

MAR 13 2012

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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NOT FOR PUBLICATION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

| | | | |
|----|------------------------|---|--------------------------|
| 5 | In re: |) | BAP No. AZ-11-1334-JuPaD |
| 6 | REALIA, INC., |) | Bk. No. 2:05-15022 |
| 7 | Debtor. |) | Adv. No. 2:10-00962 |
| 8 | <hr/> |) | |
| 9 | NORTH AMERICAN SERVICE |) | M E M O R A N D U M * |
| 10 | HOLDINGS, INC. |) | |
| 11 | Appellant, |) | |
| 12 | v. |) | |
| 13 | ERIC M. BLACK, L.L.C., |) | |
| | Appellee. |) | |
| | <hr/> |) | |

Argued and Submitted on February 24, 2012
at Phoenix, Arizona

Filed - March 13, 2012

Appeal from the United States Bankruptcy Court
for the District of Arizona

Honorable Redfield T. Baum, Sr., Bankruptcy Judge, Presiding

Appearances: Robert C. Warnicke, Esq. of Gordon Silver argued
for appellant North American Service Holdings,
Inc.; William E. Manning, Esq. of Saul Ewing LLP
argued for appellee Eric M. Black, L.L.C.

Before: JURY, PAPPAS, and DUNN, Bankruptcy Judges.

* This disposition is not appropriate for publication.
Although it may be cited for whatever persuasive value it may
have (see Fed. R. App. P. 32.1), it has no precedential value.
See 9th Cir. BAP Rule 8013-1.

1 This appeal raises the question whether, as a matter of
2 law, appellant, North American Service Holdings, Inc. ("NASH"),
3 retained an option to purchase real property after the
4 chapter 7¹ trustee sold the property in a § 363(f) sale to
5 appellee, Eric M. Black, Inc. ("EMB").² Having conducted an
6 independent and de novo review of the record, we conclude that
7 it did not and AFFIRM.

8 I. FACTS

9 A. Prepetition Events

10 Realia, a Delaware corporation, was in the business of
11 buying, developing and managing real estate. On July 31, 2003,
12 Realia acquired three properties from The Artesia Companies,
13 Inc. ("TAC"). One of those properties – which was the subject
14 of this appeal – was located in Visalia, California. Realia
15 paid \$431,010.40 for the property and, of that amount,
16 \$346,650.33 was in the form of an assumption by Realia of debt
17 owed by TAC to Volley Properties, LLC ("Volley Properties").
18 The obligation to Volley Properties was secured by a first deed
19 of trust on the property. It is unclear whether the property
20

21 ¹ Unless otherwise indicated, all chapter and section
22 references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1532.
23 "Rule" references are to the Federal Rules of Bankruptcy
24 Procedure and "Civil Rule" references are to the Federal Rules of
25 Civil Procedure.

26 ² To add to the complex procedural background of this case,
27 the appellee, Eric M. Black, L.L.C., was not the purchaser of the
28 property at the bankruptcy sale. It appears from the record that
at the summary judgment hearing on this matter, the court treated
Eric M. Black, L.L.C. and Eric Black, Inc. as affiliates and for
purposes of this appeal we do the same. We collectively refer to
both entities as "EMB."

1 had other liens against it at the time of the sale.

2 After acquiring the Visalia property, Realia entered into a
3 commercial lease dated August 1, 2003 with the prior owner TAC.
4 TAC was in the construction materials business and used a
5 portion of the property as its office. Realia entered into a
6 separate lease agreement dated August 1, 2003 with Artesia, Inc.
7 ("Artesia") for the balance of the property. The business of
8 Artesia is not apparent from the record. Both leases were for a
9 term effective August 1, 2003 and ending July 31, 2013.
10 These leases were allegedly preliminary agreements, as
11 negotiations between Realia and its lessees, TAC and Artesia,
12 were ongoing.

13 Later, Realia and TAC as to one lease, and Realia and
14 Artesia as to the other, entered into further agreements, dated
15 November 1, 2003, but made effective August 1, 2003. Similar to
16 the previous leases, the initial term of these leases were also
17 effective August 1, 2003 and ended on July 31, 2013. The leases
18 further provided that the lessee could renew the lease for ten-
19 year periods from July 31, 2013 through July 31, 2043. Further,
20 unlike the previous leases, paragraph 2 of the new agreements
21 shows that Realia, as landlord, granted TAC and Artesia the
22 option to purchase the Visalia property. The agreements
23 credited a portion of the rental payments and other payments
24 towards the purchase price. Evidently, there were further
25 amendments to the leases on December 1, 2003 and again on
26 January 31, 2004. The January 31, 2004 version of the leases
27 modified the monthly credit accumulations towards the purchase
28 price under the option. For purposes of this appeal, these

1 later agreements are largely ignored, with the focus being on
2 the November 1, 2003 agreements.

