcy court has certified its decision as a final judgment
under FRCP 54(b), applicable here via Rule 7054. See Dawson v.
Washington Mut. Bank (In re Dawson), 390 F.3d 1139, 1145-46 (9th
Cir. 2004) (considering similar factors in assessing appellate
jurisdiction).

1 enforceable under state law. But the § 502(b)(6) cap is not
2 remarkable in that regard. Through many provisions of the Code,⁹
3 Congress has decided which creditor claims are to be paid, or
4 not, in bankruptcy cases, or as in this case, how much creditors
5 can recover. In adopting the § 502(b)(6) cap, Congress has
6 exercised its judgment about the policies embodied in the Code.
7 Because policy is implicated, the bankruptcy courts, in enforcing
8 the Code, cannot appropriately alter the outcome, even if the
9 results in a particular case may seem harsh. See Lamie v. United
10 States Tr., 540 U.S. 526, 542 (2004).

11 In summary, the language of § 506(b)(6) cannot be read to
12 exclude from the scope of the lessor's damages cap claims based
13 on state tort law when the same conduct giving rise to those
14 claims also amounts to a breach of the lease.

15
16 2. BAP Precedent.

17 The decisional law in this Circuit also counsels against any
18 attempts to limit the broad scope of § 502(b)(6). In 1995, in a
19 thoughtful analysis, the panel in McSheridan gave us clear
20 guidance concerning the scope of the § 502(b)(6) cap. In that
21 case, the BAP was asked to decide whether, upon rejection of a
22 commercial real property lease in a bankruptcy case, a lessor's
23

24 ⁹ See, e.g., 11 U.S.C. §§ 502(b)(7) (capping the claim of
25 an employee for damages resulting from the termination of an
26 employment contract); 502(e)(1) (disallowing claims for
27 reimbursement or contribution under certain conditions);
28 507(a)(3) (capping the amount of a priority claim for wages,
salaries, or commissions) (to be re-codified as § 507(a)(4) under
the Bankruptcy Abuse Prevention and Consumer Protection Act of
2005, Pub. L. No. 109-8, § 212, 119 Stat. 23, 51).

1 claims for unpaid utilities, repair and maintenance costs,
2 expenses for replacement of an air conditioning system and the
3 roof of the leased premises, and for insurance costs, all came
4 within the cap. Although these were all charges that the lease
5 required the lessee to bear, because they were not "rent
6 reserved," the debtors objected to allowance of the lessor's
7 claim. To resolve the dispute, the panel was required to decide
8 whether these sorts of charges came within the scope of the
9 § 502(b)(6) cap, and if so, how the amount of the cap should be
10 calculated. The panel concluded that all the expenses claimed by
11 the lessor came within the cap, and remanded the case to the
12 bankruptcy court to decide, under a new test developed by the
13 panel, the amount of the cap.

14 Admittedly, in McSheridan, the lessor did not argue, nor did
15 the panel address, whether the tenant had committed one or more
16 torts. Nor was there any claim made by the lessor in that case
17 that the costs it sought to recover resulted from the debtor's
18 violation of local government environmental or land-use
19 regulations or ordinances. Instead, the lessor claimed the costs
20 could be recovered based upon the lease.

21 Because of this, it may be tempting to distinguish, or
22 putting it more bluntly, to disregard, the panel's decision as
23 dicta in the face of the facts and arguments made in this appeal.
24 It would be unwise, however, to read McSheridan so narrowly. In
25 resolving the issues, the McSheridan panel decided how to
26 interpret the same provisions of § 502(b)(6) that are at issue
27 here. Its interpretive approach was essential to its holding.
28 And in its reading of the Code, the McSheridan panel rejected the

1 very same interpretation offered, and authorities cited, by SVCC.

