IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF IOWA

In the Matter of: Case No. 03-01003-lmj13

PHELAN RICO THOMAS,
CARYL DENISE THOMAS,[1]

Debtors

MEMORANDUM OF DECISION
(date entered on docket: October 4, 2004)

Water Tower Place Shopping Center, L.C. ("Water Tower") seeks a court order granting it relief from the automatic stay to take repossession of the business premises rented by Chapter 13 Debtors Phelan and Caryl Thomas ("Debtors"). Debtors object and, in turn, seek a court order permitting them to assume the lease with Water Tower. Maintaining the parties' lease termination agreement controls, Water Tower objects. Debtors contend that agreement was executed under economic duress and therefore should be deemed voidable. Having conducted an evidentiary hearing on the controversy and having reviewed the record and the briefs and arguments of the parties, the Court now enters its decision in favor of Water Tower.

The Court has jurisdiction of this matter pursuant to 28 U.S.C. section 1334 and the standing order of reference entered by the United States District Court for the Southern District of Iowa. This is a core matter under paragraphs (A), (G) and (M) of 28 U.S.C. section 157(b)(2).

[1] After the Court heard and took under advisement the contested matters discussed in this Memorandum of Decision, Caryl Denise Thomas filed a motion to dismiss herself from this case. Since the case had not been converted under 11 U.S.C. section 706, 1112 or 1208, the Court granted her motion on March 19, 2004. See 11 U.S.C. section 1307(b).

BACKGROUND

In December 1995 Phelan Rico Thomas, D.D.S. ("Dr. Thomas") entered into a five-year renewable nonresidential lease agreement with Water Tower. The original lease ran from February 1, 1996 to and including January 31, 2001. (Exhibit A at 2.) In December 2000, the parties renewed the lease for another five year term that commenced as of February 1, 2001. (Exhibit 4.) Dr. Thomas has been operating his dental practice, known as Dentistry Now, in the leased space.

Julie Barnes, Water Tower's lease manager, testified that she negotiated the terms of the lease with Dr. Thomas. With respect to the payment of rent, she referenced Article III that provides in relevant part:

> **Section 3.01. Minimum Guaranteed Rent.** Tenant agrees to pay to Landlord at the office of Landlord, or at such other place designated by Landlord, without any prior demand therefore and without any deduction or setoff whatsoever, fixed Minimum Guaranteed Rent at the rate of $15.00 per square foot or $29,385.00 per annum *payable monthly* at the rate of $2,448.75[2] *on the first day of each and every month during the term of this Lease*. Tenant agrees to pay Landlord the first month of Minimum Guaranteed Rent due under this Lease at the time of the execution of said Lease.
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> . . . .
>
> **Section 3.03. Additional Rent.** Any other sums of money or charges to be paid by Tenant pursuant to the provisions of any other sections of this Lease shall be designated as "Additional Rent".
>
> **Section 3.04. Past Due Rent and Additional Rent.** If Tenant shall fail to pay, when the same is due and payable, any Minimum Guaranteed Rent or any Additional Rent or amounts or charges imposed under any provision of this Lease, Landlord may impose, in addition to the unpaid amounts, a late charge penalty equal to ten percent (10%) of the unpaid amount.
>
> If Tenant shall fail to pay, when the same is due and payable, any Minimum Guaranteed Rent or any Additional Rent or amounts or charges imposed under any provision of this Lease, and said amount has been unpaid for

[2] The minimum guaranteed rent under the renewed lease was $2,693.63. (Exhibit 4.)

> thirty (30) days, Tenant shall then pay interest on said amount after said thirty (30) day period in the amount of 15% per annum or at the highest rate allowed by law, whichever is the greatest.

Exhibit A at 3 (emphasis added).

According to Article V of the lease, additional rent included Dr. Thomas' proportionate share of Water Tower's operating costs for the common areas of the shopping center. Additional rent was due and payable on the first day of the month following receipt of a statement from Water Tower that such expenses had been incurred, and it was payable at the same place and in the same manner as the minimum guaranteed rent. (Exhibit A at 6.)

