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Ninth Circuit Decision Could Substantially Boost Landlord Claims in Bankruptcy

In a significant decision for commercial landlords, the U.S. Court of Appeals for the Ninth Circuit, in *Saddleback Valley Cmty. Church v. El Toro Materials Co.* (In re El Toro Materials Co.), No. 05-56164 WL 2822019 (9th Cir. Oct. 1, 2007), has held that the statutory cap imposed by section 502(b)(6) of the U.S. Bankruptcy Code on claims arising from a debtor's lease termination does not limit a landlord's claim for tort-related damages. Section 502(b)(6) sets limits on the "damages resulting from the termination of a lease of real property" to "the rent reserved by such lease ... for the greater of one year, or 15 percent, not to exceed three years of the remaining term of such lease[.]" In *El Toro Materials*, the Ninth Circuit ruled that a landlord's claim for \$23 million in damages for the alleged cost of removing 1 million tons of wet clay, mining equipment, and other materials from the landlords' property was not subject to the section 502(b)(6) recovery limitation for damages resulting from the termination of a lease.

El Toro Materials is an important decision, as it marks the first time that a U.S. Court of Appeals has ruled on whether landlords are constrained in their ability to recover damages on tort-based claims from tenants that reject their leases under bankruptcy protection. Courts have been split in their application of the section 502(b)(6) cap to claims beyond unpaid rent.

The *El Toro Materials* ruling will better position landlords to assert tort-based claims against bankrupt tenants, and its analysis strongly suggests that contractual claims for breach of repair and maintenance clauses that are unrelated to the rejection of the lease by the debtor-tenant should likewise not be capped. Landlords should consider ways to take advantage of the distinction drawn by the Ninth Circuit so as to better protect themselves when structuring new leases, so that claims that may validly be characterized as unrelated to future

lost rent (e.g., clean-up costs, waste removal, property damage) can be sought from a debtor-tenant's estate without being subject to the section 502(b)(6) cap.

Note:

This Legal Alert is based on an excerpt from the ABA newsletter *Bankruptcy Litigation*, Volume 14, No. 1, written by Benjamin D. Feder and Mark A. Weintraub.