2 More specifically, the McSheridan panel discussed the
3 decision of the bankruptcy court in In re Atlantic Container
4 Corp., 133 B.R. 980 (Bankr. N.D. Ill. 1991), a decision relied
5 upon by the lessor in this case. In Atlantic Container, the
6 bankruptcy court held that a lessor's claim for repair and
7 maintenance costs under the lease resulting from the lessee's
8 physical neglect and damage to the leased property was not capped
9 by § 502(b)(6) because the

10 phrase "damages resulting from the termination of the
11 lease" does not seem to contemplate the type of damages
12 being sought here. The phrase suggests that
13 § 502(b)(6) is intended to limit only those damages
14 which the lessor would have avoided but for the lease
15 termination. Any damages caused to the Premises by the
16 Debtor's failure to fulfill its repair and maintenance
17 obligations are unrelated to the termination of the
18 lease.

19 McSheridan, 184 B.R. at 100 (quoting Atlantic Container Corp.,
20 133 B.R. at 987). Because the damages caused by the lessee to
21 the leased premises in Atlantic Container were not "prospective"
22 and "had nothing to do with the long-term nature of the lease,"
23 the bankruptcy court concluded the cap should not apply.

24 McSheridan also carefully considered the bankruptcy court's
25 decision in In re Bob's Sea Ray Boats, Inc., 143 B.R. 229 (Bankr.
26 D.N.D. 1992). There, the lessor sought to recover not only
27 unpaid rent, but asserted claims for damages inflicted on the
28 premises by the lessee-debtor, and for the lessee's wrongful
removal of light fixtures from the leased property's parking lot.
Relying upon Atlantic Container, the bankruptcy court refused to
apply the § 502(b)(6) cap to the claims for damage to the
premises and removal of the lights because the cap "does not

1 address damages wholly collateral to the termination event—such
2 things as waste, destruction or removal of leasehold property.”
3 143 B.R. at 231.

4 The McSheridan panel declined to follow the approach of
5 Atlantic Container Corp. or Bob’s Sea Ray Boats. Instead, the
6 panel opted for a broad interpretation of the scope of the cap.
7 It noted that a broad cap fulfills the purpose of discharging the
8 debtor from suits based upon violation of the lease and fixes the
9 liability of the lessee. McSheridan, 184 B.R. at 101. The panel
10 also noted that § 502(b)(6) must be read in concert with other
11 provisions of the Code, including § 365(d)(3) (requiring the
12 debtor to perform a lease only until it is assumed or rejected),
13 § 365(g) (deeming rejection a breach of the lease), and § 502(g)
14 (providing that a lease rejection claim is to be treated as a
15 prepetition claim). Doing so, the panel observed:

16 [R]ejection of the lease results in the breach of each
17 and every provision of the lease, including covenants,
18 and § 502(b)(6) is intended to limit the lessor’s
19 damages resulting from that rejection. The damages are
20 those resulting from nonperformance of the debtor’s
21 obligations under the lease.

22 184 B.R. 102.¹⁰

23 The holding in McSheridan was not limited to its facts, nor
24 did it depend upon the precise type of damages being asserted by
25 the lessor. Fairly read, the holding of McSheridan was, as

26 ¹⁰ In a slightly different context, Judge Klein has
27 expressed that § 502(b)(6) “is not ambiguous when one considers
28 interrelated provisions [of the Code]” and that “[w]hat looks
like ambiguity when § 502(b)(6) is viewed in isolation is
clarified by other Bankruptcy Code provisions.” In re Mayan
Networks Corp., 306 B.R. at 303-04 (Klein, J., concurring).

1 stated in the panel's opinion, that "all damages due to
2 nonperformance [by the lessee of the lease] are encompassed by
3 [the § 502(b)(6) cap]." Id. To accept SVCC's arguments in this
4 case, which are founded upon the same cases considered and
5 rejected by the panel, would imply a limitation not found in the
6 language of the Code, and it would require us to modify the
7 McSheridan approach to interpreting this statute, which we are
8 unwilling to do. As McSheridan made clear, "all damages" flowing
9 from the debtor-lessee's conduct constituting "nonperformance" of
10 the lease are capped by § 506(b)(6).

11 3. The Undisputed Material Facts.

