

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

In the Matter of:

MP Investments, L.L.C.,
dba Vito's on the Plaza,

Case No. 10-02659-als11

Debtor

Chapter 11

**MEMORANDUM OF DECISION
(date entered on docket: November 18 , 2010)**

COURSE OF PROCEEDINGS

A voluntary chapter 11 petition was filed by MP Investments, L.L.C. ("MPI" or "Debtor") on May 21, 2010. The matter presently before the Court arises in the context of the Debtor's Motion to Assume Executory Contract ("Motion") filed on September 20, 2010, and objections thereto filed by 120 Building Co., LLP ("Landlord") and the United States Trustee. At the conclusion of the hearing conducted on October 13, 2010 ("Hearing"), deadlines were established for the submission of legal authorities. The court has jurisdiction of this core proceeding pursuant to 28 U.S.C. sections 157(b)(1) and 1334. The following findings and conclusions of law are entered by the Court pursuant to Federal Rules of Bankruptcy Procedure 7052 and 9014.

BACKGROUND

MPI operates a bar with limited food service near the University of Iowa campus in Iowa City, Iowa. The Debtor's business model and cash flow rely heavily upon the patronage of college students and the University's football season.

The original lease contract was executed on January 1, 2000 by Vito's of Iowa City, Inc. ("Vito's") and the Landlord ("Lease"). The Debtor purchased the business

from Vito's in 2008. As part of this transaction, an Approval of Assignment of Lease, Extension of Lease Term and Personal Guaranty was executed on May 14, 2008. In that document, the parties agreed that "[a]ssignor has exercised the first option extending the Lease term through December 31, 2010."¹ Currently, the Debtor is obligated to a Base Annual Rent in the amount of \$92,400, which equates to a monthly payment in the amount of \$7,700.² Insurance, property taxes and special assessments are also the tenant's responsibility as Additional Rent under paragraph 5 of the Lease.

Debtor's pending Motion requests approval to assume the executory contract identified as the Lease; allowing the Lease to be cured under the terms of its Chapter 11 Plan ("Plan"); and that MPI be permitted to exercise the contract option to extend the lease term for an additional five years.

DISCUSSION

The Court will first address the status of the option to extend the lease term. Paragraph one of the Lease contains the following provision under which MPI may exercise an option to extend the term for an additional five years:

The term of this lease shall commence on January 1, 2000 and shall end at midnight on December 31, 2005. Provided the Lessee is not in default hereunder, the Lessee shall have the option, exercisable only during the first six months of the last twelve months of the initial term of this lease, to extend the term of this lease for a five year period commencing on the expiration of the initial term and ending five years following the expiration of the initial term. Provided the Lessee is not in default hereunder, and provided further that the Lessee has exercised the first option to extend this lease, then the Lessee shall have an additional option exercisable only during the first

¹ The parties did not submit the Lease as an Exhibit at the Hearing, but in arguments and filed statements appear to believe that the Court has knowledge of its provisions. The Lease is part of the Official Court docket as Exhibit C to the Motion for Relief from Stay filed on behalf of 120 Building Company, LLC, docket number 45. The Court will use the Lease as contained therein for purposes of clarifying the record.

² The Lease at paragraph 5 provides that the Base Annual Rent increases under each option exercised.

six months of the last twelve months of the first option term of this lease to extend the term of this lease for an additional five year period commencing on the expiration of the first option term and ending five years following the expiration of the first option term. Provided the Lessee is not in default hereunder, and provided further that the Lessee has exercised the second option to extend this lease, then the Lessee shall have an additional option exercisable only during the first six months of the last twelve months of the second option term of this lease to extend the term of this lease for an additional five year period commencing on the expiration of the second option term and ending five years following the expiration of the second option term.

Although the Lease details the timeframe within which the tenant must take action to exercise the additional five year lease option, it does not specifically identify the manner in which notice of the option to renew is to be provided. A general notice provision at paragraph 31(C) of the Lease states:

Any and all notices hereunder *may* be given by certified United States mail and shall be deemed to have been given upon the date the envelope containing the same properly addressed shall have been deposited in any United States mail depository in Johnson County, Iowa, postage prepaid. Notices *may* be given to Lessor at the address at which the cash rent is payable and to Lessee at the rental premises.

