

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE

IN RE: :
: :
MONTGOMERY WARD HOLDING CORP., :
et al., :
: :
Debtors. :
_____: :
: :
JAMES W. MILLER, :
: :
Appellant, :
: :
v. : Civil Action No. 99-734-JJF
: :
MONTGOMERY WARD & CO., :
et al., :
: :
Appellees. :
: :

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MEMORANDUM OPINION

January 19, 2001
Wilmington, Delaware

Farnan, District Judge.

Pending before the Court is an appeal by Appellant James W. Miller from a Memorandum Opinion and Order (Bankruptcy D.I. 5016) of the United States Bankruptcy Court for the District of Delaware (the "Bankruptcy Court") denying Miller's Motion For Summary Judgment and disallowing two of Miller's four Proofs of Claim. For the reasons set forth, the decision of the Bankruptcy Court will be affirmed.

BACKGROUND

I. Procedural Background

On July 7, 1997 (the "Petition Date"), MW Land Corporation ("MW Land") and Montgomery Ward & Co., Incorporated ("Montgomery Ward") (collectively, the "Debtors") filed voluntary petitions for relief under Chapter 11 of the Bankruptcy Code. The Debtors' Chapter 11 cases were consolidated for procedural purposes only and are being administered jointly. The Debtors are continuing in possession of their respective properties and are operating and managing their businesses, as debtors in possession, pursuant to Sections 1107 and 1108 of the Bankruptcy Code.

Effective October 31, 1997, MW Land as Tenant and Montgomery Ward as Guarantor rejected a lease with Miller as Lessor pursuant to 11 U.S.C. § 365. On November 20, 1998, the Debtor filed a Motion For An Order Disallowing Or, Alternatively, Reducing Or Reclassifying Miller's Four Proofs Of Claims. (Bankruptcy D.I.

3302). Thereafter, the Debtors and Miller filed cross-motions for partial summary judgment on the applicability of 11 U.S.C. § 502(b)(6) to Miller's Proofs of Claim, Nos. 10341 and 10342.

On April 30, 1999, the Debtors filed the Joint Plan Of Reorganization Of Montgomery Ward Holding Corp. And Its Debtor Subsidiaries. On May 26, 1999, the Debtors filed an amended plan (the "First Amended Plan").

On July 13, 1999, the Bankruptcy Court granted the Debtors' motion for partial summary judgment and denied Millers' motion. In addition, the Bankruptcy Court disallowed Miller's Proofs of Claim, Nos. 10341 and 10342.

Two days later, on July 15, 1999, the Bankruptcy Court confirmed the First Amended Plan. The First Amended Plan became effective on August 2, 1999.

II. Factual Background

On September 23, 1994, MW Land entered into a ground lease (the "Lease") with Miller for a parcel of non-residential real property located in Waite Park, Minnesota. Montgomery Ward guaranteed MW Land's obligations under the Lease pursuant to a Guaranty Agreement (the "Guaranty").

Under the Lease, MW Land was obligated to build or cause to be built a building upon the leased property. In addition, MW Land was obligated to install and maintain all parking areas, driveways, sidewalks, roads, alleys, exits and entrances on the

leased property. Upon expiration of the Lease term, Miller was to become the owner of the building.

On October 11, 1995, Miller's attorney sent a letter to the Debtors inquiring as to the Debtor's "intent regarding the leased property." (Bankruptcy D.I. 4226 at A84-A85). The letter indicates that Miller's attorney advised Miller that the "Tenant is in default under several provisions of the Lease." However, the letter expressly states that "it is not the intent of this correspondence to provide notice of any default and we reserve all remedies available to Mr. Miller." The letter also requests a conference call to discuss Miller's concerns about such issues as the percentage rent provision of the Lease, the use restrictions on adjacent and adjoining property, and certain expenses incurred by Miller under the Lease.

As of the Petition Date, which was more than a year and a half after the October 11 letter, MW Land still had not built the Building contemplated by the Lease; however MW Land continued to pay the fixed rent it owed for the use of the leased property. During this time, Miller neither terminated the Lease nor filed a lawsuit for damages or specific performance. Effective October 31, 1997, MW Land rejected the Lease pursuant to 11 U.S.C. § 365(g).