3 On January 31, 2004, TAC assigned its interest in its lease
4 to Artesia.

5 On September 9, 2004, an entity named Valley Pacific
6 Petroleum Services, Inc. ("VP") obtained a default judgment
7 against Realia for \$373,352.62 and recorded a lien against the
8 Visalia property. The amount of the judgment supposedly
9 reflected amounts owed by TAC to VP for fuel and the like. VP
10 alleged that Realia was the successor corporation to TAC.

11 In connection with this allegation, VP maintained that
12 Realia's secured creditor, Kraft Americas Holding, Inc.
13 ("KAHI"), a Delaware corporation, controlled Realia. KAHI held
14 a security interest on all assets of Realia which, besides the
15 real property, included equipment and machinery.³ KAHI was also
16 a shareholder of TAC, but allegedly sold all its shares on
17 May 2, 2002, which would have been prior to the sale of the
18 property to debtor. In addition, an individual by the name of
19 Rune Kraft ("Kraft"), who had been a director of TAC, allegedly
20 resigned on May 1, 2002. Kraft was also involved with KAHI and
21 was chairman, director and an officer of NASH.⁴

22
23 ³ It appears any KAHI secured position on the Visalia real
24 property would have been junior to Volley Properties' lien.

25 ⁴ From what we can tell, Kraft is the link among the various
26 entities involved in this appeal. It appears that he owned KAHI
27 which in turn was the 100% shareholder of TAC. He was also a
28 director of TAC. TAC sold the Visalia property to Realia and
then TAC and Realia entered into the purported lease containing
the option. TAC then assigned its interest in the lease to

(continued...)

1 **B. Bankruptcy Events**

2 It is not entirely clear from the record why Realia filed
3 it chapter 11 petition on August 16, 2005. Less than ten days
4 after the filing, VP moved to dismiss or convert the case.
5 Debtor contested the dismissal or conversion, alleging that VP
6 was not a creditor in its case. The hearing on the motion to
7 dismiss or convert was continued from time to time, but
8 eventually the bankruptcy court converted debtor's case to one
9 under chapter 7 on December 13, 2005. Roger W. Brown was
10 appointed the chapter 7 trustee.

11 Debtor's Schedule A listed its 100% ownership interest in
12 five pieces of real property, including the office building in
13 Visalia, with a total value of \$914,000. Debtor also listed
14 personal property as 100% stock ownership in Concreteworks,
15 Inc., \$193,000 in accounts receivable, \$476,000 in machinery and
16 equipment, and the leases (presumably the ones relating to the
17 Visalia property) valued at \$406,000. Debtor's Schedule D
18 showed KAHI with a security interest in all debtor's assets in
19 an amount over \$1 million and Volley Properties as being secured
20 by the Visalia property in the amount of \$301,000. Debtor
21 listed the leases on the Visalia property in Schedule G and no
22 unsecured creditors in Schedule F.

23 Upon conversion of the case, debtor provided the trustee
24 with information about its properties, including the lease
25

26 ⁴(...continued)
27 Artesia and Artesia assigned its interest in the lease to NASH.
28 Kraft controlled NASH, and there are allegations in the record
that he also had controlled Realia.

1 agreements related to the Visalia property. According to the
2 record, the trustee was given the version of the leases which
3 did not contain the option provisions.

4 **The Sale Under Section 363(f)**

5 In July 2006, the trustee moved to sell the Visalia
6 property free and clear of all claims and interests under
7 § 363(f). The trustee's application showed that the buyer was
8 EMB, the purchase price was \$425,000, and the property was
9 severely overencumbered.⁵ The application further showed that
10 the property was subject to two leases, which would not be
11 affected by the sale: "Commercial Lease Agreement with The
12 Artesia Companies, Inc. as tenant, effective August 1, 2003 and
13 ending July 31, 2013, and Commercial Lease Agreement with
14 Artesia, Inc. as tenant, effective August 1, 2003 and ending
15 July 31, 2013." The sale was subject to overbid.

16 Attached to the application was a letter of intent setting
17 forth the basic terms of the purchase. The letter of intent
18 stated that "Buyer has conducted all due diligence and is
19 satisfied with the subject property in its entirety." The
20 letter also reflected that "Buyer is aware that the property is
21 subject to two existing leases" No leases were attached
22

23 ⁵ The trustee's amended application showed that Volley
24 Properties' lien was for \$355,000. There were also numerous tax
25 liens and judgment liens filed against the property with VP's
26 judgment lien greater than \$320,000. At the sale hearing, the
27 trustee explained that certain tax liens would be paid from the
28 proceeds and that debtor owned other properties that could
partially satisfy some of the liens. This offer of proof
apparently satisfied the court as a basis for authorizing the
sale free and clear.

1 to the application contained in the record.