(emphasis added). The use of the word "may" is "normally understood to mean 'is permitted to; has liberty to. Where there is nothing in the connection of the language or in the sense and policy of the provision to require an unusual interpretation, its use is merely permissive and discretionary.'" See Ralston Purina Co. v. Hartford Accident and Indem. Co., 540 F. 2d 915, 919 (8th Cir. 1976) (citing 2 Bouvier's Law Dictionary 2168 (8th ed. 1914)). Through its use of the word "may," the Lease does not mandate written notice. "It is the duty of the courts to give effect to the language of the contract in accordance with its plain and ordinary meaning, and not make a new contract for the

parties." Mopper v. Circle Key Life Ins. Co., 172 N.W.2d 118, 124 (Iowa 1969). The plain language of the contract suggests that notification could be effective if made by other means. Debtor asserts in its Response to the Landlord's Objection that it "unequivocally" stated its intent to exercise the option. Additionally, MPI contends that the Landlord stated that the option was unavailable due to MPI's default. It is plausible that the Landlord did receive some type of notification of MPI's intent to exercise the renewal option based upon the statements contained in the filed documents.

Unfortunately, neither party presented any direct evidence at the hearing which clarified the sufficiency, or timing, of any notice provided to the Landlord. The record is incomplete for purposes of making a factual determination on this issue, and the Court does not reach any conclusion as to whether the option has been appropriately exercised.

Whether or not the option was exercised, MPI must meet certain additional conditions set forth in the Bankruptcy Code to assume the Lease. A Debtor's ability to assume, reject or assign executory contracts is governed by 11 U.S.C. section 365. Pursuant to 11 U.S.C. section 365(d)(4) (2010) a debtor has 120 days from the date of filing to assume a non-residential lease to avoid the contract from being deemed rejected. MPI timely met this Code requirement by filing the pending Motion.

Existence of a default does not preclude the renewal of a lease and assumption of the contract in bankruptcy. See Coleman Oil Co. v. Circle K Corp. (In re Circle K Corp.), 127 F.3d 904, 906 (9th Cir. 1997). However, MPI must comply with 11 U.S.C. section 365(b)(1) (2010) to obtain authorization to assume its Lease which requires the Debtor to show that it has the ability to cure the pre-petition defaults in a lump sum or by prompt payment; and provide adequate assurance of future performance.

In its Motion, the Debtor proposes to cure the default under its Chapter 11 Plan which states that the default will be cured in full at the time of confirmation.³ This intent was also expressed at the time of the hearing. The amount required to cure the outstanding pre-petition defaults is not stated in the Debtor's Motion. The Court must initially calculate the cure amount based upon the evidence presented at the hearing and relevant documents filed in this case.

The Statement of Financial Affairs filed by the Debtor indicates that MPI was served a Notice to Quit on May 20, 2010, one day prior to the bankruptcy filing. Schedule F of the petition states that the Debtor was in default for monthly rental payments to the Landlord in the amount of \$44,293.00. The Debtor did not list any payments owing for pre-petition property taxes on its schedules. The Landlord's Objection asserts that pre-petition defaults include rent in the amount of \$38,500 and real estate taxes in the amount of \$13,493. The sum of these numbers coincides with the amount of the pre-petition default to be cured pursuant to the Debtor's Plan at Section IV, Treatment of Claims and Interests, 4.04 Class Four Claim. The cure amount to be paid for assumption of the Lease is \$51,993.00.