On February 27, 1998, Miller filed Proofs of Claim Nos. 10341, 10342, 10343, 10344 asserting claims resulting from the Debtors' rejection of the Lease. Claims 10341 and 10342 are at

issue in this appeal. Claim 10341 is against the Debtors for a total of \$10,987,146.82, which includes the estimated value of the Building, the value of asphalt and concrete removal, the value of lost rent at adjacent retail spaces and the value of lost fixed rent for the remaining twenty-two year term of the Lease. Claim number 10342 is against MW Land for \$4,515,191.82, which includes all of the previously enumerated items, except the value of the lost fixed rent for the remaining term of the Lease.

III. The Bankruptcy Court's Decision

The issue before the Bankruptcy Court was whether Miller was entitled to any damages in excess of the capped lease rejection damages allowed pursuant to 11 U.S.C. § 502(b)(6). Before examining the applicability of Section 502(b)(6), the Bankruptcy Court rejected Miller's argument that his remedies for default under Section 22.1 of the Lease were triggered prior to the Petition Date. Specifically, the Bankruptcy Court examined the October 11, 1995 letter from Miller's attorney and concluded that this letter did not provide the notice of default contemplated by Section 22.1 of the Lease. According to the Bankruptcy Court:

Miller did not provide MW Land or the Debtor with a written notice of default as contemplated by Section 22.1 of the Lease. The only correspondence is an October 11, 1995 letter from Miller's attorney to the Debtor which specifically states that "it is not the intent of this correspondence to provide notice of any default and we have reserved all remedies for Mr. Miller."

(D.I. 7 at A6-A7). As a result, the Bankruptcy Court concluded

that Miller never became entitled to exercise any of the default remedies provided by the Lease before the Petition Date.

According to the Bankruptcy Court:

Section 22.1 of the Lease plainly states that (a) if a default occurs, and (b) if Miller gives a written default notice, and (c) if MW Land fails to cure the default within the cure period, then Miller "shall have the rights and remedies" set forth in Section 22.1 of the Lease. Only one of these triggering events occurred.

(D.I. 7 at A9, emphasis in original).

Having concluded that Miller was not entitled to the default remedies set forth in the Lease, the Bankruptcy Court next examined what items of damages may be included in a lease rejection claim. Stating that Miller could only recover those damages to which he was contractually entitled to recover under the terms of the Lease and state law, the Bankruptcy Court concluded that Section 22.1 of the Lease did not give Miller the right to recover damages for any loss resulting from the value of the Building not built by MW Land, the value of the asphalt and concrete removal, and the lost rent for adjacent retail spaces. Construing Section 22.1, the Bankruptcy Court stated, "[s]implify put, recoveries for any such losses are not within the plain intent of Section 22.1 of the Lease." (D.I. 7 at A11).

In addition, the Bankruptcy Court rejected Miller's argument that its right to specifically enforce the covenants of the Lease allowed Miller the right to recover monetary damages for the covenants not performed. Specifically, the Bankruptcy Court

concluded that because the Lease was not terminated in accordance with the provisions of the Lease, but as a result of the Debtors' Section 365(a) rejection, Miller's "entitlement to the building has not become choate." (D.I. 7 at A12). In addition, the Bankruptcy Court held that "any state law rights Miller has to specific enforcement is negated by MW Land's rejection of the Lease." (D.I. 7 at A12). Accordingly, the Bankruptcy Court concluded that the covenants obligating MW Land to build the Building and remove the asphalt and concrete could not be transformed into a vehicle for recovery of monetary damages. (D.I. 7 at A13).

Having established which damages Miller was entitled to recover, the Bankruptcy Court next examined whether Section 502(b)(6) applied to cap those damages. Distinguishing cases cited by Miller to support his claims and recognizing the policy behind Section 502(b)(6) of limiting prospective damages to strike a balance between protecting the claims of non-lessor and lessor creditors, the Bankruptcy Court concluded that the Section 502(b)(6) cap applied to any damages that Miller was entitled to recover from the Debtors. The Bankruptcy Court specifically noted that, in this case, a full recovery would reward Miller with a windfall at the expense of other unsecured creditors. As the Bankruptcy Court explained:

Miller seeks to recover the value of the Building which MW Land was to build on the property -- \$4,014,570.23. The Lease provided, however, that title to the

building, and therefore the value of the building, would belong to MW Land until the end of the Lease term. Allowing Miller to recover an amount representing the current value of the building would allow Miller to receive more than the benefit of his bargain under the Lease's terms. That Miller would obtain a windfall if he were allowed to recover the cost of the Building is illustrated by reference to Section 15.7 of the Lease. That Section allows MW Land to "go dark" at any time during the Lease term. However, if MW Land gave Miller a "go dark notice," then Miller could elect to terminate the Lease but, in so doing, Miller would have to purchase the Building at its then fair market value. The prospective rent that MW Land was to pay Miller, and not the value of the Building that MW Land was to build, own and operate on Miller's land during the Lease term, constitute the benefit of Miller's bargain under the Lease. Congress intended that such benefit be limited by operation of the § 502(b)(6) cap.