With respect to default in payment of rent, Ms. Barnes observed that Article XIII states in relevant part:

> **Section 13.01. Events of Default.** The following events shall be deemed to be events of default by Tenant under Lease:
>
> (a) Tenant *shall fail to pay any installment* of Minimum Guaranteed Rent or Additional Rent, or any portion thereof, *as and when the same shall be due and payable, and* such failure shall continue for a period of ten (10) days after receipt of written notice from Landlord, *or* in the event Landlord fails to give Tenant written notice within said ten (10) day period, it shall be deemed that the default occurred as of the tenth (10th) day after the rent became due and payable;
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> . . . .
>
> If any default occurs, Landlord may at its option terminate this Lease, re-enter, take possession of the Demised Premises and remove all personnel and property therefrom all without notice or legal process and without being deemed guilty of trespass, or liable for any loss or damage occasioned thereby.

Exhibit A at 12-13 (emphasis added).

According to Ms. Barnes' testimony, Dr. Thomas' rental payments were not punctual. That is, despite Section 3.01 of the lease stating rent was due the first of every month, Dr. Thomas often paid on the tenth of the month and sometimes after that

date. During the term of the original lease, Ms. Barnes found it necessary to send four notices of default to him. Specifically, she sent notices on the following dates: November 11, 1997 for delinquent minimum guaranteed rent for November and for additional rent for July and September (Exhibit C); June 12, 1998 for delinquent minimum guaranteed rent for May (shortfall) and June and for additional rent for February and April (Exhibit E); on August 14, 2000 for additional rent for February, March, April, May, June and July (Exhibit F); and October 4, 2000 for delinquent minimum guaranteed rent for October and for additional rent for August and October (Exhibit H).

The notices were similar in format and wording. The subject line in each notice began with "Notice of Default." The first paragraph in each notice identified any delinquent minimum guaranteed rent and additional rent.[3] The second paragraph in each notice calculated late fees and any interest, added those amounts to the delinquent rents, and set forth the total owed in bold print. The third paragraph in each notice indicated Dr. Thomas was in default under the terms of the lease.[4] It also contained a warning that Water Tower "may, at its option, terminate the Lease, take possession of the premises and all property therein or otherwise pursue its remedies under the Lease" if he did not pay the stated total amount within ten days of receiving

[3] Given the wording of section 3.01 of the lease, the notices appear to be correct with respect to the minimum guaranteed rent being delinquent. Given the months indicated for additional rent, the notices probably are correct as to those amounts being delinquent. The exhibits, however, do not reveal when Dr. Thomas received statements that such expenses had been incurred. Ms. Barnes' testimony did not address that status of those amounts.

[4] Given the wording of section 13.01 of the lease, it does not appear that the delinquent minimum guaranteed rent for October was in default when the October 4, 2000 notice was issued. Likewise, given the date of that notice, it is unlikely that the additional rent for October was even delinquent. Once again the record is silent regarding the status of that additional rent.

the notice. With the exception of the first notice, each notice concluded by stating in bold: **"Please help us to avoid further legal action by responding immediately and delivering to the Landlord a certified check in the amount of [*repeated total amount shown in the second paragraph*] on or before the tenth day after your receipt of this notice."**

Ms. Barnes also testified that she sent a general letter regarding late payments to all Water Tower tenants on or about October 11, 2000. (Exhibit J.) In the letter, Ms Barnes stressed that rent not received on the first of the month was "technically considered late and therefore subject to default." (Id.) She advised that "because many tenants are displaying a tendency to pay later and later each month, we feel we have no choice but to implement an immediate notice of default action until the rent payments begin to arrive on time." (Id.) She explained that, due to mortgage payments Water Tower was required to pay by the first of every month, "we simply don't have the luxury of giving our tenants a 10-day grace period each month." (Id.)

A few months after sending that general letter and a few days after the second term of the lease commenced, Ms. Barnes found it necessary to resume issuing notices of default to Dr. Thomas. Specifically, she sent notices on the following dates: February 6, 2001 for delinquent minimum guaranteed rent for February and for additional rent for December (Exhibit K); June 11, 2001 for additional rent for January, February, March and April and also for an annual insurance reconciliation (Exhibit M);[5] July 3, 2001 for delinquent minimum guaranteed rent for July and for additional rent for March, April and May (Exhibit P); October 17, 2001 for delinquent minimum guaranteed

[5] A notice dated June 13, 2001 corrected a calculation error in the June 11, 2001 notice. (Exhibit N.)

rent for October (shortfall), for additional rent for July and August and for real estate taxes (Exhibit R); February 7, 2002 for delinquent minimum guaranteed rent for February and for additional rent for February (Exhibit T); April 4, 2002 for delinquent minimum guaranteed rent for April and for additional rent for April (Exhibit V); and October 10, 2002 for delinquent minimum guaranteed rent remainder of $2,943.67 for October (Exhibit X).

