UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF	)	
	)	
KINNAN & KINNAN PARTNERSHIP	)	
BILL KINNAN, KATHLEEN KINNAN	)	
AND DOROTHY KINNAN,	)	CASE NO. BK87-464
	)	CH. 11
DEBTOR(S)	)	
		Filing No. 542, 529

MEMORANDUM

Hearing was held on May 18, 1993, on Objection to Claim of Agristor and Resistance. Appearing on behalf of debtor was William Needler of William L. Needler & Associates, Ltd., Ogallala, Nebraska. Appearing on behalf of Agristor Leasing was Patrick J. Nelson of Jacobsen, Orr, Nelson, Wright, Harder & Lindstrom, P.C., Kearney, Nebraska. This memorandum contains findings of fact and conclusions of law required by Fed. Bankr. R. 7052 and Fed. R. Civ. P. 52. This is a core proceeding as defined by 28 U.S.C. § 157(b)(2)(B).

Issue and Decision

The issue before the Court is the amount, if any, of the allowed unsecured claim of Agristor Leasing (Agristor). The unsecured claim of Agristor is allowed in the amount of $61,340.20.

Background

Agristor is in the business of leasing grain handling equipment commonly sold under the Harvestore name. The parties executed an agricultural equipment lease on March 15, 1983, with a lease termination date of May 1, 1991. On March 15, 1983, the debtor paid a security deposit in the amount of $7,757.65. Pursuant to the terms of the lease, that security deposit was to earn interest at the rate of 10% per year. Annual payments were to begin on May 1, 1984, in the amount of $21,959.31 and continue through and including May 1, 1991, in the same amount. The lease provided for a total payment by the lessee of $175,674.48.

In prior litigation between these parties, the Bankruptcy Court and the District Court on appeal found that the contract between the parties was a true lease. That lease was rejected effective August 9, 1988. Agristor filed an unsecured claim in the amount of $123,998.73. That claim represented a full remaining balance due under the terms of the lease, including

payments in default prepetition, interest on the prepetition payments which were in default from the default date up to the petition date, and the gross amount of the post-petition payments due under the lease.

During the administration of the case, Agristor filed a request for an allowance of an administrative claim. This Court granted the request and allowed an administrative claim for the time from the petition date to the date of the rejection of the lease. However, that determination and allowance of the administrative claim was reversed on appeal to the United States District Court for the District of Nebraska.

Agristor's Right to an Unsecured Claim

The debtor asserts that because the administrative claim was disallowed and because Agristor did not further appeal or preserve its rights to any unsecured claim, its unsecured claim is totally barred.

This Court rejects the position of the debtor on this issue. There is nothing in the Bankruptcy Code that would require disallowance of an unsecured claim representing damages from a breach of a lease solely because a post-petition administrative claim was disallowed. The Code, at 11 U.S.C. § 365(g)(1) provides that the rejection of an unexpired lease constitutes breach of such lease, in a Chapter 11 case, immediately before the date of the filing of the petition. That section does not deal with administrative claims.

The claim for administrative expenses was brought by Agristor under 11 U.S.C. § 503. The only issue which was determined in favor of Agristor by the Bankruptcy Court and determined in favor of the debtor by the District Court was whether Agristor could be allowed an administrative expense claim without proving that the debtors' retention of the equipment post petition was of benefit to the estate. The issue tried in the administrative expense claim litigation had absolutely nothing to do with the right of Agristor to an unsecured claim by virtue of the rejection of the unexpired lease.

Agristor's Current Claim

In the joint pretrial statement, Agristor now asserts its claim in the amount of $74,056.73 resulting from the rejection of the lease. That amount represents a calculation which included the sum of the unpaid May 1, 1986, payment of $21,959.31 plus the payment due May 1, 1987, pro rated from May 1, 1986, to the date of the petition in the approximate amount of $17,000.00 plus

interest at the contract default rate from May 1, 1986, through the date of the petition, calculated on the May 1, 1986, lease payment, less application of the security deposit of $7,757.65, plus some type of present value calculation with regard to the remaining lease payments due pursuant to the lease terms. At any rate, no matter how the calculation is made, the $74,056.73 is the minimum unsecured claim asserted by Agristor.

