

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK

In re

C.Y.A. VIDEO SERVICES, INC. d/b/a
MISTER MOVIE and SUZANNE'S VIDEO

Case No. 00-16146

Debtor

APPEARANCES:

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Hon. Robert E. Littlefield, Jr., U.S. Bankruptcy Judge

MEMORANDUM-DECISION AND ORDER

The current matter before the court is the motion of The Grand Union Company (“GU”) pursuant to Federal Rule of Civil Procedure 60, made applicable to this matter by Federal Rule of Bankruptcy Procedure 9024, for an order modifying the court’s order dated June 28, 2002 that authorized C.Y.A. Video Services, Inc. (“Debtor”) to assume and assign certain unexpired leases pursuant to 11 U.S.C. § 365. The court has jurisdiction over this matter pursuant to 28 U.S.C.

§ § 1334(b) and 157. This is a core proceeding pursuant to 28 U.S.C. §157(b)(2)(A).

FACTS

Having read the affidavits of the parties and the briefs in support of their positions, the court makes the following findings of fact .

- 1) On or about June 10, 1994, GU, as tenant, entered into a lease with First Mountain Limited Partnership (the “Master Lease”) covering certain nonresidential real property located on Route 9 in Valatie, New York (the “Premises”).
- 2) On June 30, 1997, GU, as sub-landlord, entered into a sublease with the Debtor for a portion of the Premises known as Store No. 101 (the “Sublease”). (Portion of Ex. A to Debtor’s assumption motion.)
- 3) On October 3, 2000, GU and its related companies filed a voluntary petition under Chapter 11 of the United States Bankruptcy Code with the United States Bankruptcy Court for the District of New Jersey.
- 4) On November 14, 2000, the Debtor filed a voluntary petition under Chapter 11 of the United States Bankruptcy Code with the United States Bankruptcy Court for the Northern District of New York.
- 5) On December 8, 2000, the United States Bankruptcy Court for the District of New Jersey entered an order authorizing GU to, among other things, assume certain unexpired leases and assign them to C&S Wholesale Grocers, Inc. (“C&S”) and GU Markets, LLC (“GU Markets”) or their designees. (Ex. A to affidavit of Morris S. Bauer.)
- 6) One of the leases assumed was the Master Lease.
- 7) Pursuant to a lease assignment and assumption agreement dated March 4, 2001, GU, as tenant, assigned the Master Lease to GU Markets’ designee, GU Markets of Valatie, LLC (the”Assignment”).¹ (Ex. B to affidavit of Morris S. Bauer.)
- 8) At the time of the Assignment, the Debtor owed GU certain rental arrears² under the Sublease.

¹Neither party has provided the court with a separate assignment of the Sublease, although both parties refer to a March 4, 2001 assignment of the Sublease. The court assumes that Exhibit A to the Assignment, which the court was not provided with, references the Sublease.

²While the parties agree the payment of rent was not current, the amount of arrears is in dispute. GU claims the arrearage to be \$33,849.29, while the Debtor believes the number to be

9) The rental arrearage claim was not assigned to GU Markets of Valatie LLC but was retained by GU.³

10) On or about May 7, 2001, GU sent the Debtor a letter advising that GU sold assets to GU Markets, LLC. Tenants were notified to make their rental checks payable to GU Markets, LLC and to send the checks to GU Markets, LLC at the address provided. (Portion of Ex. A to Debtor's assumption motion.)

11) On or about September 14, 2001, the Debtor notified GU Markets, LLC by letter that it was exercising its five year renewal option under the Sublease for the period January, 2003 through December 31, 2008. (Portion of Ex. A to Debtor's assumption motion.)

12) On June 28, 2002, the court granted the Debtor's motion to assume and assign the Sublease to Video Update, Inc.

13) The motion did not propose to cure the GU rental arrearage claim in connection with the assumption of the Sublease.

14) On July 17, 2002, the Debtor converted its Chapter 11 case to one under Chapter 7 of the Bankruptcy Code.

15) On September 19, 2002, the court held that notice given to GU of the assumption motion, which ultimately resulted in the June 28, 2002 order, was deficient.

16) The court requested that the parties submit supplemental pleadings and memoranda of law on the issue of whether the Debtor was required to cure the arrearage claim owed to GU in connection with its assumption of the Sublease.

ARGUMENTS

GU argues that the plain language of 11 U.S.C. § 365⁴ requires the Debtor to cure all

\$24,272.31.

³Although the Assignment is silent as to GU's retention of its rental arrears claim against the Debtor under the Sublease, and no other documentation evidencing the rental arrears claim was provided to the court, the parties agree that it was always understood that this claim was retained by GU.

⁴11 U.S.C. § 365 is entitled "Executory contracts and unexpired leases" and states in part: (b)(1) If there has been a default in an executory contract or unexpired lease of the debtor, the trustee may not assume such contract or lease unless, at the time of assumption of such contract or lease, the trustee -

defaults under the Sublease regardless of whom the default is owed to. GU further states that equity demands the arrearage be cured for “Allowing the Debtor to avoid its cure responsibility to Grand Union, when it unquestionably could not avoid that liability if it were due to GU Markets, will result in an undeserved windfall to the Debtor...” (GU’s Supplemental Memorandum of Law p. 6)

The Debtor argues that the Sublease was not executory as to GU at the time that it was assumed and assigned, and therefore, any contract claim which GU has against the Debtor should be treated as a general unsecured claim.