12 Finally, the facts of this appeal compel reversal of the
13 bankruptcy court's grant of summary judgment to SVCC concerning
14 the damages cap. Though SVCC has invited us to do so, we cannot
15 ignore these important undisputed facts. When they are
16 considered, it becomes clear that any claims that SVCC could
17 assert for damages for nuisance or waste based on El Toro's
18 conduct in this case would also constitute a breach of the
19 covenants of the parties' lease.

20 Before discussing those facts, it is important to recognize
21 an issue we need not decide – whether there could ever be a
22 situation in which a lessor should be allowed to assert a state
23 law tort claim against its lessee that would be excluded from the
24 § 502(b)(6) cap. In this regard, the analogies offered by SVCC
25 in its briefing are inapt. This is not a case, as SVCC's
26 approach suggests, where one party commits an intentional tort
27 (or even a crime) against another while those parties, as a
28 matter of coincidence, occupy the status of tenant and landlord.

1 Those are not our facts.

2 Here, we need only determine whether a lessor's claim for
3 damages caused by a lessee's acts, which acts also constitute a
4 breach of its lease, should be excluded from the reach of the
5 § 502(b)(6) cap, simply because those same acts may constitute a
6 state law tort, or because those acts also violate a state or
7 local regulation or ordinance. When the issue is properly
8 framed, it is apparent that if the cap is not applied, SVCC will
9 succeed in a classic end-run around the will of Congress.

10 It is undisputed that El Toro (or its predecessor) had
11 occupied and used the property in question since the 1960's, most
12 recently pursuant to a 1988 written real property lease with
13 SVCC's predecessor. That lengthy document comprehensively
14 details El Toro's rights and duties as to the leased property.
15 It is also important to recognize it was a long-term lease; its
16 original term would not have expired until 1999. And in
17 connection with SVCC's acquisition of the property, SVCC and El
18 Toro agreed to extend the term of the lease indefinitely and to
19 allow that it could be terminated only upon two years' notice.

20 Some of the lease terms that are critical in this appeal
21 include:

22 - El Toro was allowed by the lease to mine and remove rock,
23 sand, gravel and fill materials from the land. This provision
24 contemplated that El Toro would wash sand from excavated
25 materials, a process that created the "goo," "residue" or
26 "debris" involved in this case.

27 - Incident to its operations, El Toro was authorized by the
28 lease to store materials it mined from the land on the leased

1 premises. Fairly read, this provision authorizes El Toro to
2 stockpile the residue.

3 - El Toro committed to remove "debris deposits" from the
4 leased premises "no later than four (4) months following the date
5 of termination [of the lease]." This provision reflects the
6 parties' understanding that, upon termination of the lease, there
7 may be stockpiles of residue remaining on the leased premises.

8 - In conducting its business operations on the leased
9 property, El Toro promised to comply with all applicable federal,
10 state and local laws, regulations and ordinances.

11 - And El Toro agreed to restore the grade of the leased
12 premises, and to "rehabilitate" the property, so as to comply
13 with a reclamation plan that had been approved by the county.

14 SVCC did not succeed to the lessor's interest under the
15 lease until 1997. In other words, El Toro had been operating
16 under the terms of the lease, mining material from the leased
17 land, washing out saleable sand, and producing and storing
18 residue clay on the property, for nearly a decade prior to SVCC's
19 succession to Baker Ranch's interest under the El Toro lease.
20 SVCC was presumably aware and approved of the nature of El Toro's
21 operations, since in connection with acquiring the lease, SVCC
22 agreed to an indefinite extension of the lease with El Toro. El
23 Toro apparently continued in its use of the property in this
24 fashion for several years after SVCC became its neighbor and
25 landlord.

