



Signed and Filed: December 06, 2005

Dennis Montali

DENNIS MONTALI
U.S. Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA

In re)	
)	Bankruptcy Case
DELTAGEN, INC., a Delaware)	No. 03-31906DM
corporation,)	
)	
)	Debtor(s) Chapter 11

MEMORANDUM DECISION RE APPLICATION OF LETTER OF CREDIT
DRAWS TO LANDLORD'S CAPPED CLAIM FOR LOST FUTURE RENT

On October 14, 2005, this court heard the motion for partial summary judgment filed by Deltagen, Inc. ("Deltagen") and the counter-motion for partial summary judgment filed by Woodside Technology Center, LLC ("Woodside"). Both motions pertained to Woodside's amended proof of claim and Deltagen's objections to it. Pamela E. Singer, Esq. appeared on behalf of Deltagen and Patricia S. Mar, Esq. appeared on behalf of Woodside. The court took both motions under submission. For the reasons set forth below, the court will deny Deltagen's motion and grant Woodside's counter-motion.

Woodside's claim against Deltagen is based on its status as Deltagen's landlord. Both parties agree that Woodside's claim is

1 capped under 11 U.S.C. § 502(b)(6).¹ Both parties agree that the
2 amount remaining as of the petition date on a letter of credit
3 issued in favor of Woodside must be applied to reduce Woodside's
4 maximum capped claim for lease termination damages. The parties
5 disagree whether amounts drawn on that letter of credit by
6 Woodside prior to the petition date should reduce the capped
7 claim. The court agrees with Woodside that those amounts do not
8 reduce the capped claim.

9 **I. Undisputed Facts**²

10 On or about July 11, 2001, Woodside and Deltagen entered into
11 a lease (the "Lease") whereby Deltagen leased space in a building
12 located in Redwood City, California (the "Premises"). Deltagen's
13 monthly rent was \$225,462.11 and Deltagen provided Woodside with a
14 collateralized letter of credit ("Letter of Credit") in the amount
15 of \$1,701,481.00 to secure the rent payments.

16 On or about March 31, 2003, Deltagen and Woodside entered
17 into an option agreement ("Agreement") which authorized Woodside
18 to make draws on the Letter of Credit to pay rent accruing after
19 March 1, 2003. Agreement at ¶¶ 3(a) and 4(a). Debtor filed for
20 chapter 11 relief on June 27, 2003. Prior to the petition date,
21 and pursuant to the Agreement, Woodside drew \$901,848.00 on the
22 Letter of Credit.

23

24

25 ¹Unless otherwise indicated, all chapter, section and rule
26 references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1330, as
27 enacted and promulgated prior to the effective date of The
28 Bankruptcy Abuse Prevention and Consumer Protection Act of 2005,
Pub. L. 109-8, Apr. 20, 2005, 119 Stat. 23.

²The following discussion constitutes the court's findings of
fact and conclusions of law. Fed. R. Bankr. P. 7052(a).

1 The Agreement provided Deltagen with an option (exercisable
2 through June 30, 2003) to terminate the Lease prior to its 2010
3 scheduled expiration date upon notice to Woodside and tender of a
4 termination payment equaling more than \$2 million. Agreement at
5 ¶¶ 1, 2 and 3. In the interim, Deltagen's ongoing rent
6 obligations would be satisfied by Woodside drawing monthly rent
7 amounts on the Letter of Credit.

8 In paragraph 5 of the Agreement, Deltagen and Woodside
9 acknowledged that as of March 31, 2003, Deltagen had vacated and
10 surrendered the Premises. Notwithstanding that paragraph, the
11 Agreement provides that the Lease was not terminated, as evidenced
12 by (1) the ability of Woodside to draw on the Letter of Credit to
13 satisfy ongoing rent obligations, (2) the ability of Deltagen to
14 terminate the Lease upon making the termination payment, (3) the
15 parties' recognition (in ¶ 3(e)) that other leases had been
16 terminated, and (4) the parties' agreement (in ¶ 6) that Deltagen
17 would be the sublessor under any sublease if Woodside were able to
18 locate another tenant for the Premises.

19 In the event Deltagen did not exercise the termination option
20 by the deadline set forth in Agreement, "Then the Termination
21 Option shall be void and of no further force or effect and the
22 parties' rights and obligations under the Lease shall be as though
23 this Agreement had never existed." Agreement at ¶ 1(a).