2 On August 2, 2006, the bankruptcy court heard the sale
3 motion and presided over the auction. In the transcript of that
4 hearing, trustee's counsel stated that the trustee intended to
5 assume and assign the leases,⁶ with all the terms of the leases
6 applicable to the purchaser. Hr'g Tr. August 2, 2006 at 7:9-14.
7 However, the record indicates that the trustee had obtained only
8 the version of the leases between debtor and its lessees which
9 did not contain the option. Moreover, there was no further
10 discussion regarding whether the trustee met the requirements
11 for assumption under § 365, and there are no documents in the
12 record - other than one line in the sale order - that show an
13 assignment ever occurred.

14 Kraft, the principal of KAHI, was at the hearing and
15 represented by counsel. Interested in overbidding EMB's price,
16 Kraft's counsel brought up the issue of the option in the
17 November 1, 2003 leases. Mr. Black stated that he had recently
18 heard about the option to purchase and asked the court for any
19 such provision to be set aside. He further stated that he was
20 interested in purchasing the property with or without the
21 leases, but without the option. Hr'g Tr. August 2, 2006 at
22 14:8-12. After further discussion, the court stated: "Well, as
23 I understand the current status of this, that the leases will be
24 assigned whatever right, title, and interest the estate has; and
25 then it will be between the buyer and the tenants to decide
26 legally where that leaves them, assuming somebody closes on the

27
28 ⁶ Assumption was not mentioned in the sale application.

1 property." Id. at 14:13-17. EMB and KAHI then bid on the
2 property, with EMB's final bid in the amount of \$465,000 and
3 KAHI's "back-up" bid for \$455,000.

4 The court approved the sale by order entered on August 9,
5 2006. The order stated:

6 IT IS FURTHER HEREBY ORDERED that the Trustee shall
7 assign to Buyer any interest the Estate may have in
8 the two(2) commercial leases described as follows: a.
9 Commercial Lease Agreement with The Artesia Companies,
10 Inc. as tenant, effective August 1, 2003 and ending
11 July 31, 2013; and Commercial Lease Agreement with
12 Artesia, Inc. as tenant, effective August 1, 2003 and
13 ending July 31, 2013.

14 **The Trustee's Adversary Proceeding**

15 After the entry of the sale order and prior to the closing
16 of the sale, the issue whether EMB was bound by the option in
17 the November 1, 2003 leases persisted. Apparently, KAHI
18 contacted the trustee, claiming that TAC and Artesia had a
19 purported option to purchase the property until October 1, 2010,
20 for the purchase price of \$439,630 less certain credits. As a
21 result, on November 8, 2006, the trustee commenced an adversary
22 proceeding in the bankruptcy court against KAHI; TAC; Artesia;
23 and others, seeking to avoid the unrecorded real estate option
24 under § 544. The trustee alleged that there were no documents
25 evidencing the option or any other purported interest, claim, or
26 contract right of the defendants in the property that were
27 recorded as of the petition date. The bankruptcy court granted
28 a default judgment against all defendants in February 2007.

In apparent reliance on the default judgment and the leases
with no option given by the trustee to it, EMB closed its
purchase of the Visalia property on February 28, 2007.

1 **The Assignment Of The Leases To NASH**

2 On March 31, 2007, Artesia assigned the two commercial leases to
3 NASH for \$806,378.65. According to the assignment, NASH assumed
4 all the obligations under the leases.

5 **The Unlawful Detainer**

6 After the closing, EMB received no rent from TAC or
7 Artesia. Consequently, on April 25, 2007, EMB filed an action
8 for unlawful detainer against TAC and Artesia. The California
9 state court granted the requested relief by order dated May 9,
10 2007. After judgment was entered, NASH appeared in state court
11 to seek relief from that judgment, as assignee under the leases
12 dated November 1, 2003 between Realia and TAC and Realia and
13 Artesia. The state court denied NASH's requested relief.⁷ It
14 was at this time that Mr. Black supposedly saw the leases that
15 contained the option for the first time.

16 **The Motion To Set Aside The Default Judgment**

17 On May 22, 2008, Artesia moved to set aside the default
18 judgment in the trustee's § 544 adversary proceeding, contending
19 that it had not been properly served. The bankruptcy court
20 denied the motion in a written Minute Entry Order filed on
21 July 30, 2008. The court found that Artesia had been properly
22 served; Artesia had not acted timely with its motion to set
23 aside the default; and Artesia had no meritorious defense to the
24 trustee's adversary complaint. The order denying Artesia's
25 motion was entered August 11, 2008.

26
27 _____
28 ⁷ Neither Artesia nor NASH occupied the property at the time
of this appeal.

1 Artesia appealed that order to the district court. The
2 district court reversed the bankruptcy court's decision, finding
3 that Artesia had not been properly served and therefore the
4 bankruptcy court did not have personal jurisdiction over
5 Artesia. The matter was remanded to the bankruptcy court. On
6 April 16, 2009, the trustee dismissed his complaint in the § 544
7 adversary proceeding.