26 It was not until October 2002 that SVCC gave El Toro a
27 written notice that it intended to forfeit the lease. In that
28 notice, SVCC alleged that El Toro had breached the lease. In

1 particular, SVCC relied upon provisions of the lease requiring El
2 Toro to comply with local laws, ordinances and regulations, and
3 it contended El Toro had failed to do so because certain local
4 laws allegedly required it to "regularly remove" the clay residue
5 it was stockpiling on the property. SVCC also alleged in the
6 notice that El Toro breached the lease terms requiring it to
7 restore the property to conditions described in the county's
8 reclamation plan, although the lease provides that this duty does
9 not arise until expiration or termination of the lease.

10 El Toro's response to SVCC's notice was to seek chapter 11
11 relief, and in that bankruptcy case, to reject the lease. In its
12 proof of claim, SVCC recites the same lease provisions referenced
13 in the notice it had given to El Toro, and alleges its damages
14 are based upon breach of the lease. It seeks recovery of in
15 excess of \$23 million to "[remove] the debris and deleterious
16 material stockpiled by the debtor in violation of the permits,
17 Reclamation Plan, and Lease" ¹¹

18 Based upon this record, it appears clear that SVCC's claim
19 is based upon El Toro's storage of, and failure to remove, the
20 residue from the leased premises, allegedly in violation of
21 county rules and ordinances. Nor is there any question, at least
22 in SVCC's view, that El Toro's conduct is expressly prohibited by
23

24 ¹¹ There is no indication in the record that SVCC has ever
25 amended its proof of claim to show that, in addition to breach of
26 the lease, SVCC seeks to recover against El Toro for state law
27 torts or for El Toro's violations of local law. Apparently the
28 first mention in the bankruptcy court record of SVCC's contention
that it is asserting claims for other than breach of the lease is
in SVCC's answer and amended counterclaim filed in the adversary
proceeding from which this appeal originated.

1 the various provisions of the parties' lease cited above.¹²
2 Again, contrary to SVCC's assertions, this is not a case
3 involving a lessee's commission of a tort against another person
4 who, coincidentally, happens to be the tortfeasor's landlord.
5 Instead, the facts more closely resemble the Atlantic Container
6 and Bob's Sea Ray Boats cases, where the debtor-lessee had
7 committed lease violations (such as neglecting the premises, or
8 "stealing" light fixtures) that may have also given rise to state
9 law tort claims for nuisance, waste, trespass, and although not
10 alleged here, perhaps conversion.

11 Simply put, the undisputed facts in this appeal show the
12 same conduct that SVCC alleges constitutes nuisance and waste in
13 this case also constitutes a breach of the lease.

14 4. Based upon the statute, case law, and facts of this
15 case, the damage cap in § 502(b)(6) applies to SVCC's
counterclaims arising under state tort law.

16 El Toro's rejection of the lease in its bankruptcy case is
17 deemed as a matter of bankruptcy law to constitute a breach of
18 that lease immediately before the date of the filing of the
19

20 ¹² It is disconcerting that SVCC, which purchased
21 adjoining property and the lessor's ownership interest more than
22 ten years after El Toro began its business on the leased land,
23 could recover, years later, under state tort law for El Toro's
24 continuing activities. It is also unclear whether SVCC, as a
25 private party, has standing to enforce state or local mining laws
26 and regulations. The bankruptcy court rejected El Toro's
27 standing arguments because it failed to provide legal support for
28 them. Although the court's reaction to such a lackadaisical
approach is understandable, on remand the bankruptcy court is
reminded that "federal courts are under an independent obligation
to examine their own jurisdiction, and standing 'is perhaps the
most important of [the jurisdictional] doctrines.'" FW/PBS,
Inc. v. City of Dallas, 493 U.S. 215, 231 (1990) (quoting Allen
v. Wright, 468 U.S. 737, 750 (1984)).

1 petition. 11 U.S.C. § 365(g)(1). As a result, SVCC's claim
2 against El Toro for failure to remove the residue stockpile is a
3 prepetition claim. 11 U.S.C. § 502(g); K-4, Inc. v. Midway
4 Engineered Wood Prods., Inc. (In re Treresource Indus., Inc.), 363
5 F.3d 994, 998 (9th Cir. 2004).