A review of the financial information indicates that MPI has not provided that it can pay the required cure amount in a lump sum at the time of confirmation as proposed in its Plan. The Debtor's Annualized Income and Expenses does not contain any entry

³ The Debtor's Chapter 11 Plan of Reorganization and Disclosure Statement were not on the docket at the time the pending Motion was filed. These items were later filed on October 8, 2010 and October 12, 2010, respectively (Docket numbers, 107, 118). Prior to the Hearing, the Debtor filed an Exhibit and Witness List at docket number 116 which included September 2010 Monthly Operating Report – not due until October 15, 2010 (in process) and the Disclosure Statements and attachments in the Court file. The Disclosure Statement included a copy of the proposed Plan as an Exhibit. At the Hearing, Exhibit A and Exhibit A attached to the Disclosure Statement were admitted. Due to the lack of information included in the record related to the Debtor's Disclosure Statement and information attached thereto, other than Exhibit A, the Court will reference these items for purposes of clarifying the record.

for curing the default based upon plan payments starting in January 2011. (Exhibit A to Debtor's Disclosure Statement at 3). The unaudited financial statement for the time period June 2010 through September 2010 indicates a loss of \$23,588.05. Michael Porter ("Porter"), the Debtor's sole member, testified that he believed that the cash position of the business would be higher in November. Other than optimism, there is nothing in the record that would support this projection.

Absent the ability to pay the cure amount in full at the time an executory contract is assumed, a debtor must demonstrate the payment of the cure will be made promptly. See 11 U.S.C. § 365(b)(1) (2010). What constitutes a prompt cure is determined on a case by case basis. See In re Embers 86th St., Inc., 184 B.R. 892 (Bankr. S.D.N.Y. 1995); In re Gen. Oil Distrib., 18 B.R. 564, 568 (Bankr. E.D.N.Y. 1982). Generally, a time period of one year or less has been construed as satisfying the requirement of prompt payment of the cure amount. See 2 William L. Norton, Jr., Norton Bankruptcy Law and Practice 3d § 46:29 (2010). During the hearing, contrary to the treatment proposed in the Plan, counsel for the Debtor stated that the pre-petition defaults could be cured over a reasonable time, perhaps up to five years. There is no authority provided to support extending the default payments for a time period of up to five years, while still permitting assumption of the executory contract.

MPI's cash flow in support of its Plan indicates that "Capital Inject to cover Bankruptcy Costs" will be necessary in the total amount of \$28,550 during the first year of post-confirmation operation.⁴ The source, or actual availability, of these funds has not been disclosed, and was not the subject of evidence supplied at the hearing. Assuming,

⁴ This statement appears inconsistent with the Plan at docket number 107 and as Exhibit D to the Disclosure Statement filed at docket number 118 which provides at Article III, Plan Funding, page 9: "The means of funding shall be the income generated by the Debtor, from its ongoing operations, over time."

arguendo, that the Debtor can access the required capital, MPI's net profit at the end of calendar year 2011 is in the amount of \$8,176. Porter testified that the projections were based upon past business performance. Even if a prompt cure was permitted over the course of twelve months, MPI's cash position is substantially less than would be needed to pay the outstanding pre-petition defaults. The Debtor, therefore, has not provided adequate assurance of a prompt cure.

Adequate assurance of future performance is the final component that must be satisfied to permit assumption of an executory contract. See 11 U.S.C. § 365(b)(1)(C) (2010). This standard does not require a "guarantee of future performance" but must be based upon "more than the debtor's speculative plans." In re Washington Capital Aviation & Leasing, 156 B.R. 167, 173 (Bankr. E.D. Va. 1993). Similarly, a Debtor is not required to prove that it will "thrive and make a profit," but it must, however, appear that the "rent will be paid and the other lease obligations met." See In re Natco Indus., Inc., 54 B.R. 436, 440 (Bankr. S.D.N.Y. 1985); In re Westview 74th St. Drug Corp., 59 B.R. 747, 754 (Bankr. S.D.N.Y. 1986). The concept of adequate assurance protects the parties' rights in the reorganization process.

It is only on default that a landlord is entitled to adequate assurance, § 365(b)(1), and the obvious purpose of this section, particularly in light of the statutory voiding of bankruptcy default clauses contained in § 365(e)(1), is to afford landlords with a measure of protection from having to be saddled with a debtor that may continue to default and return to bankruptcy.