8 **The Delaware State Court Action**

9 On September 20, 2007, NASH sued EMB in the Delaware
10 Chancery Court to enforce the option to purchase the property
11 referenced in the lease dated November 1, 2003 between Realia
12 and Artesia. More than two years later, on November 18, 2009,
13 the Delaware Chancery Court stayed its proceeding for six months
14 so that EMB could seek clarification of the bankruptcy court's
15 sale order and whether that sale assigned the leases with the
16 option.

17 **The Closing And Reopening Of The Case**

18 On June 9, 2008, debtor's chapter 7 case was closed. EMB
19 moved to reopen the bankruptcy case, and the bankruptcy court
20 granted the motion to reopen on March 11, 2010.

21 **EMB's Adversary Complaint**

22 On June 1, 2010, EMB filed a complaint against NASH in the
23 bankruptcy court seeking declaratory relief. In Count I, EMB
24 sought a declaration that the August 2003 leases were the only
25 leases assigned to EMB in the sale order and that any option to
26 purchase contained in the November 1, 2003 leases was
27 unenforceable as against EMB. In Count II, EMB sought a
28 declaration that the option to purchase contained in the

1 November 1, 2003 leases was not enforceable against EMB as a
2 bona fide purchaser without notice of the option to purchase.

3 **NASH'S Motion To Dismiss The Adversary Complaint**

4 On July 2, 2010, NASH moved to dismiss the complaint under
5 Civil Rule 12(b)(1) and (3). NASH maintained that the
6 bankruptcy court did not have jurisdiction over the matter
7 because NASH had never appeared in the bankruptcy court and the
8 dispute was between two parties to a lease. NASH asserted that
9 the dispute was governed purely by state law. NASH further
10 argued that the commercial lease agreements contained provisions
11 that if a dispute arose under the agreement, Delaware law
12 applied.

13 EMB responded, arguing that NASH waived any objection to
14 personal jurisdiction because it did not object to the Delaware
15 court's imposition of the stay of the state court proceeding.
16 EMB also maintained that the bankruptcy court had subject matter
17 jurisdiction under its "related to" jurisdiction because the
18 dispute over what was assigned by the trustee arose out of the
19 sale approved by the bankruptcy court.

20 At an August 12, 2010 hearing, the bankruptcy court granted
21 NASH's motion to dismiss in part. The court dismissed Count II
22 of the complaint, finding that Count I was the proper procedural
23 vehicle to request the court to consider whether there should be
24 a clarification of the sale order.

25 **EMB'S Motion For Summary Judgment**

26 On March 15, 2011, EMB moved for summary judgment, arguing
27 that the undisputed facts showed that the only leases assigned
28 to EMB by the court's sale order were the August 1, 2003 leases.

1 EMB provided a statement of uncontroverted facts in support.

2 NASH responded to the motion, arguing that several other
3 documents were "effective" August 1, 2003 besides the two leases
4 referred to by EMB. NASH further maintained that the bankruptcy
5 court made clear at the August 2, 2006 sale hearing, that any
6 buyer would take the property subject to whatever right, title,
7 and interest the estate had in the leases. NASH asserted that
8 it was irrelevant what EMB or the trustee knew or did not know.
9 Rather, NASH's position was that the narrow issue before the
10 court was what interest did the estate have in the leases at the
11 time the sale was approved. In addition, NASH maintained that
12 the trustee's § 544 complaint, filed four months prior to the
13 actual closing of the sale, put EMB on notice of the existence
14 of the additional documents. Therefore, according to NASH, EMB
15 should have known about the lease incentives and option at the
16 time of the closing. NASH provided a statement of controverted
17 facts and separate statement of facts in support.

18 On April 26, 2011, NASH filed a cross motion for summary
19 judgment. In that motion, NASH requested the court to find, as
20 a matter of law, that the lease agreements effective August 1,
21 2003 and ending July 31, 2013, referenced on page 2 of the sale
22 order, included, among other documents, the subsequent lease
23 agreements dated November 1, 2003, December 1, 2003, and
24 January 31, 2004.

25 On June 1, 2011, the bankruptcy court heard argument from
26 the parties on the summary judgment motions and took the matter
27 under advisement. On June 14, 2011, the bankruptcy court ruled
28 that the leases were never assumed by the trustee in connection

1 with the sale of the Visalia property or at any other time. The
2 court further found that leases not assumed by the chapter 7
3 trustee are "deemed rejected" under § 365(d)(1). The court
4 therefore concluded that Artesia did not retain its rights under
5 the option to purchase because of the rejection of its leases.
6 The court further reasoned that the option was not an executory
7 contract under the holding of Unsecured Creditors' Comm. of
8 Robert L. Helms Constr. & Dev. Co., Inc. v. Southmark Corp.
9 (In re Robert L. Helms Constr. & Dev. Co., Inc.), 139 F.3d 702
10 (9th Cir. 1998). In the end, the court granted EMB's motion for
11 summary judgment and denied NASH's cross motion for summary
12 judgment.