DISCUSSION

In the absence of a conflicting federal interest, we must look to state law to define property rights. *Butner v. United States*, 440 U.S. 48, 54-55, 99 S.Ct. 914, 59 L.Ed 2d 136 (1979). Under New York law, when a landlord enters into a lease with a tenant, a twofold privity exists between them: a privity of contract, and a privity of estate. 74A N.Y. Jur. 2d *Landlord and Tenant* §16. The first is based upon the terms of agreement between the parties, and the second is based upon the interest in the real property leased. 74A N.Y. Jur. 2d *Landlord and Tenant* §740; *See New Amsterdam Casualty Co. v. National Union Fire Ins. Co.*, 266 N.Y. 254, 259, 194 N.E. 745 (1935).

A transfer of a lessee’s entire interest in the real property covered by the lease or a part thereof to a third party who enters into possession constitutes an assignment of the lease. *Id.*

(A) cures, or provides adequate assurance that the trustee will promptly cure, such default;

(B) compensates, or provides adequate assurance that the trustee will promptly compensate, a party other than the debtor to such contract of lease, for any actual pecuniary loss to such party resulting from such default; and

(C) provides adequate assurance of future performance under such contract or lease.

When a lessee assigns a lease, he or she divests himself or herself of the privity of the estate and creates that relationship between the lessor and the assignee. *Gillette Bros., Inc. v. Aristocrat Restaurant, Inc.*, 239 N.Y. 87, 145 N.E. 748 (1924) . The privity of contract, however, between the original landlord and the assignor remains after assignment, absent an express agreement to the contrary, and the assignor remains liable on all express covenants in the lease. *Id.*; *See Pool v. Pellati*, 251 A.D. 2d 480, 674 N.Y.S.2d 433 (2d Dept. 1998); *New York Business Bldgs. Corp. v. McCutcheon & Co.*, 229 A.D. 681, 243 N.Y.S. 255 (1st Dept. 1930), *aff'd*, 257 N.Y. 554, 178 N.E. 792 (1931).

GU puts forth two arguments to support its position that the Debtor must cure its rental arrearage claim owed to GU in connection with its assumption and assignment of the Sublease. In support of its first argument based on black letter law and statutory interpretation, GU cites *Allied Technology, Inc. v. R.B. Brunemann & Sons, Inc.*, 25 B.R. 484 (Bankr. S.D. Ohio 1982) . GU relies upon *In re Wingspread Corporation*, 145 B.R. 784 (S.D.N.Y. 1992), *aff'd*, 992 F.2d 319 (2nd Cir. 1993), in support of its second argument which focuses on equity principles.

In *Allied Technology, supra*, the debtor, as lessee, assigned its interest in a certain lease, but remained contractually liable under the assignment to the original lessor. Under that scenario, the court correctly found that privity of contract continued to exist between the debtor and original lessor. *Id.* Likewise, in this case, GU, as lessee, assigned its entire interest in the Master Lease to GU Markets of Valatie, LLC. In so doing, GU's privity of estate with First Mountain Limited Partnership was extinguished, but, absent an express release, its privity of contract with First Mountain Limited Partnership remained intact.

GU also assigned its interest, as sub-lessor, in the Sublease to GU Markets of Valatie, LLC. A general unqualified assignment of one's rights, title and interest in a lease divests the

assignor of all rights and obligations existing thereunder. *Singer v. Boychuk*, 194 A.D.2d 1049, 1051, 599 N.Y.S.2d 680 (3d Dept. 1993). The Assignment, which is unambiguous and speaks for itself, establishes GU relinquished all of its rights under the Master Lease and, consequently, the Sublease. GU had no further involvement contractually or otherwise with the Debtor. It voluntarily relinquished any nexus to the Sublease with the exception of substituting its position as sub-lessor of the Debtor with that of a creditor of the Debtor. No portion of GU's creditor status can remotely be considered part of an executory contract or unexpired lease with the Debtor. It simply holds an unsecured claim.

Section 365(b)(1) places conditions on the assumption of an executory contract or unexpired lease for the purpose of protecting the interests of the other party to the contract or lease, in this case the lessor. See *In re Grayhall Resources, Inc.*, 63 B.R. 382, 385 (Bankr. D. Colo. 1986); *In re Harry C. Partridge, Jr. & Sons, Inc.*, 43 B.R. 669, 671 (Bankr. S.D.N.Y. 1984). Once the Assignment was executed, there was no longer a landlord-tenant relationship between GU and the Debtor. To require an immediate repayment of the arrearage claim owed to GU under the guise of § 365(b)(1) would be to subvert the statutory payment distribution scheme and to elevate an otherwise general unsecured claim to a standing not contemplated by Title 11. Contrary to GU's argument, this would result in an undeserved windfall, not to the Debtor, but to GU.

The court declines to invoke any of its equitable powers under the facts presented. No statement is made that GU was somehow inveigled or unduly influenced by the Debtor to retain the arrearage claim. GU made a business decision to keep the arrearage claim rather than cut its ties completely with the Debtor in connection with its assignment of the Sublease. As with most cases under Title 11, an argument will always exist that a debtor has somehow obtained a

windfall. Typically, debtors in bankruptcy will have received numerous goods and services, for which they legitimately owe a debt and, in most instances, will receive a discharge from those debts. This case is no different.

Based upon all of the foregoing, it is hereby

ORDERED, that the Grand Union Company's motion for an order modifying the court's order dated June 28, 2002 shall be and hereby is denied.

Dated:

Hon. Robert E. Littlefield, Jr.
U.S. Bankruptcy Judge