6 The § 502(b)(6) damage cap should apply because SVCC's claim
7 against El Toro for its alleged failure to comply with local laws
8 and to remove the residue stockpile is one for damages resulting
9 from El Toro's rejection (i.e., the breach) of the lease. That
10 El Toro's acts may also give rise to claims by SVCC founded on
11 state law tort does not matter.

12 The language of § 502(b)(6) is broad and includes all claims
13 by a lessor for "damages," provided those claims result from
14 termination of the lease. Sound precedent from this panel
15 instructs that the lease cap applies to all damages flowing from
16 a breach of the covenants of a lease, and not just to claims for
17 unpaid "rent." That same case law rejects the approach taken by
18 other courts, and invoked by SVCC here, that the cap does not
19 apply to "collateral" claims for infliction of damages to the
20 leased premises or for conversion of leasehold improvements and
21 furnishings. And finally, the notice SVCC gave to El Toro, and
22 the proof of claim filed in El Toro's bankruptcy case, both
23 establish that SVCC's claim is for conduct constituting a breach
24 of the lease.

25 The bankruptcy court erred when it decided that any claims
26 SVCC can assert for nuisance or waste under state law are
27 excepted from the § 502(b)(6) cap. We reverse that decision.

28

1 B. Did the bankruptcy court err in dismissing SVCC's trespass
2 claim?

3 SVCC argues in its cross-appeal that the bankruptcy court
4 erred procedurally in dismissing its counterclaim for trespass.
5 It complains that El Toro did not request such relief in its
6 motion and the issue was raised so late in the proceedings that
7 it did not have adequate notice its trespass claim had been
8 called into question. Alternatively, SVCC argues the bankruptcy
9 court misapplied the law regarding the merits of its trespass
10 action.

11 1. Did the court commit procedural error?

12 A trial court generally may not grant summary judgment on a
13 claim when a party has not requested it, Kelly v. Arriba Soft
14 Corp., 336 F.3d 811, 822 (9th Cir. 2003), unless the opposing
15 party has had a full and fair opportunity to ventilate the issues
16 involved in the motion. United States v. Grayson, 879 F.2d 620,
17 625 (9th Cir. 1989). In this case, SVCC requested injunctive
18 relief to remedy El Toro's alleged trespass based on El Toro's
19 post-rejection failure to remove the residue. El Toro moved for
20 summary judgment arguing equitable relief was not available to
21 SVCC, a contention which surely put the trespass claim in the
22 spotlight. Apparently SVCC perceived that El Toro's motion for
23 summary judgment placed its trespass claim in jeopardy because,
24 in its opposition papers, SVCC argued its trespass claim should
25 proceed to trial. Apparently, SVCC's contentions prompted El
26 Toro to include in its reply brief a more direct attack on the
27 substance of the trespass claim, as opposed to just the remedy
28 sought, albeit in a footnote.

1 On this record, we are persuaded that the bankruptcy court
2 afforded SVCC a "full and fair opportunity to ventilate" its
3 position before it ruled on the validity of SVCC's trespass
4 claim. SVCC submitted to the court its arguments why its
5 trespass claim should be allowed to go forward. Since SVCC was
6 fairly heard, the bankruptcy court did not commit a procedural
7 error in granting summary judgment.

8 2. Did the bankruptcy court incorrectly apply state law?

9 The bankruptcy court did not discuss its basis for
10 dismissing SVCC's trespass claim. Rather, it simply agreed with
11 El Toro's contention that "trespass will not lie under the facts
12 of this case." El Toro had argued that because it had been in
13 rightful possession of the property prior to termination of the
14 lease, it could not be liable for trespass under California law
15 because its actions were not "an invasion of the interest in the
16 exclusive possession of land," citing Capogeannis v. Superior
17 Court, 15 Cal. Rptr. 2d 796, 799 (1993). SVCC contends that El
18 Toro's post-rejection failure to remove the residue and equipment
19 constitutes a wrongful occupation of Plot 1, and that the
20 bankruptcy court erred in summarily dismissing its trespass claim
21 because the uncontroverted evidence established trespass. In the
22 alternative, SVCC argues that there are issues of material fact
23 with respect to this cause of action.