13 On July 6, 2011, the court entered the Final Declaratory
14 Judgment in favor of EMB. That judgment provides that EMB took
15 the property "free and clear of any option agreement . . .
16 contained in those certain leases dated November 1, 2003."
17 NASH timely appealed the bankruptcy court's decision to grant
18 summary judgment in favor of EMB.

19 II. JURISDICTION

20 As a threshold matter, we must determine whether the
21 bankruptcy court had jurisdiction to issue a final judgment and
22 whether we, in turn, have jurisdiction to review the judgment on
23 appeal. See Krasnoff v. Marshack (In re Gen. Carriers Corp.),
24 258 B.R. 181, 188-89 (9th Cir. BAP 2001). Generally, disputes
25 between purchasers of a debtor's assets and third parties are
26 not within the bankruptcy court's jurisdiction. Miller v.
27 Kemira, Inc. (In re Lemco Gypsum, Inc.), 910 F.2d 784, 789 (11th
28 Cir. 1990); In re Hall's Motor Transit Co., 889 F.2d 520, 522-23

1 (3d Cir. 1989). However, a bankruptcy court has ancillary
2 jurisdiction to interpret its own orders after the closing of a
3 case. See generally Battle Ground Plaza, LLC v. Ray (In re
4 Ray), 624 F.3d 1124, 1130 (9th Cir. 2010) (Ancillary
5 jurisdiction enables a court to vindicate its authority and
6 effectuate its decrees). Ancillary jurisdiction should only be
7 used “when necessary to resolve bankruptcy issues, not to
8 adjudicate state law claims that can be adjudicated in state
9 court.” In re Ray, 624 F.3d at 1136.

10 Here, the parties have different interpretations of the
11 sale order based on statements the judge made during the sale
12 hearing; namely, whether the sale included the assignment of the
13 leases with or without the option. Because this aspect of the
14 parties’ dispute could arise only in a bankruptcy proceeding, we
15 conclude that the bankruptcy court properly exercised its
16 ancillary jurisdiction over the matter. See also Travelers
17 Indem. Co. v. Bailey, 557 U.S. 137, 129 S.Ct. 2195, 2205 (2009)
18 (“[T]he Bankruptcy Court plainly had jurisdiction to interpret
19 and enforce its own prior orders.”). Therefore, we have
20 jurisdiction under 28 U.S.C. § 158.

21 **III. ISSUE**

22 Whether the bankruptcy court erred in granting summary
23 judgment in favor of EMB.

24 **IV. STANDARD OF REVIEW**

25 We review de novo the bankruptcy court’s grant of a motion
26 for summary judgment. Ilko v. Cal. St. Bd. of Equalization
27 (In re Ilko), 651 F.3d 1049, 1055 (9th Cir. 2011). De novo
28 means review is independent, with no deference given to the

1 trial court's conclusion. See First Ave. W. Bldg., LLC v. James
2 (In re Onecast Media, Inc.), 439 F.3d 558, 561 (9th Cir. 2006).
3 We may affirm the bankruptcy court's decision on any ground
4 supported by the record. Shanks v. Dressel, 540 F.3d 1082, 1086
5 (9th Cir. 2008).

6 V. DISCUSSION

7 In reviewing the bankruptcy court's decision on a motion
8 for summary judgment, we apply the same standards as the
9 bankruptcy court. Summary judgment is properly granted when no
10 genuine and disputed issues of material fact remain, and, when
11 viewing the evidence most favorably to the non-moving party, the
12 movant is entitled to prevail as a matter of law. Civil
13 Rule 56, incorporated by Rule 7056; Celotex Corp. v. Catrett,
14 477 U.S. 317, 322-23 (1986). Material facts which would
15 preclude entry of summary judgment are those which, under
16 applicable substantive law, could affect the outcome of the
17 case. The substantive law will identify which facts are
18 material. Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 248
19 (1986).

20 A. Section 365

21 The bankruptcy court found that the chapter 7 trustee had
22 not assumed any version of the leases and, furthermore, the
23 leases were deemed rejected under § 365(d)(1). NASH contends
24 that the bankruptcy court ruled on these issues without the
25 benefit of briefing on the applicability of § 365.⁸ On appeal,
26

27 ⁸ In the underlying summary judgment motion and cross
28 motion, the parties did not mention § 365 at all. Rather, their
(continued...)

1 NASH does not challenge the bankruptcy court's decision with
2 respect to the assumption issue, but contends the court erred by
3 concluding that the leases were rejected as a matter of law
4 under § 365(d)(1).