24 The parties agree that Woodside's damages are capped at
25 \$2,178,429.00 pursuant to section 502(b)(6) and that this claim
26 should be offset by the amount remaining on the Letter of Credit
27 as of the petition date (\$799,633.00). They disagree, however,
28 whether the capped amount should be reduced by the prepetition

1 draws on the Letter of Credit or whether those prepetition draws
2 shall be applied towards Woodside's gross claim for lost future
3 rent in excess of the statutory cap.

4 **II. Issues**

5 1. Were the prepetition draws against the Letter of Credit
6 payments of current, accruing rent and thus not subject to section
7 502(b)(6)'s cap on the lost future rent claim?

8 2. Even if the draws were not payments of current rent,
9 does the section 502(b)(6) cap apply to prepetition, post-
10 termination draws?

11 **III. Discussion**

12 A. The Draws Satisfied Current, Ongoing Rent Obligations

13 "Summary judgment is appropriate when [] contract terms are
14 clear and unambiguous, even if the parties disagree as to their
15 meaning." U.S. v King Features Entertainment, Inc., 843 F.2d 394,
16 398 (9th Cir. 1988); United Bhd. of Carpenters and Joiners of Am.
17 Lathers Local 42-L v. United Bhd. of Carpenters and Joiners of
18 Am., 73 F.3d 958, 961 (9th Cir. 1996). "Interpretation of a
19 contract is a matter of law, including whether the contract is
20 ambiguous." King Features, 843 F.2d at 398. Here, the Agreement
21 clearly and unambiguously provides that the prepetition draws
22 against the Letter of Credit were used to satisfy ongoing,
23 accruing monthly rent obligations; thus, as a matter of law, such
24 draws are not subject to the cap of section 502(b)(6).

25 Section 502(b)(6) limits the claims allowable to a landlord
26 for future rent or damages resulting from the termination of a
27 lease. In particular, the landlord's claim is limited to the rent
28 reserved by the lease, without acceleration, for the greater of

1 either one year or fifteen percent (not to exceed three years) of
2 the remaining lease term following the earlier of the petition
3 date or the surrender/repossession date. The limitation does not
4 apply to rents that accrued prior to the petition date. See 11
5 U.S.C. § 502(b)(6); Lawrence P. King, 4 Collier on Bankruptcy
6 ¶ 502.03[7][e] (rev'd 15th ed. 2005).

7 Under the Agreement, Deltagen agreed to pay its post-March 1,
8 2003 gross rent by draws on the Letter of Credit. Agreement at
9 ¶¶ 3(a) and 4(a) ("Landlord shall have the right to draw on the
10 Letter of Credit to pay Gross Rent accruing under the Lease from
11 and after March 1, 2004"). The Agreement thus clearly treats the
12 rent obligation as ongoing and accruing. Other provisions of the
13 Agreement unambiguously demonstrate that the Lease was not
14 terminated upon surrender of the Premises and that rent continued
15 to accrue (and be paid via Letter of Credit draws) on a monthly
16 basis. For example, the parties agreed that Woodside could
17 sublease the Premises -- after obtaining the consent of Deltagen -
18 - and that Deltagen would be the sub-lessor under any such sub-
19 lease. See Agreement at ¶ 6. Other provisions explicitly
20 provided Deltagen an option to terminate the Lease upon paying
21 certain amounts and specifically referenced the immediate
22 termination of other leases between Woodside and Deltagen (of
23 other property in Menlo Park and Alameda). See Agreement at
24 ¶¶ 3(e) and 1-3.

25 Deltagen seeks to avoid the effect of these provisions (while
26 ironically seeking to use the "surrender" clause of the Agreement)
27 by pointing to the provision in paragraph 1(a) providing that the
28 termination option (but not the Agreement itself) would be null

1 and void and the parties' rights to be as if the Agreement never
2 existed. As a result, under California Civil Code sections 1951.2
3 and 1951.4, termination occurred in March 2003 when surrender
4 purportedly occurred.