24 Trespass is "an unlawful interference with the possession of
25 property." Mangini v. Aerojet-Gen. Corp., 281 Cal. Rptr. 827,
26 837 (Cal. Ct. App. 1991).

27 A trespass may be committed by the continued presence
28 on the land of a structure, chattel, or other thing
which the actor or his predecessor in legal interest

1 has placed on the land
2 (a) with the consent of the person then in possession
3 of the land, if the actor fails to remove it after the
4 consent has been effectively terminated, or
5 (b) pursuant to a privilege conferred on the actor
6 irrespective of the possessor's consent, if the actor
7 fails to remove it after the privilege has been
8 terminated, by the accomplishment of its purpose or
9 otherwise.

6 Restatement (Second) of Torts § 160 (1965). See also Mangini,
7 281 Cal. Rptr. at 837. California case law supports the
8 proposition that a holdover tenant may be liable to a landlord
9 for trespass. Fragomeno v. Ins. Co. of the W., 255 Cal. Rptr.
10 111, 115-17 (Cal. Ct. App. 1989), overruled on other grounds by
11 Vandenberg v. Superior Court, 88 Cal. Rptr. 2d 366 (Cal. 1999);
12 Peter Kiewit Sons' Co. v. Richmond Redevelopment Agency, 223 Cal.
13 Rptr. 728, 734 (Cal. Ct. App. 1986); Stephens v. Perry, 184 Cal.
14 Rptr. 701, 706 n.4 (Cal. Ct. App. 1982).

15 In light of these authorities, that El Toro was in lawful
16 possession of Plot 1 prior to termination of the lease does not
17 necessarily preclude SVCC's trespass claim targeting El Toro's
18 failure to remove its property (i.e., the "goo") when it
19 surrendered the premises. In this respect, the bankruptcy
20 court's dismissal of the trespass claim was erroneous and must be
21 reversed.

22 On remand, the bankruptcy court must also address several
23 questions we do not reach. Of course, while SVCC may proceed on
24 its trespass counterclaim, we express no opinion on the merits of
25 that claim. Moreover, if SVCC prevails on more than one of its
26 counterclaims, the bankruptcy court, prior to applying the
27 § 502(b)(6) cap, may be required to analyze the damages available
28 to SVCC under each theory and to reconcile the result in light of

1 the prohibition under California law against double recovery.
2 See McCall v. Four Star Music Co., 59 Cal. Rptr. 2d 829, 831
3 (Cal. Ct. App. 1996) (discussing rule against double recovery);
4 Stoiber v. Honeychuck, 162 Cal. Rptr. 194, 209 (Cal. Ct. App.
5 1980).

6 And the parties have raised yet another issue that we cannot
7 fully resolve. El Toro argues that California law prohibits a
8 party from recovering in tort if the allegedly tortious conduct
9 is covered by the terms of a contract (i.e., a lease). As a
10 general principle, El Toro's argument correctly reflects the law.
11 JRS Prods., Inc. v. Matsushita Elec. Corp. of Am., 8 Cal. Rptr.
12 3d 840, 849 (Cal. Ct. App. 2004) ("a party to a contract cannot
13 recover damages in tort for breach of contract"). But the same
14 conduct that constitutes breach of a contract may also amount to
15 an actionable tort if the conduct violates a duty that is
16 independent of the contract and arises from principles of tort
17 law. Erlich v. Menezes, 981 P.2d 978, 983 (Cal. 1999). Because
18 the bankruptcy court did not reach this issue, we will not
19 address it either.

20 However, while the trespass claim must be remanded for
21 trial, it is proper on this record for us to conclude that if
22 SVCC prevails in recovering an award of money damages against El
23 Toro,¹³ any damages awarded to SVCC would be subject to the cap
24 in § 502(b)(6). This conclusion results from the analysis above
25

26
27 ¹³ This presumes SVCC forgoes its claim for equitable
28 relief since SVCC did not appeal the bankruptcy court's ruling
that it is not entitled to an injunction because it has an
adequate remedy at law.