5 We need not decide whether NASH had sufficient notice that
6 in ruling on the summary judgment motion the bankruptcy court
7 intended to consider the assumption or rejection issues, or
8 whether if the court sua sponte ruled on these issues, it erred
9 in so doing. We have independently reviewed the record and have
10 considered not only the arguments NASH made to the bankruptcy
11 court, but also the arguments and the evidence on which it
12 relies as set forth in its brief and in oral argument to this
13 Panel. Having considered such arguments and evidence, our
14 analysis regarding § 365 differs from that employed by the
15 bankruptcy court because we address the threshold question
16 whether the leases containing the option were true leases
17 falling within the scope of § 365. See City of S.F. Mkt. Corp.
18 v. Walsh (In re Moreggia & Sons, Inc.), 852 F.2d 1179, 1182 (9th
19 Cir. 1988) (only true leases fall within the scope of § 365).
20 We conclude that they are not. Our review is based on
21 uncontroverted facts in the record on summary judgment – the
22 lease documents.

23 In analyzing whether a lease is a true lease falling within
24 the scope of § 365, the Ninth Circuit in In re Moreggia & Sons,

25 _____
26 ⁸(...continued)
27 arguments and statements of undisputed facts centered on the
28 parties' and the court's statements at the hearing and on what
the trustee or EMB knew, or should have known, regarding the
sale.

1 Inc. observed that "not every interest that might qualify as a
2 lease under state law is subject to the automatic rejection
3 provision of § 365." 852 F.2d at 1182. Thus, because state law
4 was not dispositive on the "true lease" question, the court
5 instructed that the "appropriate focus" was on the "economic
6 realities of [the] particular situation." Id. at 1082.
7 Therefore, even assuming that the leases containing the option
8 were "true leases" under Delaware law,⁹ we turn our focus to the
9 "economic realities" of those agreements.

10 Here, we believe that under In re Moreggia & Sons, Inc.,
11 the purported leases with the option do not fall within the
12 scope of § 365 because they lack the requisite landlord/tenant
13 relationship and the debtor, Realia, had de minimis executory
14 burdens. We considered the following provisions:

- 15 • The rent payable for each renewal term (which span as
16 long as forty years) remained the same.
- 17 • With each rental payment, the tenant obtained a "credit"
18 towards the purchase price of the property.
- 19 • The tenant had sole discretion to make all necessary
20 repairs and maintenance to the building. The landlord agreed to
21 reimburse the tenant for all repairs and maintenance within ten
22 days of the tenant making such a request.
- 23 • The tenant had the right without the landlord's consent
24 to remodel, redecorate, and make additions. However, the
25 landlord also was required to reimburse the tenant within ten
26

27 ⁹ Each of the leases provided that they should be construed
28 under Delaware law.

1 days of tenant making a request.

2 • The tenant paid all charges for utilities, including
3 electricity, gas, water, waste, alarm and any other utilities,
4 but then again was entitled to reimbursement from the landlord.

5 • The tenant also paid all charges for parking lot paving
6 and resurfacing, and again the landlord was required to
7 reimburse the tenant within ten days of tenant making such a
8 request.

9 • Paragraph 15 of the lease provides that the tenant was
10 responsible for managing the building and for collecting all
11 rental payments on behalf the landlord, and was also responsible
12 for paying Volley Properties, the first trust deed holder on the
13 property.

14 • When the option was exercised, the purchase price varied
15 not only by the rental credit, but also by the amounts not
16 "reimbursed" by the landlord, i.e., for the utilities,
17 improvements, etc.

18 • The leases gave the tenant the "right" to skip rent for
19 up to three consecutive months at its discretion.

20 • The landlord was prohibited from encumbering the
21 property, and tenant had the right to demand the release of any
22 such encumbrance.

23 • Default of the landlord under the lease gave the tenant
24 the right to add twelve percent interest to the amounts not
25 reimbursed.

26 • Finally, at some point in time prior to the end of the
27 renewed term ending in 2043, the credits would have more than
28 paid the full option purchase price, leaving not even one dollar

1 due at the end.

2 Taken together, these provisions do not indicate a
3 landlord/tenant relationship. Although the tenant was required
4 to pay rent, there was no increase in rent for as long as forty
5 years. Thus, the landlord-debtor did not receive any return on
6 its investment nor did the rent appear to be based on the market
7 value of the property in the future. Moreover, the allocation
8 of responsibilities between the landlord and tenant shows that
9 the tenant was not only in possession of the property, but also
10 in control. The tenant was given "sole discretion" to make
11 repair and renovation decisions about the property, paid all
12 utilities and taxes, managed the property, collected rent
13 (presumably its own), and paid the first trust deed holder on
14 the property. Although the tenant could seek "reimbursement"
15 for certain items, if those amounts were not paid by the
16 landlord, they would be credited towards the purchase price.
17 Furthermore, the landlord was penalized for not making the
18 reimbursements with an interest rate of 12%. Finally, the
19 landlord could not encumber its own property. In short, under
20 these leases, the tenant had far more than permission to use the
21 property in exchange for rent. See Int'l Trade Adm. v.
22 Rensselaer Polytechnic Inst., 936 F.2d 744 (2nd Cir. 1990)
23 (noting that the legislative history of § 502(b) indicates that
24 "the fact that the lessee assumes and discharges substantially
25 all the risks and obligations ordinarily attributed to the
26 outright ownership of the property is more indicative of a

1 financing transaction than of a true lease").¹⁰

2 Moreover, the terms of the leases show that the landlord-
3 debtor had essentially no ongoing executory burdens. The
4 landlord was required to reimburse the tenant for certain
5 expenses and provide financing in the event the tenant exercised
6 the option. However, these responsibilities were conditional
7 and essentially under the control of the tenant.