5 Sections 1951.2 and 1951.4 of the California Civil Code do
6 provide that termination occurs when a lessee surrenders leased
7 property. Those sections, however, are subject to California
8 Civil Code section 3268, which provides that those provisions are
9 "subordinate to the intention of the parties" as ascertained by
10 the provisions on interpretation of contracts. Here, the
11 Agreement demonstrates that the parties did not intend to
12 terminate the Lease as of the date of purported surrender. If
13 Deltagen wants to argue that the Agreement demonstrates that
14 surrender did indeed occur on March 1, 2003, it must also concede
15 that the Agreement demonstrates that the parties did not intend to
16 terminate the Lease on the same date. In any event, the clause
17 voids the termination option and not the Agreement itself; the
18 Agreement (which clearly treats the rent obligation as ongoing) is
19 not void. To the extent the parties stated that they would act as
20 though the Agreement never existed if the termination option were
21 not exercised, the Lease remained in effect during the term of the
22 Agreement and the draws on the Letter of Credit were thus for
23 ongoing rent.

24 B. Prepetition Draws Are Not Subject to Cap In Any Event
25 Even if the prepetition draws were not payments of ongoing
26 rent but were payments of termination damages, section 502(b)(6)'s
27 cap would not apply. The plain language of section 502(b)(6) does
28 not require the cap to be reduced by prepetition payments.

1 Rather, such payments plainly reduce the total claim for
2 termination damages, but do not affect the mathematical
3 calculation of the cap. Section 502(b)(6) contains no suggestion
4 that prepetition payments would reduce the cap. Therefore, for
5 the reasons set forth below, the timing of the draws (prepetition
6 versus post-petition) insulate them from the cap.

7 The parties agree that under AMB Prop., L.P. v. Official
8 Creditors for the Estate of AB Liquidating Corp. (In re AB
9 Liquidating Co.), 416 F.3d 961, 964-65 (9th Cir. 2005), a security
10 deposit or letter of credit held by a landlord post-petition must
11 be applied against the landlord's capped, and not its gross,
12 damages. See also Redback Networks, Inc. v. Mayan Networks Corp.
13 (In re Mayan Networks Corp.), 306 B.R. 295, 299 (9th Cir. BAP
14 2004) (landlord's post-petition draw on letter of credit must be
15 deducted from the landlord's capped damages). Deltagen, citing a
16 Delaware bankruptcy court case, argues that whether a draw is made
17 against a letter of credit pre- or post-petition is immaterial;
18 instead, whatever amount was held by the landlord at the
19 termination of the lease should be offset against the capped
20 amount. In re PPI Enterprises (U.S.), Inc., 228 B.R. 339, 350
21 (Bankr. D. Del. 1998), aff'd, 324 F.3d 197 (3d Cir. 2003).

22 In PPI, the debtor abandoned its leased premises in September
23 1991 and the landlord terminated the lease by notice on October
24 21, 1991. Id. at 342. Subsequent to the 1991 termination, the
25 landlord drew upon a \$650,000 standby letter of credit. Id. at
26 350. Almost five years later (in April 1996), the debtor filed
27 its bankruptcy petition, and argued that the landlord's capped
28 damages should be offset by the amount of the prepetition draw

1 against the letter of credit. The bankruptcy court agreed with
2 the debtor, stating that "The legislative history and case law
3 pertaining to the treatment of security deposits under § 502(b)(6)
4 makes clear that any security deposit held by a landlord at the
5 time of termination of the lease of real property will be applied
6 in satisfaction of the claim allowed under § 502(b)(6)." Id.
7 (emphasis added) (citing cases involving post-petition draws
8 against letters of credit or security deposits). The PPI court
9 dismissed the landlord's argument that all of the cases requiring
10 setoff of letters of credit or security deposits against the
11 capped section 502(b)(6) amount involved landlords who held the
12 full deposit or the full amount of the letter of credit as of the
13 petition date:

14 However, these differences in timing are irrelevant
15 because § 502(b)(6)'s cap on a landlord's claim takes
16 effect at the earlier of (i) the date of filing and (ii)
17 the date on which lessee surrenders or lessor
18 repossesses the property. Thus, so long as the landlord
19 applied the security deposit at a time subsequent to
20 either (i) or (ii) above, § 502(b)(6) will require that
21 security deposit to be subtracted from the landlord's §
22 502(b)(6) claim. In this case, because Solow drew down
23 the letter of credit for \$650,000 subsequent to
24 termination of the lease, Solow's § 502(b)(6) claim
25 should be reduced by that amount.