The notices were similar in format and wording to those Ms. Barnes sent during the first term of the lease, including the directive in bold in the previously quoted concluding paragraph. The only significant difference was that she did not wait ten days after the minimum guaranteed rent was due and payable to send the notices in February and July of 2001 and in February, April and October of 2002. Ms. Barnes acknowledged on cross-examination that those payments technically were not in default when she sent those notices. She further clarified that the additional rents for February and April of 2002 were not in default but that all other additional rents appearing on these various notices were in default.

With respect to the above delinquencies and defaults, Ms. Barnes testified that Dr. Thomas ultimately made the required payments. He, however, did not pay any portion of the amount set forth in the October 2002 notice until sometime after Ms. Barnes sent a notice of default on November 5, 2002.[6] (Exhibit Z.) The notice covered the October rent remainder in the amount of $2,943.67 that was in default and the November rent in the amount of $3,092.30 that was delinquent but not in default as of

[6] A comparison of the prior notices of default suggests there was only one other time that a notice covered rent listed in a prior notice. Compare additional rent for March and April of 2001 on Exhibits M and N with additional rent for the same months on Exhibit P.

the date of the notice. While this notice followed the general format of all the prior notices she had sent him, there were some key noteworthy changes in wording and style. First, instead of the subject line beginning with **"Notice of Default,"** it read: **"FINAL NOTICE OF DEFAULT."** (Id.) The third paragraph warning changed as follows: **"[T]he Landlord will have no choice but to terminate this Lease, change the locks on your door and take possession of the premises and all property therein."** The concluding paragraph read: **"In order to avoid this Lease termination, lock-out, and further legal action you must respond immediately and deliver to the Landlord a certified check in the amount of $6,639.57 on or before the tenth day after your receipt of this notice."** (Id.)

Ms. Barnes testified that Dr. Thomas eventually cured essentially all of that default but did not pay the January rent when it was due and payable. Hence Ms. Barnes issued a **"FINAL NOTICE OF DEFAULT"** for minimum guaranteed rent for January in the amount of $3,092.30 and for additional rent remainder for November in the amount of $64.93 on January 10, 2003. (Exhibit AA.) Except for the total cure amount being $3,472.95, the notice was virtually the same as the one dated November 5, 2002. Ms. Barnes reported that the Debtors provided her with a check on January 17, 2003. Though the check was not certified and was not written for the full cure amount, she deposited it upon receipt.

On January 27, 2003, Water Tower's bank contacted Ms. Barnes to report that the check had not cleared the Debtors' bank on or about January 22, 2003 due to non sufficient funds. (This was not the first time that had happened. According to Ms. Barnes' records, the Debtors' checks had been returned for non sufficient funds a few

times over the years.) Ms. Barnes called Water Tower's managing partner about the status of the recent check. Then she phoned the Debtors, but there was no answer. She did not leave a message. Upon actual receipt of the returned check and Debtors having failed to cure the default in the interim, Ms. Barnes carried out the managing partner's directive by contacting a locksmith on February 3, 2003 to change the locks to the Debtors' office.

When Dr. Thomas arrived at his office on February 4, 2003, he discovered his keys would not open the door. He testified as to his surprise and disbelief over the action Water Tower was taking given the landlord had accepted late payments so many times in the past. He shared his recollection of that chaotic morning. In addition to addressing the lockout and what to do about patients that would be arriving for their appointments that day, he had been in a car accident. (Exhibit 2.) As for the reason there were not enough funds in the bank account to cover the January check, Dr. Thomas explained that around this time he began using a debit card to make purchases. He had not advised his wife about this. Hence, she would not have known the balance in their account was low when she wrote the January check.