(D.I. 7 at A18-A19).

As for Miller's claim that he was entitled to collect from Montgomery Ward the sum of \$6,471,955 for the lost fixed rent for the remaining Lease term, the Bankruptcy Court held that Section 502(b)(6) applies to guarantors, as well as lessees, in bankruptcy. Accordingly, the Bankruptcy Court rejected Miller's Proofs of Claim against both Montgomery Ward and MW Land.

DISCUSSION

I. Jurisdiction and Standard of Review

Under 28 U.S.C. § 158(a), this Court has jurisdiction to adjudicate appeals from final judgments, orders and decrees of bankruptcy judges. Pursuant to Federal Rule of Bankruptcy Procedure 8013, the Court "may affirm, modify, or reverse a bankruptcy judge's judgment, order or decree or remand with

instructions for further proceedings." Fed. R. Bankr. P. 8013. In reviewing a case on appeal, the bankruptcy court's factual determinations are subject to deference and shall not be set aside unless clearly erroneous. Id.; see In re Gutpelet, 137 F.3d 748, 750 (3d Cir. 1998). However, a bankruptcy court's conclusions of law are subject to plenary review and are considered de novo by the reviewing court. Meespierson, Inc. v. Strategic Telecom, Inc., 202 B.R. 845, 847 (D. Del. 1996). Mixed questions of law and fact are subject to a "mixed standard of review" under which the appellate court accepts findings of "historical or narrative facts unless clearly erroneous, but exercise[s] plenary review of the trial court's choice and interpretation of legal precepts and its application of those precepts to the historical facts." Mellon Bank, N.A. v. Metro Communications, Inc., 945 F.2d 635, 641-642 (3d Cir. 1991) (citing Universal Mineral, Inc. v. C.A. Hughes & Co., 669 F.2d 98, 101-02 (3d Cir. 1981)), cert. denied., 112 S. Ct. 1476 (1992).

II. Whether the Bankruptcy Court Erred In Disallowing Miller's Proofs of Claim

In arguing that the Bankruptcy Court erred in disallowing his Proofs of Claim, Miller contends that (1) the Bankruptcy Court erred as a matter of law in failing to make any finding of fact or conclusions of law that no notice of default or non-performance was required to be provided by Miller to Montgomery

Ward under the Guaranty; and (2) the Bankruptcy Court erred as a matter of law in concluding that Miller's claims are subject to the Section 502(b)(6) cap. The Court will address each of Miller's arguments in turn.

A. Whether The Bankruptcy Court Erred As A Matter Of Law In Considering Montgomery Ward's Obligations Under The Guaranty

Miller contends that the Bankruptcy Court erred as a matter of law in refusing to recognize the obligations of Montgomery Ward under the Guaranty. Specifically, Miller contends that the Bankruptcy Court abused its discretion in failing to address "the effect of the absence of a notice requirement in the Guaranty or Miller's remedies under the Guaranty and whether the obligations of Ward for Miller's damages arose pre-petition and pre-lease termination" for purposes of triggering the Guaranty. (D.I. 6 at 10). Miller further contends that under the terms of the Guaranty, Montgomery Ward absolutely and unconditionally guaranteed MW Land's full and faithful payment, performance and observance of the obligations, covenants, conditions and agreements under the Lease without any requirement that Miller provide Montgomery Ward with notice of MW Land's default. Miller contends that MW Land's default under the Lease occurred pre-petition and pre-lease termination when MW Land failed to build the building on the premises. Thus, Miller contends that MW Land's default triggered his remedies against Montgomery Ward under the Guaranty prior to the Debtor's rejection of the Lease

under Section 365, and therefore, Miller contends that he is entitled to damages against Montgomery Ward under the Guaranty without regard to the Section 502(b)(6) cap.

In response to Miller's argument, the Debtors contend that Miller "did not assert at the Bankruptcy Court either that a default had occurred for purposes of separately enforcing Montgomery Ward's obligations under the Guaranty or that he could have enforced the Guaranty obligations separately from the Lease obligations." (D.I. 10 at 17-18). Thus, the Debtors contend that Miller failed to preserve this issue for appeal, and therefore, the Court need not consider the issue.