1 regarding SVCC's counterclaims for nuisance and waste. Because
2 SVCC's trespass claim against El Toro stems from the lessee's
3 failure to remove the stockpile at lease termination, a clear
4 violation of the terms of the parties' lease, the cap applies.

5 And even though El Toro's alleged failure to remove the
6 residue results from its conduct during the bankruptcy case,
7 SVCC's trespass damages would nonetheless constitute a
8 nonadministrative, prepetition claim. In Treesource Indus., the
9 Ninth Circuit addressed whether a lessor's claim for the
10 debtor/lessee's failure to restore leased property to its pre-
11 lease condition upon termination should be considered a
12 prepetition or postpetition claim. 363 F.3d at 995-96
13 (considering administrative expense priority under § 503). The
14 lease required the debtor to remove, upon termination, all
15 improvements it made during the term of the lease, including
16 footings, floors, and foundations, and to regrade the land to its
17 natural contours. Id. at 996. The debtor failed to remove a
18 concrete slab upon rejection of the lease. Although the lessor
19 in Treesource Indus. did not assert a trespass claim, the court
20 provided a straightforward analysis. Because the debtor's
21 obligation to restore the leased property was triggered, under
22 the terms of the lease, upon its "termination or expiration," and
23 because the debtor's rejection of the lease terminated it, the
24 lessor's claim for the debtor's failure to remove the concrete
25 slab was a prepetition claim. Id. at 998.

26 That same logic applies with equal force to the facts here.
27 El Toro's obligation to vacate Plot 1 and restore the property as
28 detailed in the reclamation plan was triggered, under ARTICLE 23,

1 upon the lease's expiration or termination. El Toro's rejection
2 of the lease terminated it. The termination gave rise to El
3 Toro's obligation to remove the mining waste, a corollary of
4 which is El Toro's liability under state trespass law for its
5 failure to do so. Viewed this way, any harm SVCC suffers as a
6 result of the stockpiled waste, regardless of the legal theory
7 employed, is a result of the termination of the lease, is a
8 prepetition claim, and is therefore subject to the damage cap in
9 § 502(b)(6).

10 VI. CONCLUSION

11 The bankruptcy court erred in deciding that SVCC's nuisance
12 and waste claims were not limited by the cap on lease termination
13 damages in § 506(b)(6). The bankruptcy court also erred by
14 dismissing SVCC's trespass claim. The decision of the bankruptcy
15 court is REVERSED and this adversary proceeding is REMANDED to
16 the bankruptcy court for further proceedings consistent with this
17 opinion.

18
19
20 BRANDT, Bankruptcy Judge, concurring:

21
22 Confined by our prior authority, In re McSheridan, 184 B.R.
23 91 (9th Cir. BAP 1995), I reluctantly concur, but I find the
24 reasoning of In re Atlantic Container Corp., 133 B.R. 980 (Bankr.
25 N.D. Ill. 1991) and In re Bob's Sea Ray Boats, Inc., 143 B.R. 229
26 (Bankr. D.N.D. 1992), more persuasive.

27 I disagree that the language of the statute is plain, and in
28 this case, the result is potentially very harsh. Further, it is

1 perverse: to enforce tenants' guarantees of lease obligations
2 other than those ordinarily understood by business folk to be
3 "rent" in state proceedings, or security for those guarantees, a
4 lease must make breaches of those obligations defaults. But then
5 if the tenant becomes a debtor in bankruptcy, an expansive
6 interpretation of the cap of 11 U.S.C. § 506(c) vitiates the
7 perfectly reasonable protections so bargained for. It is also
8 ironic that, were El Toro a trespasser, SVCC's claim would not be
9 limited by the cap. Finally, I see no principled distinction
10 between violations of covenants to comply with environmental laws
11 and violation of covenants not to engage in tortious or criminal
12 conduct – all of those obligations arise independently of the
13 landlord-tenant relationship.