Caryl Thomas, who is the office and business manager for her husband's dentistry practice, agreed with her husband's assessment of the reason the critical January check did not clear the bank. She too did not understand why Water Tower was now so concerned about late payments when it had been her general practice to tender any given month's rent payment between the 8th and the 10th of that month. (Exhibit 3 at 1-2.) She did not believe checks she wrote were returned for non sufficient funds except on rare occasion. Nevertheless, in addition to the check submitted in mid

January of 2003, the check originally submitted for the October 2002 rent did not clear the bank. (Exhibit 3 at 6.)

As for events leading up to the lockout, Ms. Thomas testified that she immediately called Ms. Barnes upon receipt of the January 10, 2003 notice,[7] and then she delivered the check in person.[8] When Ms. Barnes called on January 28, 2003 to advise her there was a $290.00 shortfall in the cure payment, Ms. Thomas immediately sent a check for that amount to Ms. Barnes via priority express mail. She observed that had Ms. Barnes mentioned the non sufficient funds check at that time, she could have taken care of the matter then. She maintained that neither the bank nor Water Tower gave her any indication the original check had not cleared. Instead, she first knew the January 10, 2003 notice of default had not been satisfied when her husband called her the morning of February 4, 2003 to report the lockout.

As for what transpired next, Ms. Barnes testified that the managing partner and Water Tower's attorney negotiated a lease termination agreement with the Debtors. It was her understanding the Debtors were represented by counsel. Indeed, Ms. Thomas testified she called their attorney soon after learning about the lockout from her husband and after calling Ms. Barnes to verify that Water Tower was unwilling to curtail the course of action it had begun. Likewise, Dr. Thomas acknowledged that his attorney acted on his behalf. Both Debtors, however, contended they had no real choice in the matter. That is, they had patients to treat and no where to care for them unless they could reenter the premises. They could not easily and quickly move the practice to

[7] The return receipt for the January 10, 2003 notice indicates Dr. Thomas' office received the document on January 14, 2003. (Exhibit BB.)

[8] Early in her testimony, Caryl Thomas indicated she delivered the check via priority express mail. Page three of Exhibit 3, however, does not support that version of how delivery was accomplished.

another location. Additionally, for every day they were forced to cancel patient appointments, they would lose significant income. Ms. Thomas reported they lost over $30,000.00 during the time they were locked out of their office. (Exhibit 1.) She also believed their financial situation was precarious due to a failed Chapter 13 case that had been dismissed.[9]

Debtors contend Water Tower wanted to terminate the lease in order to rent the space to new tenants for a higher monthly rate. Ms. Barnes acknowledged that the tenants on each side of the Debtors' office had inquired about the space because they wanted to expand their businesses. She disputed that they would have paid more had they moved into that space. She observed that the current market forced Water Tower to reduce its rent for new space to a range of $15.00 to $17.00 per square foot.

On February 4, 2003 the parties entered into a Lease Termination Agreement that provided the lease would terminate on February 28, 2003 and that required Dr. Thomas immediately pay Water Tower $6,525.55 in certified funds for rent, taxes, common area maintenance charges, insurance charges and late fees computed to the termination date. (Exhibit B at 1.) The agreement permitted Dr. Thomas to extend the termination date for only one more month and only if he paid Water Tower $3,193.21 in certified funds for rent, taxes, common area maintenance charges and insurance charges for the period beginning March 1, 2003 and ending March 31, 2003 on or before February 14, 2003.

[9] The Debtors' prior Chapter 13 case was filed February 19, 1997. It was dismissed April 18, 2002 on Debtors' motion, filed after the Trustee moved to dismiss because the Debtors were $35,720.50 in arrears in plan payments and had failed to make the additional $60,258.35 balloon payment in the final month of the five year plan. (SD Iowa Case No. 97-00706-rjh13.)

Dr. Thomas made the payments indicated above and thereby extended the termination date of the lease to March 31, 2003. On March 4, 2003 the Debtors commenced the pending Chapter 13 case. Before the month was out, Water Tower had filed a motion for relief from stay that Debtors resisted. Less than a week later, Debtors filed a motion to assume the lease that Water Tower resisted. As of April 14, 2003, the date of the preliminary telephonic hearing on the stay matter, the lease already had terminated—unless the February 4, 2003 agreement was voidable. The Court scheduled evidentiary hearings on both motions for May 12, 2003. By agreement of the parties that date was continued to June 3, 2003.