In the alternative, the Debtors contend that Miller never asserted a default against MW Land under the Lease or the Guaranty, and therefore, regardless of whether the Guaranty required notice of a default or not, Miller's rights under the Guaranty were not triggered. To this effect, the Debtor's argue that

[Miller's] decision to ignore MW Land's default and forego his default remedies under the Lease likewise precluded him from asserting that default and the resulting default remedies against Montgomery Ward under the terms of the Guaranty. While the Guaranty excused [Miller] from providing Montgomery Ward with notice of MW Land's default, it did not absolve [Miller] from asserting the default against MW Land at all.

(D.I. 10 at 19-20). The Court will consider each of the parties' arguments in turn.

1. Whether Miller preserved the Guaranty issue for

appeal

As a general matter, issues not raised before the Bankruptcy Court cannot be raised for the first time on appeal to this Court. See In re Ledet, 2000 WL 278092, *3 (E.D. La. Mar. 14, 2000) (citing Matter of Quenzer, 19 F.3d 163, 164 (5th Cir. 1993)); The Merchants Bank v. Goodyear, 228 B.R. 87, 88 (D. Vt. 1997)(citing In re La Roche, 969 F.2d 1299, 1305 (1st Cir. 1992)). However, "the matter of what questions may be taken up and resolved for the first time on appeal is one left primarily to the discretion of the courts of appeals, to be exercised on the facts of individual cases." Singleton v. Wulff, 428 U.S. 106, 120 (1976).

After reviewing Miller's Summary Judgment Motion, his Reply to Appellee's Summary Judgment Motion, and the transcript of the hearing in the Bankruptcy Court, the Court concludes that although Miller's argument is not as detailed as it appears before this Court, Miller raised the issue clearly enough to preserve it for appeal. See In the Matter of Minton Group, Inc., 46 B.R. 222 (S.D.N.Y. 1985) (observing that bankruptcy judge did not render clear ruling on issue because brief submitted by party only discussed issue in "very obscure terms", but recognizing argument because of "slightly more pointed papers" submitted on appeal and holding that issue was raised sufficiently to preserve it for appeal). Accordingly, the Court will consider Miller's argument that the Bankruptcy Court erred in failing to consider

Montgomery Ward's obligations under the Guaranty.

2. Whether the Bankruptcy Court erred in failing to make any findings of fact or conclusions of law that no notice of default or non-performance was required to be provided by Miller to Montgomery Ward under the Guaranty

Miller contends that the Bankruptcy Court erred in failing to consider that the Guaranty did not require notice of default or non-performance and erred in failing to consider whether Miller's claims arose pre-petition and pre-lease termination under the Guaranty. Because the Bankruptcy Court did not consider the terms of the Guaranty in its analysis, Miller contends that the Bankruptcy Court erred in concluding that Miller's claims were derived from MW Land's rejection of the Lease pursuant to Section 365(a). According to Miller, his claims arose pre-petition and pre-termination of the Lease by operation of Section 365(a), because MW Land was required to build the building and improvements within a year after receiving the land from Landlord. Thus, Miller asserts that MW Land's default occurred on October 1, 1995, and that this default gave rise to Montgomery Ward's liability as guarantor under the terms of the Guaranty.

In response to Miller's argument, the Debtors contend that Miller failed to assert a default against MW Land, and therefore, a default could not have occurred for purposes of enforcing the guarantor's collateral obligations under the Guaranty. The Debtors point to the October 1995 letter sent by Miller's counsel

to Montgomery Ward, the guarantor, which states that "it is not the intent of this correspondence to provide notice of any default and we reserve all remedies available to Mr. Miller." (Bankruptcy D.I. 4226 at A84). Thus, the Debtors argue "no matter whether the Guaranty required notice of a default or not, the Miller not only chose to contact Montgomery Ward, the guarantor, but also chose to reiterate to Montgomery Ward that he was not asserting a default under the terms of the Lease or the Guaranty." (D.I. 10 at 19). In addition, the Debtors point out that for more than a year and a half after sending the October 1995 letter, Miller continued to enforce the Lease by collecting fixed rent from MW Land and never terminated the Lease or sought specific performance from either MW Land as lessee or Montgomery Ward as guarantor.