21 Id. at 350. Therefore, the PPI court required a landlord who had
22 drawn against a tenant's security deposit almost five years prior
23 to the petition date to reduce its capped claim by the amount of
24 that security deposit.

25 In response, Woodside relies on the Ninth Circuit Bankruptcy
26 Appellate Panel's ("BAP") decision in Young v. Condor Systems,
27 Inc. (In re Condor Systems, Inc.), 296 B.R. 5 (9th Cir. BAP 2003),
28 that prepetition, post-termination payments made by the debtor

1 could not be offset against the employee's capped (under section
2 502(b)(7)) damages. Id. at 13-15. In Condor, a case of first
3 impression, BAP explained why golden parachute payments made to a
4 former employee after termination but before bankruptcy do not
5 affect the section 502(b)(7) cap. The panel analyzed the language
6 and statutory construction of section 502(b)(7), which for the
7 purposes of this particular analysis is the same as section
8 502(b)(6).³ Condor is more persuasive than PPI and should
9 control.

10 The Condor bankruptcy court held that prepetition termination
11 payments count against the section 502(b)(7) cap, comparing the
12 prepetition termination payments to prepetition security deposits
13 which apply to the section 506(b)(6) cap. In reversing, BAP
14 correctly noted that the bankruptcy court had compared "apples to
15 oranges." Id. at 14. Unlike the facts of Condor (and in the
16 present case), none of the cases cited by the Condor bankruptcy
17 court in support of its (ultimately reversed) decision involved
18 prepetition draws against prepetition letters of credit or
19 prepetition security deposits. In contrast, the facts here and
20 the facts of Condor are more "apples to apples": both cases

21
22 ³In Condor, the panel stated that in another case, it
23 "declined to analogize §§ 502(b)(6) and (b)(7) in derogation of §
24 502(b)(7)'s plain language . . ." Condor, 296 B.R. at 14, citing
25 Bitters v. Networks Elec. Corp. (In re Networks Elec. Corp.), 195
26 B.R. 92, 100 (9th Cir. BAP 1996). In Bitters, the terminated
27 employee cited a case which relied on the legislative history of
28 section 502(b)(6) in deciding that the plain language of section
502(b)(7) did not apply. The Bitters panel rejected that
approach, noting that the "employee-creditor of § 502(b)(7) cannot
readily be analogized to the landlord of § 502(b)(6)." Bitters,
195 B.R. at 100. The Bitters court did not, however, state that
sections 502(b)(6) and (b)(7) cannot be analogized, particularly
when the issue pertains to the interpretation of similar plain
language.

1 involve prepetition payments (or draws).

2 In Condor, the former employee was terminated prepetition and
3 was the beneficiary of a severance package paying him \$1,400,000
4 in eight quarterly installments. The \$1,400,000 was funded by an
5 irrevocable letter of credit. The employee drew \$1,050,000 in
6 prepetition payments against the letter of credit and ultimately
7 drew the remaining \$350,000 on the letter of credit. The Condor
8 court faced two issues: whether the prepetition draws had to be
9 offset against the capped damages (to which BAP answered "no") and
10 whether the post-petition draws had to be offset against the cap
11 (to which BAP also answered "no", applying an analysis that is
12 irrelevant here).⁴

13 The panel in Condor notes that section "502(b)(6) tracks the
14 language of [section] 502(b)(7)"⁵ (id. at 14, n.10) and holds that

15
16 ⁴Only the first issue is pertinent here. The Ninth Circuit
17 distinguished BAP's holding with respect to the second issue in AB
18 Liquidating. The Ninth Circuit, not having faced the first issue
19 in any published decision, has not criticized or distinguished
20 Condor's analysis of the first issue, notwithstanding Deltagen's
21 implications to the contrary.