APPLICABLE LAW

11 U.S.C. section 365(a) states that: "Except as provided in sections 765 and 766 of this title and in subsections (b), (c), and (d) of this section, the trustee, subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor." Relevant to the pending contested matter, 11 U.S.C. section 365(c)(3) provides:

> The trustee may not assume or assign any executory contract or unexpired lease of the debtor, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties, if—
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> . . . .
>
> (3) such lease is of nonresidential real property and has been terminated under applicable nonbankruptcy law prior to the order for relief;
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> . . . .

11 U.S.C. § 365(c)(3). With respect to these provisions, a chapter 13 debtor stands in the legal shoes of the trustee. See 11 U.S.C. § 1303.

Iowa Code section 562.6, the applicable nonbankruptcy law, states in relevant part: "If an agreement is made fixing the time of the termination of the tenancy, whether in writing or not, the tenancy shall cease at the time agreed upon, without notice." In turn, 11 U.S.C. section 362(b)(10) provides:

> The filing of a petition under section 301, 302, or 303 of this title, or of an application under section 5(a)(3) of the Securities Investor Protection Act of 1970, does not operate as a stay—
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> . . . .
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> (10) under subsection (a) of this section, of any act by a lessor to the debtor under a lease of nonresidential real property that has terminated by the expiration of the stated term of the lease before the commencement of or during a case under this title to obtain possession of such property;
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> . . . .

11 U.S.C. § 362(b)(10).

DISCUSSION

Water Tower contends that the lease of nonresidential real property terminated under the lease termination agreement shortly after the commencement of this case. Debtors maintain they can assume the terms of the lease agreement because the lease termination agreement is voidable as a result of economic duress and the lease agreement had not terminated as of the commencement of this case. If the lease termination agreement is deemed voidable, then Water Tower would argue that the lease of nonresidential real property terminated under the lease agreement before the commencement of this case.

With respect to the concept of economic duress, both Water Tower and the Debtors cite Fees v. Mutual Fire & Auto. Ins. Co., 490 N.W.2d 55 (Iowa 1992). In that case, the plaintiffs contended they accepted the defendants offer of compromise and signed a release of all their claims under their homeowners policy as a result of

economic duress. In determining whether there were material fact issues regarding the elements of economic duress that would defeat the defendants' motion for summary judgment, the Iowa Supreme Court summarized economic duress as follows:

> A contract is voidable by the victim "if the party's manifestation of assent is induced by an improper threat by the other party that leaves the victim no reasonable alternative." Restatement (Second) of Contracts § 175(1), at 475 (1981). Based upon this standard, we have recognized a release or settlement agreement may be invalid by reason of economic duress. Turner v. Low Rent Hous. Agency, 387 N.W.2d 596 (Iowa 1986). Economic duress can serve as a basis for invalidating a release when the releasor involuntarily accepted the terms of the release, the circumstances allowed only that alternative, and such circumstances were the results of the coercive acts of the releasee. Id. at 598-99. The releasor must establish that the duress resulted from the releasee's wrongful oppressive conduct and not by the releasor's necessities. Id.

Fees, 490 N.W.2d at 58. "Obviously, the burden of proving economic duress is upon the party alleging it." Id.

With respect to whether the plaintiffs involuntarily accepted the terms of the defendants, the Fees court found the plaintiffs did not establish there was a material fact issue. In support of that determination, the Iowa Supreme Court observed:

> Kenneth Fees had an associate art degree in sociology and three additional years college education in human relations. He was trained and employed as a health and life insurance salesman at the time of the fire. It is clear Fees understood their rights at the time of executing the release. The terms of the release were not ambiguous. They understood the release was a full and final settlement of the claims. Prior to and during the settlement negotiations, Fees talked with their attorney who acted on their behalf. Substantial consideration was paid to Fees. The final settlement amount was nearly the amount proposed by Fees. They had ample time to consider and to discuss with their attorney Mutual Fire's offer of settlement before accepting it.

Id. at 59.