After reviewing the parties' arguments in light of the record in this case and the applicable legal principles, the Court concludes that Miller is precluded from exercising the default remedies against Montgomery Ward under the terms of the Guaranty, because Miller never asserted a default against either MW Land or Montgomery Ward. A guarantor is not liable for the principal party's duties under a contract until it is established that the principal party defaulted in performing his or her contractual obligations.¹ Douglass v. Reynolds, Byrne & Co., 32

¹ See also In re Century Glove, Inc., 74 B.R. 958, 962 (Bankr. D. Del. 1987); Holbert v. Wemerskirchen, 297 N.W. 327,

U.S. 113, 127 (1833) (“[T]he guarantors are only collaterally liable upon the failure of the principal debtor to pay the debt.”); United States v. Vanornum, 912 F.2d 1023, 1026 (8th Cir. 1990) (“[A] guarantor’s obligation under a guaranty arises only upon the default of the debtor.”). In this case, Miller chose to contact Montgomery Ward as the Guarantor, yet Miller expressly stated that it was “not the intent of this correspondence to provide notice of any default.” (Bankruptcy D.I. 4226 at A84). Moreover, that Miller continued to enforce the Lease by collecting rent from MW Land and never terminated the Lease or sought specific performance against MW Land or Montgomery Ward confirms the Court’s conclusion that Miller did not assert a default against either MW Land or Montgomery Ward. Thus, irrespective of whether the Guaranty required notice of default, the Court concludes that Miller never asserted a default against Montgomery Ward or MW land, and therefore, Miller cannot recover damages against Montgomery Ward based solely on the Guaranty.²

328 (Minn. 1941).

² As for Miller’s argument that the Bankruptcy Court erred in failing to expressly address whether the Guaranty required notice of default or not, the Court concludes that the Bankruptcy Court’s failure to address this issue was no more than harmless error. First, as the Court indicated previously, the Guaranty issue was not raised in detail before the Bankruptcy Court. Second, in discussing whether a default was asserted under the terms of the Lease, the Bankruptcy Court stated, “Miller’s claim is not derived from a prepetition default by MW Land, but instead arises solely from MW Land’s § 365(a) rejection of the Lease.” (D.I. 7 at A7, emphasis added). Thus, the Bankruptcy Court at least implicitly found that Miller had not

B. Whether The Bankruptcy Court Erred In Determining The Amount Of Damages Due Miller Under The Lease And Concluding That The Damages Are Subject To The Section 502(b)(6) Cap

In arguing that the Bankruptcy Court erred in determining the amount of damages due Miller under the Lease and concluding that the damages are subject to the Section 502(b)(6) cap, Miller challenges five findings and/or determinations by the Bankruptcy Court. Specifically, Miller contends that (1) the Bankruptcy Court erred in finding that Miller did not provide MW Land or Montgomery Ward with a written notice of default as required by Section 22.1 of the Lease; (2) the Bankruptcy Court erred in "finding a distinction between the Debtor's obligations regarding monetary versus non-monetary covenants contained in the lease" (D.I. 6 at 14); (3) the Bankruptcy Court erred by finding that "any state law right Miller has to specific performance is negated by MW Land's rejection of the Lease" (D.I. 6 at 14); (4) the Bankruptcy Court erred in interpreting cases cited by Miller; and (5) the Bankruptcy Court erred in finding that recovery of monetary damages for the cost of the building would give Miller a

asserted a default against the Debtors. Because the Bankruptcy court recognized that a default was never asserted against the Debtors in the first place, whether the Guaranty required notice of default is of no consequence. Accordingly, the Court cannot conclude that the Bankruptcy Court's failure to expressly address whether the Guaranty required notice of default was anything more than harmless error. See e.g. Stevens v. Baas, 197 B.R. 57 (N.D. Ohio 1995) (applying harmless error standard to bankruptcy court's failure to render findings on applicability of defense where record showed defense would not succeed as a matter of law).

windfall at the expense of other unsecured creditors.

The Court has reviewed the reasoning of the Bankruptcy Court with respect to each of the errors raised by Miller, and concludes that the Bankruptcy Court did not err in its findings and/or determination. The Court agrees with the Bankruptcy Court's analysis in every regard, and adopts the rationale set forth by the Bankruptcy Court for each of the challenged findings and/or determinations. Thus, the Court concludes that the Bankruptcy Court's findings and conclusions were not erroneous. Accordingly, the Court will affirm the decision of the Bankruptcy Court.

CONCLUSION

For the reasons discussed, the Bankruptcy Court's decision denying Miller's Motion For Summary Judgment and disallowing two of Miller's four Proofs of Claim will be affirmed.

An appropriate Order will be entered.