14 Were I free to follow the contrary authority, I would do so.

15
16
17 KLEIN, Bankruptcy Judge, concurring in result:

18
19 I reluctantly concur in the result and share Judge Brandt's
20 concerns. My doubts are substantive and procedural.

21 I assume, for purposes of analysis, that McSheridan
22 controls, even though that decision did not deal with a
23 bargained-for restore-the-premises post-expiration obligation.
24 Our McSheridan panel dealt with how to determine whether
25 particular expenses, not expressly denominated as "rent,"
26 nevertheless qualified as "rent reserved by" a so-called "triple-
27 net" lease and rejected arguments that non-rent expenses might be
28 recovered on a tort theory.

1 A

2 While I agree that re-branding contractual obligations as
3 "torts" is not a promising strategy for eluding the § 502(b)(6)
4 cap, thinking about the problem head-on as a matter of contract
5 gives pause.

6 I am not confident that a bargained-for contractual restore-
7 the-premises obligation following the end of a lease by either
8 expiration or termination is necessarily subsumed by § 502(b)(6).
9 It may, instead, be an independently cognizable obligation. The
10 language of the statute appears to include a causation
11 requirement linked to termination of a lease ("damages resulting
12 from the termination of a lease of real property"). A
13 contractual restore-the-premises obligation that applies
14 regardless of whether the lease terminates or merely expires
15 arguably is an obligation that does not "result from"
16 termination.

17 As noted in the majority opinion, the § 502(b)(6) cap
18 reflects a balancing of interests struck by Congress by allowing
19 a lessor a reasonable sum without unfairly diluting or squeezing
20 out other creditors by virtue of the common-law measure of
21 damages that permits a landlord to obtain, subject to a duty of
22 mitigation, the full balance of rent owed under the lease. In a
23 functional sense, the cap amounts to a conclusive presumption, as
24 between landlord and estate, that the landlord will have fully
25 mitigated all future lost-rent damages once it receives the
26 amount of the cap.

27 A restore-the-premises obligation does not fit comfortably
28 within either the language or the policy of § 502(b)(6). Hence,

1 it may be doubted that the second half of the McSheridan
2 analysis, which appears to say that all sums owed pursuant to a
3 lease contract following lease termination are subsumed by the
4 capped rent claim, would survive scrutiny by the court of
5 appeals. McSheridan, 184 B.R. at 100-02.

6 If the lease had expired by its terms before the bankruptcy
7 case was filed, it is doubtful that § 502(b)(6) would cap the
8 full restoration obligation under a lease contract. Similarly,
9 if the lease were to expire by its terms within one year after
10 the filing of the petition, it is not clear that the cap would
11 impair the contractual restoration obligation. If these doubts
12 are meritorious, then it arguably ought not to matter that the
13 lease was terminated prematurely.

14
15 B

16 As a matter of procedure, the trial court's certification of
17 finality pursuant to Federal Rule of Civil Procedure 54(b), as
18 incorporated by Federal Rule of Bankruptcy Procedure 7054(a),
19 directing entry of judgment makes the judgment that was rendered
20 on partial summary judgment final and immediately appealable. 28
21 U.S.C. § 158(a)(1).

22 Nevertheless, there is reason for caution. This appeal
23 appears to be inextricably intertwined with numerous other as-yet
24 unresolved facets of the larger dispute between the parties. It
25 appears that, in reality, it was the landlord who did the
26 terminating. Each party continues to have claims against the
27 other. There may be issues of setoff and other complications
28 that add up to create a settlement imperative.

1 The consequence of all this is that, while we must exercise
2 jurisdiction, the circumstances are inherently interlocutory.
3 Our ruling may be more advisory than definitive. I am reluctant
4 to make definitive determinations in speculative circumstances
5 about a very complex problem.

6 Hence, I CONCUR IN THE RESULT.

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