8 For these reasons, we conclude that the purported leases
9 were not "true leases."¹¹ Based on the terms of the leases that
10 contain the option clauses, there is no dispute concerning
11 material facts. We thus conclude that the leases containing the
12 option were not unexpired non-residential leases within the
13 scope of § 365.¹² Given our conclusion, § 365(h)(2) is

14
15 ¹⁰ Another unusual feature of the lease agreements
16 highlighted at the hearing on this matter was that the tenants
17 were not required to be in possession nor did it matter that they
18 had defaulted at the time they wished to exercise the option.

19 ¹¹ The arrangement appears to be a land sale contract with
20 TAC as the buyer. However, it is also possible that TAC and
21 Realia were one and the same and there really was never a bona
22 fide "sale" between those parties. In any event, we need not
23 give a label to the transaction.

24 ¹² Even if the leases with the option were subject to § 365,
25 the trustee's purported assignment of those leases vis-a-vis the
26 estate was ineffective. Under § 365(f)(2), the trustee was
27 required to assume the leases before assigning them. Section
28 363(f)(2) provides that a trustee may assign an executory
contract or unexpired lease only if the trustee first assumes
such contract or lease in accordance with provisions of § 365 and
provides adequate assurance of future performance by the assignee
of such contract or lease. (Emphasis added.) It is undisputed
that the trustee did not assume any version of the leases and it
is only through assumption that the debtor's estate would have
been bound to accept the obligations and the benefits under the

(continued...)

1 inapplicable.

2 **B. Section 363**

3 Accordingly, our focus shifts to the legal effect of the
4 sale. Keeping in mind that the sale order is a final order, we
5 first construe the sale order and then consider whether NASH's
6 interest in the leases containing the option was extinguished
7 through the sale free and clear.

8 **1. Construction Of The Sale Order**

9 "When construing an agreed or negotiated form of order,
10 such as the Sale Order in this case, we approach the task as an
11 exercise of contract interpretation rather than the routine
12 enforcement of a prior court order." In re Trico Marine Servs.,
13 Inc., 450 B.R. 474, 482 (Bankr. D. Del. 2011); see City of
14 Covington v. Covington Landing Ltd. P'ship, 71 F.3d 1221, 1227
15 (6th Cir. 1995) ("An agreed order, like a consent decree, is in
16 the nature of a contract, and the interpretation of its terms
17

18 ¹²(...continued)
19 leases. See NLRB v. Bildisco & Bildisco, 465 U.S. 513, 531-32
20 (1984). Without assumption, the estate was not bound to accept
21 the obligations and benefits under the leases. Thus, as a
22 matter of law, the trustee's purported assignment of the leases
23 to EMB (regardless of which version) was legally ineffective to
24 transfer the obligations and rights under the leases to EMB. See
25 New Falls Corp. v. Boyajian (In re Boyajian), 367 B.R. 138, 145
26 (9th Cir. BAP 2007), aff'd, 565 F3d 1088 (9th Cir. 2009) ("Stated
27 as a basic principle, an assignee merely steps into the shoes of
28 his assignor. The question of what rights and remedies pass with
a given assignment depends on the interest of the parties.").
Moreover, we observe that there is no document in the record
evidencing an assignment whereby EMB agreed to step into the
shoes of debtor with respect to the leases containing the option.
In reality, as further explained below, the record shows that EMB
did not bargain for or intend to purchase the property subject to
the leases containing the option.

1 presents a question of contract interpretation."); Rifken v.
2 CapitalSource Fin., LLC (In re Felt Mfg. Co., Inc.), 402 B.R.
3 502, 511 (Bankr. D.N.H. 2009) ("The terms of court orders, plans
4 of reorganization, and stipulations between parties are
5 typically examined under principles of contract
6 interpretation."). "At bottom, the goal is to determine the
7 rights, duties, and reasonable expectations of the parties, as
8 disclosed to and blessed by the Court. The paramount goal of
9 contract interpretation is to determine the intent of the
10 parties." Trico Marine, 450 B.R. at 482 (citing Am. Eagle
11 Outfitters v. Lyle & Scott Ltd., 584 F.3d 575, 587 (3d Cir.
12 2009)).

13 The sale order plainly stated:

14 IT IS FURTHER HEREBY ORDERED that the Trustee shall
15 assign to Buyer any interest the Estate may have in
16 the two(2) commercial leases described as follows: a.
17 Commercial Lease Agreement with The Artesia Companies,
18 Inc. as tenant, effective August 1, 2003 and ending
19 July 31, 2013; and Commercial Lease Agreement with
20 Artesia, Inc. as tenant, effective August 1, 2003 and
21 ending July 31, 2013.