Debtor's Claimed Offsets

The debtors assert that the unsecured claim can be no more than the amount due prepetition, approximately $39,000.00 less the security deposit with its accrued interest from the deposit date March 15, 1983, less damages resulting from the failure of Agristor to properly remove the equipment when the lease was rejected. In addition, the debtors claim that there should be a reduction for the value of the equipment removed. Apparently this request results from some theory of mitigation of damages.

A. Mitigation

There was no evidence that the equipment had been resold or leased to another party after removal from the premises of the debtors. Counsel for Agristor stated in argument that it was his understanding that the equipment had not been resold or released.

In addition to there being no evidence of a dollar amount received by Agristor for reselling or releasing the equipment, the lease agreement provides that any proceeds from such sale or lease belong to Agristor. Therefore, the claim of offset for some amount of value of the equipment is denied.

B. Damages for Failure to Remove Foundation

When Agristor removed the equipment from the premises, it did not remove the concrete foundation. Debtor William Kinnan testified that the foundation interferes with his row crop operation and interferes with his ability to sell the premises because it reduces the value of the premises.

The lease itself specifically provides at paragraph 11 that "[L]essor shall not be obligated to remove the foundation, if any, under the Equipment. . . . Lessor or its designee shall not be liable for any damage except for willful injury to such real property." Since the lease document itself excuses Agristor from any requirement to remove the foundation, the assertion that the cost of such removal should be deducted from the claim is spurious. No such reduction shall be allowed.

C. Security Deposit

On Page 1 of the lease, there is a requirement that the lessee provide the lessor with a security deposit in the amount of $7,757.65 which would bear interest at the rate of 10% per year. The debtors did, on March 15, 1983, provide such deposit. Section 3 of the lease, on page 2, provides, concerning the security deposit: "[I]f Lessee defaults in any of its obligations hereunder, Lessor, in addition to its other rights and remedies, may apply or retain all or any part of such security deposit to cure the default or to reimburse Lessor for any sum which Lessor may spend by reason of such default, and all interest then accrued on the security deposit shall be forfeited by Lessee and retained by Lessor."

Section 3 further provides: "[I]f, at the end of the term of this lease or any renewal term, Lessee is not in default, or if Lessee exercises its option to purchase the Equipment pursuant to Section 19, the security deposit plus accrued interest, or any balance thereof, shall be returned to Lessee. The security deposit is not an advance payment of rent or a measure of Lessor's damages."

The default provisions of the lease are contained in Section 16. One default provision is a failure by the lessee to make any payment of rent within ten days of its due date.

The remedies section of the lease is at Section 17. That section does not refer to the security deposit, its retention or forfeiture.

It is the position of Agristor that upon the default in payment on May 1, 1986, and the failure to cure such default within ten days, the security deposit became the property of Agristor and that all accrued interest thereon was forfeited. Because of such position, Agristor has given credit to the debtors of only the principal amount of the security deposit, $7,757.65 when asserting its claim of $74,056.73. The lease requires no notice to the lessee that the security deposit will be retained by the lessor and that the interest will be forfeited upon default. Lessor did not give any notice to lessee that the deposit would be retained pursuant to Section 3 and that the interest would be forfeited.

The lease document is a form created by Agristor. The security deposit section states, as mentioned above, that upon default lessor "may apply or retain all or any part of such security deposit. . .and all interest then accrued on the

security deposit shall be forfeited by the Lessee and retained by the Lessor." Such language is permissive and not mandatory. In other words, it is not an absolute requirement of the lease that the lessor, on default by the lessee, apply or retain such security deposit or require forfeiture of the interest. In addition, the second portion of Section 3 provides that if at the end of the lease the lessee is not in default or if the lessee exercises an option to purchase, the security deposit plus interest shall be returned to the lessee.