The emphasis is on protection. Section 365 gives no indication that a landlord . . . is to improve its position upon the bankruptcy of a tenant. The statute affords no relief to a landlord simply because it might have the opportunity to rent the premises to others at a higher base or percentage rent and would otherwise seek to escape the bargain it

made. In re Webster Clothes Inc., 36 B.R. 260, 264 (Bankr. D. Md. 1984). Such a notion would be totally contradictory to the Congressional “policy of favoring assumption and assignment as a means of continuing performance and realizing value and thereby assisting the debtor in its rehabilitation or liquidation.” In re Evelyn Byrnes, Inc., 32 B.R. 825, 829 (Bankr. S.D.N.Y. 1983).

In re Natco, 54 B.R. at 440-41. There is no information before the Court which indicates that the Landlord is attempting to improve its position by objecting to the Debtor’s Motion to Assume the Lease.⁵

The testimony provided by Porter is not convincing in establishing MPI’s ability to assure performance of its obligations under the Lease. Porter stated that he did not prepare the financial documents; had not reviewed monthly reports prior to submission; believed that information on the profit and loss statement may be inaccurate; and was unaware that funds were not available to pay post-petition rent payments. Moreover, he appeared to lack fundamental knowledge of MPI’s financial transactions.

Post-filing a debtor is required to perform its obligations under a non-residential lease until the executory contract is assumed or rejected. See 11 U.S.C. § 365(d)(3) (2010). Whether a debtor has timely performed its post-petition obligations is relevant to evaluating the assurance of future performance. See Cannery Row Co. v. Leisure Corp. (In re Leisure Corp.), 234 B.R. 916, 923 (B.A.P. 9th Cir. 1999). See generally 2 William L. Norton, Jr., Norton Bankruptcy Law and Practice 3d § 46:29 (2010). In re Leisure held that in determining whether a DIP may renew a lease despite post-petition defaults, a court should consider “whether the scope of the default, the cause of the default, any subsequent cure of the default, and the significance of the lease to the reorganization are

⁵ “[S]ubstantial and valuable leasehold improvements” to the business premises (Debtor’s Disclosure Statement at 4, docket number 118) are not quantified in any evidence presented to the Court. Lease is at market value. (Debtor’s Disclosure Statement at 6, docket number 118).

sufficient to outweigh the policy of § 365(d)(3) that the landlord has a right to timely payment post-petition.” 234 B.R. at 924.

Post-petition payments under the Lease have been sporadic. Although MPI endeavored to cure these post-petition defaults, there were late payments and insufficient funds. The Landlord contends that the Debtor has been delinquent in its post-petition rental payments to the extent of \$23,100. At the time of Hearing, post-petition lease defaults appeared to remain for the months of September and October in the total amount of \$15,400. It is uncertain whether the remaining property taxes owing by September 30, 2010 have been paid.

The record demonstrates that MPI has been unable to successfully maintain payments under the Lease both before, and after its bankruptcy filing. The Disclosure Statement and Plan state that the Debtor has generated a cash reserve from its post-petition business activity. The financial data does not substantiate this claim. The Debtor's post-petition defaults are substantial, and appear to be directly related to MPI's inability to generate income sufficient to meet its ongoing operating costs. No evidence was provided to support the Debtor's contention that its profits will substantially increase during the remaining portion of the University of Iowa football season. Notwithstanding the fact that the month of September showed a profit, there was no explanation for the Debtor's inability to make its post-petition Lease payments during that same time period. The Landlord's expectation of timely performance of Lease obligations cannot be ignored solely because the business location may be essential to MPI's efforts to reorganize. MPI has not provided adequate assurance of future performance.

MPI has not met the requirements of 11 U.S.C. section 365(b)(1) to permit assumption of the non-residential property lease.

It is therefore ORDERED that the Objections to the Motion to Assume Executory Contract are sustained and the Debtor's Motion is denied.

/s/ Anita L. Shodeen
Anita L. Shodeen
U.S. Bankruptcy Judge

Parties receiving this Memorandum of Decision from the Clerk of Court:
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