19 NASH attempts to create an ambiguity in the wording of the order
20 by arguing that several other documents were "effective"
21 August 1, 2003, besides the two leases referred to by EMB. NASH
22 further maintains that the bankruptcy court made clear at the
23 August 2, 2006 sale hearing, that any buyer would take the
24 property subject to whatever right, title, and interest that the
25 estate had in the leases. In other words, it was an "as is"
26 sale, subject to later surprises.

27 We are not persuaded by NASH's arguments. Where a contract
28 is ambiguous, "the interpreting court must look beyond the

1 language of the contract to ascertain the parties' intentions."
2 Eagle Indus., Inc. v. DeVilbiss Health Care, Inc., 702 A.2d
3 1228, 1232 (Del. 1997); Restatement (Second) of Contracts
4 § 202(1)(1979) ("Words and other conduct are interpreted in the
5 light of all the circumstances, and if the principal purpose of
6 the parties is ascertainable it is given great weight").

7 The evidentiary record shows that the trustee and EMB
8 negotiated for the sale of the property subject to the two
9 leases without the option. This is evident because there was no
10 mention of the leases with the option in the record until the
11 actual sale hearing. The bankruptcy court observed: "[A] fair
12 reading of the transcript is that the trustee did not have the
13 complete set of documents then [at the sale hearing] that is now
14 before this court" Hr'g Tr. June 1, 2011 at 24:21-
15 25:25:1. It follows that the trustee's application to sell the
16 property and the attached letter of intent could have only been
17 referencing the leases without the option when those pleadings
18 were submitted to the court.

19 Mr. Black's statements at the hearing are consistent with
20 our conclusion because he stated that he would purchase the
21 property with or without the leases, but without the option.
22 The trustee's adversary proceeding filed subsequent to the sale
23 hearing also demonstrates that the parties to the sale – EMB and
24 the trustee on behalf of the estate – did not negotiate or
25 intend the sale of the property subject to the leases with the
26 option. As the bankruptcy court observed, "there probably
27 wouldn't have been a closing without [the trustee's] action."
28 Hr'g Tr. June 1, 2011 at 26:1. Finally, what is telling in this

1 matter is that at no time during the sale hearing did NASH's
2 principal, Mr. Kraft, produce the leases with the option.

3 Given this background, we cannot construe the sale order as
4 being ambiguous when the reasonable intentions and expectations
5 of the parties show otherwise. Accordingly, we conclude that,
6 as a matter of law, the sale order is a final order which did
7 not include the leases with the option.

8 **2. NASH's Interest In the Option Was Extinguished By The**
9 **Sale**

10 Alternatively, we conclude that the option did not survive
11 the sale. Section 363(f) authorizes a chapter 7 trustee to sell
12 property free and clear of any "interest" in such property. We
13 have construed the term "interest" to have an expansive scope.
14 Clear Channel Outdoor, Inc. v. Knupfer (In re PW, LLC), 391 B.R.
15 25, 41-2 (9th Cir. BAP 2008) (citing United States v.
16 Knox-Schillinger (In re Trans World Airlines, Inc.), 322 F.3d
17 283 (3d Cir. 2003) (finding that travel vouchers issued in
18 connection with settlement of a discrimination action and
19 discrimination claims made by the EEOC were "interests" subject
20 to § 363(f)(5)); see also P.K.R. Convalescent Ctrs., Inc. v. Va.
21 (In re P.K.R. Convalescent Ctrs., Inc.), 189 B.R. 90, 94 (Bankr.
22 E.D. Va. 1995) (statutory right to recapture depreciation on
23 sale of health facility an interest within meaning of
24 § 363(f)(5)). Moreover, courts have noted that the purpose of
25 the "free and clear" language is to allow the debtor to obtain a
26 maximum recovery on its assets in the marketplace. See In re
27 Med. Software Solutions, 286 B.R. 431 (Bankr. D. Utah 2002)
28 (citing WBO P'ship v. Va. Dep't of Med. Assistance Serv. (In re

1 WBO P'ship), 189 B.R. 97, 108 (Bankr. E.D.Va. 1995)).

2 We decide, as a matter of law, that NASH's interest in the
3 option was an interest included within the scope of § 363(f).
4 NASH does not complain that it did not have proper notice of the
5 sale, nor can it when its principal was at the sale hearing.
6 Further, NASH's continued silence left the bankruptcy court
7 unaware that NASH might exploit the situation to undermine the
8 intended goal of the bankruptcy sale to dispose of Realia's
9 property free and clear of any interests. Therefore, we
10 conclude that the property was sold free and clear of NASH's
11 interest in the option.

12 **VI. CONCLUSION**

13 For the reasons stated, we AFFIRM.