Reading Section 3 as a whole, the Court finds that although a lessee could be in default during some portion of the lease, if, by the end of the term of the lease, all the defaults were cured or if the lessee exercised its option to purchase the equipment, the security deposit plus accrued interest would be returned. Under this construction of the section, the retention of the security deposit by the lessor upon default and the forfeiture of the interest are not absolute. The debtor, even after default, and up until the termination of the lease or the failure to exercise an option to purchase, has a property interest in the security deposit plus accrued interest.

The Bankruptcy Code at Section 541 defines property of the estate as all legal or equitable interests of the debtor in property as of the commencement of the case. This case commenced on February 19, 1987. On that date, the debtors had an interest in the security deposit plus accrued interest. The lease had not been terminated by either party. The debtor/lessee could have cured the defaults and assumed the lease pursuant to Section 365 of the Code. Upon such cure and assumption, the security deposit would have been deemed property of the lessee, both under the terms of the lease and under the Bankruptcy Code.

Any right of the lessor to apply or retain the security deposit post petition would have been subject to the provisions of the automatic stay of Section 362(a). The exercise of such lease right would have been the equivalent of a setoff. The automatic stay prohibits the setoff without first obtaining relief from the automatic stay. No such relief was ever requested by Agristor. Instead, Agristor filed a motion requesting the Court to order the debtors to assume or reject the lease by a date certain. In response to such motion, there was significant litigation with regard to the characterization of the contract between the parties as a lease or disguised sale and security interest.

This Court concludes that the security deposit and the right to accrued interest was property of the estate as of the date of the bankruptcy. Since the automatic stay prohibited a setoff and

no motion for relief from the automatic stay was filed, interest has accrued at the rate of 10% per year on the security deposit. As of the trial date, May 18, 1993, the total balance of the security deposit plus accrued interest is $20,474.18. A schedule of such calculation is shown at Exhibit A to this memorandum.

The debtors do have a right to set off the security deposit plus interest against the unsecured claim. To do so, the $7,757.65 principal amount of security deposit should be added to the claim asserted in the pretrial statement of $74,056.73. From that total should be deducted $20,474.18 which represents the principal plus accrued interest. This leaves a balance of $61,340.20. This amount is the allowed unsecured claim of Agristor.

Separate journal entry to be issued.

DATED: May 24, 1993.

BY THE COURT:

/s/ Timothy J. Mahoney
Timothy J. Mahoney
Chief Judge

CC: Wm. Needler, Attorney for debtor
Patrick Nelson, Attorney for Agristor Leasing

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AND DOROTHY KINNAN,	)	CASE NO. BK87-464 A
DEBTOR(S)	)	
	)	CH. 11
	)	Filing No. 452, 529
Plaintiff(s)	)	
vs.	)	JOURNAL ENTRY
	)	
	)	
	)	DATE: May 24, 1993
Defendant(s)	)	HEARING DATE: May 18, 1993

Before a United States Bankruptcy Judge for the District of Nebraska regarding Objection to Claim of Agristor and Resistance.

APPEARANCES

William L. Needler, Attorney for debtor
Patrick J. Nelson, Attorney for Agristor Leasing

IT IS ORDERED:

The allowed unsecured claim of Agristor is $61,340.20. See memorandum entered this date.

BY THE COURT:

/s/ Timothy J. Mahoney
Timothy J. Mahoney
Chief Judge

ATTACHMENT A

Date	Deposit Plus Accrued Interest
March 15, 1983	$7,757.65
March 15, 1984	$8,533.42
March 15, 1985	$9,386.76
March 15, 1986	$10,325.44
March 15, 1987	$11,357.98
March 15, 1988	$12,493.78
March 15, 1989	$13,743.16
March 15, 1990	$15,117.48
March 15, 1991	$16,629.23
March 15, 1992	$18,292.15
March 15, 1993	$20,121.37

$$\left(\frac{2012.137}{365} \times 64 + 20{,}121.37\right)$$

May 18, 1993 = $20,474.18

Days from March 15, 1993 - May 18, 1993

March	16
April	30
May	18
	64 days