22 ⁵The sections provide:

23 (b) Except as provided in subsections (e)(2), (f), (g),
24 (h) and (i) of this section, if such objection to a
25 claim is made, the court, after notice and a hearing,
26 shall determine the amount of such claim in lawful
27 currency of the United States as of the date of the
28 filing of the petition, and shall allow such claim in
such amount, except to the extent that--

(6) if such claim is the claim of a lessor for damages resulting
from the termination of a lease of real property, such claim
exceeds--

(A) the rent reserved by such lease, without acceleration,
for the greater of one year, or 15 percent, not to exceed
three years, of the remaining term of such lease, following
the earlier of--

1 the language and structure of section 502(b)(7) do not contemplate
2 offsets of prepetition payments (or, in this case, draws):

3 The preambular portion of § 502(b)--"shall determine the
4 amount of such claim in lawful currency of the United
5 States as of the date of the filing of the petition" --
6 admits of one reading. 11 U.S.C. § 502(b) (emphasis
7 added).

8 The date of filing bankruptcy is the measuring date for
9 determining substantive damages, while the earlier of
10 the date of termination or date of filing is the
11 measuring date for determining the § 502(b)(7) cap [and
12 the section 502(b)(6) cap]. The use of the earlier of
13 the date of bankruptcy or of termination as the
14 measuring date for cap determination, but not damages,
15 compels the conclusion that prepetition payments are
16 irrelevant.

17 The fact that the back pay provision at § 502(b)(7)(B)
18 raises the cap by the amount of "unpaid compensation due
19 under such contract, without acceleration, on the
20

21 (I) the date of the filing of the petition; and
22 (ii) the date on which such lessor repossessed, or the
23 lessee surrendered, the leased property; plus
24 (B) any unpaid rent due under such lease, without
25 acceleration, on the earlier of such dates;
26 (7) if such claim is the claim of an employee for damages
27 resulting from the termination of an employment contract, such
28 claim exceeds--

29 (A) the compensation provided by such contract, without
30 acceleration, for one year following the earlier of--
31 (I) the date of the filing of the petition; or
32 (ii) the date on which the employer directed the
33 employee to terminate, or such employee terminated,
34 performance under such contract; plus
35 (B) any unpaid compensation due under such contract, without
36 acceleration, on the earlier of such dates;
37 (Emphasis added.)
38

1 earlier of such dates"⁶ supports our conclusion.
2 Consistent with canons of construction that require
3 terms such as "unpaid" and "due" to be interpreted so as
4 to give effect to each, the term "unpaid" makes the most
5 sense as a separate concept if it means back pay due [or
6 unpaid rent] that remains unpaid at the time of the
7 filing of the petition.

* * *

8 If Congress meant for the damages cap of § 502(b)(7)(A)
9 to be reduced by prepetition payments, it could have
10 included the term "unpaid" that it used in §
11 502(b)(7)(B). Compare, § 502(b)(7)(A) ("the
12 compensation provided"), with § 502(b)(7)(B) ("any
13 unpaid compensation due").

14 Id. at 14-15 (emphasis and bracketed commentary added). This
15 court agrees with BAP that if Congress had intended prepetition
16 payments (or, in this case, prepetition draws) to be applied
17 against the capped amount of section 502(b)(6), it would have used
18 "unpaid" in that subsection.

19 As in Condor, those amounts received by Woodside in
20 prepetition draws in the interval between the surrender of the
21 Premises and the petition date do not have to be offset against
22 the section 502(b)(6) capped claim. While those amounts reduce
23 Woodside's gross claim, the calculation of the capped, and thus
24 allowable, portion of that claim is a purely mathematical
25 function, made as of the date of the termination of the Lease and
26 without regard to subsequent, prepetition payments.

27 **IV. Conclusion**

28 Because the prepetition draws against the Letter of Credit
were used to satisfy ongoing rent payments, the cap of section
502(b)(6) is inapplicable. Moreover, to the extent such draws

⁶Likewise, section 502(b)(6)(B) raises the landlord's cap by
"any unpaid rent due under such lease, without acceleration, on
the earlier of such dates." 11 U.S.C. § 502(b)(6)(B).

1 were made prepetition, they do not have to be offset against the
2 cap. The court will therefore grant Woodside's counter motion for
3 partial summary judgment and deny Deltagen's motion for summary
4 judgment. Counsel for Woodside is directed to prepare orders and
5 a partial summary judgment in accordance with this Memorandum
6 Decision, stating that relief is being granted or denied for the
7 reasons set forth in this Memorandum Decision, and to comply with
8 B.L.R. 9021-1.

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END OF MEMORANDUM DECISION

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