Likewise, the Debtors in the pending case are well educated individuals. They have been running a professional business for a number of years. Though they did not have as much time to review the lease termination agreement as the Fees had to

review the release of their claims, the Debtors were represented by competent counsel in the negotiation of the agreement. The two page agreement was not ambiguous. As a result of the termination agreement, the Debtors could tend to their patients without significant delay. Likewise, given the agreement gave them the option to extend the termination date by one month, the Debtors had almost two months from the date the parties executed the agreement to relocate their business or take other legal action. The Debtors did exercise that option, commenced this bankruptcy case and listed a claim for wrongful lockout on their Schedule B (Personal Property). In sum, the Debtors have not carried their burden of proving that they involuntarily accepted the terms of the termination agreement.

With respect to whether the circumstances permitted no other alternative, the Fees court found the plaintiffs did establish there was a material fact issue. In support of that determination, the Iowa Supreme Court observed:

> The defendants urge the plaintiffs could have maintained a lawsuit to resolve their claim. The second element of economic duress is a practical one under which we take in the exigencies of the victim, and the mere availability of a legal remedy is not controlling if it will not afford effective relief to one in the victim's circumstances. Restatement § 175, comment b, at 476.

Id. at 60.

Likewise, the Debtors in the pending case were in a position where time was of the essence. They needed immediate access to their dental office in order to care for their patients. They needed access to their office in order to obtain their patient records and other business related documents. Pursuing other legal remedies was not a viable solution on the day in question. In sum, the Debtors have carried their burden of proving that they had no reasonable alternative under the circumstances.

With respect to whether the circumstances were the result of coercive acts of the defendants, the Fees court found the plaintiffs did not establish there was a material fact issue. In support of that determination, the Iowa Supreme Court observed:

> Fees were experiencing financial difficulties before the fire destroyed their home. They urge their economic problems were the results of the defendants' wrongful and coercive acts. They claim the defendants wrongfully accused them of committing arson and perjury in their bankruptcy proceeding. Even though these acts are in the record, there is no showing that the acts caused or contributed to the plaintiffs' economic troubles.
>
> Although plaintiffs claim the defendants' failure to settle left them homeless, it is admitted by the plaintiffs that Mutual Fire provided $1000 for loss of use prior to settlement. There is no inference of wrongful conduct by reason of the insurer's initial investigation having taken more than two months to complete. Nor does the insurer commit a wrongful act when it exercises its right to insist upon satisfactory proof of the fire claim.

Id.

Likewise, the Debtors in the pending case were experiencing financial difficulties long before Water Tower took steps to terminate the lease agreement and lock them out of the leased premises. Indeed, the Chapter 13 case they filed in 1997 failed in 2002. As the record before this Court demonstrates, during and after that same time frame the Debtors frequently delayed their payments to Water Tower and were delinquent or in default on a number of occasions. In sum, the Debtors have not carried their burden of proving that their financial troubles were the result of any wrongful or coercive acts by Water Tower.

Since the party alleging economic duress must prove all three elements and the plaintiffs in the Fees case carried their burden of proof only as to the second element, the Iowa Supreme Court granted the defendants' motion for summary judgment. Id. Likewise, given the Debtors in this case carried their burden of proof only as to the

second element, this Court finds that the lease termination agreement is not voidable. By operation of the terms of that agreement and in accordance with Iowa Code section 562.6, the tenancy terminated on March 31, 2003. In turn, pursuant to 11 U.S.C. section 362(b)(10), the stay of any act by Water Tower to obtain possession of the nonresidential real property lifted automatically on March 31, 2003. Finally, while the Debtors' motion to assume the lease was filed prior to the termination of the tenancy, they could not change the termination date of the agreement through assumption.

CONCLUSION

WHEREFORE, for the reasons set forth in this Memorandum of Decision, the Court finds that:

(1) The lease termination agreement is not voidable;

(2) The automatic stay lifted by operation of 11 U.S.C. section 362(b)(10) on March 31, 2003;

(3) The motion for relief from stay is moot and Water Tower may act to obtain possession of the nonresidential real property; and

(4) The motion to assume lease is moot.

A separate Order shall be entered accordingly.

/s/ Lee M. Jackwig
LEE M. JACKWIG
U.S. BANKRUPTCY JUDGE

Parties receiving this Memorandum of Decision from the Clerk of Court:
Electronic filers in this Chapter Case