CASE NO. 21-56264

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

SMART CAPITAL INVESTMENTS I, LLC, SMART CAPITAL INVESTMENTS II, LLC, SMART CAPITAL INVESTMENTS III, LLC, SMART CAPITAL INVESTMENTS IV, LLC, AND SMART CAPITAL INVESTMENTS V, LLC,

Appellants,

v.

HAWKEYE ENTERTAINMENT, LLC, AND W.E.R.M. INVESTMENTS, LLC,

Appellees.

APPELLANTS' OPENING BRIEF

On Appeal From The United States District Court for the Central District of California, Western Division

Case No. 2:20-cv-10656-FLA

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CORPORATE DISCLOSURE STATEMENT

Pursuant to Federal Rule of Appellate Procedure ("FRAP") 26.1, Appellants Smart Capital Investments I, LLC, Smart Capital Investments II, LLC, Smart Capital Investments III, LLC, Smart Capital Investments IV, LLC, and Smart Capital Investments V, LLC (collectively, "Smart Capital" or "Appellants"), certify that each is a privately held California limited liability company and has no parent corporation, subsidiaries, or affiliates that have issued shares to the public.

Dated: January 24, 2022

SulmeyerKupetz
A Professional Corporation

By: */s/David S. Kupetz*
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I.

JURISDICTIONAL STATEMENT

Appellee Hawkeye Entertainment, LLC ("Hawkeye"), filed a voluntary chapter 11 petition under Title 11 of the United States Code ("Bankruptcy Code") on August 21, 2019, commencing the bankruptcy case entitled *In re Hawkeye Entertainment, LLC*, bankruptcy case no. 1:19-bk-12102-MT ("Bankruptcy Case"). The United States Bankruptcy Court for the Central District of California ("Bankruptcy Court") had subject matter jurisdiction over the Bankruptcy Case pursuant to 28 U.S.C. §§ 157(a) and 1334(a) and standing General Order 266 referring all bankruptcy cases filed in the United States District Court for the Central District of California ("District Court") to the Bankruptcy Court. Venue was proper in the Central District of California pursuant to 28 U.S.C. § 1409(a) because the Bankruptcy Case was pending in this district.

On October 27, 2020, the Bankruptcy Court entered the Order Granting Debtor's Motion To Assume Lease and Sublease ("Assumption Order"). ER 017.[1] Smart Capital timely appealed the Assumption Order to the District Court which had subject matter jurisdiction over the appeal pursuant to 28 U.S.C. § 158(a)(1). ER 231.

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[1] References to "ER ##" are to the identified page number(s) in Appellants' concurrently-filed Excepts of Record in support of this opening brief.

On October 26, 2021, the District Court entered its Order Affirming Bankruptcy Court Order Granting Debtor's Motion to Assume Lease And Sublease ("District Court Order"). ER 003. The District Court Order, which affirmed the Assumption Order in its entirety, is now a final order. See Stanley v. Crossland, Crossland, Chambers, MacArthur & Lastreto (In re Lakeshore Vill. Resort), 81 F.3d 103, 105 (9th Cir. 1996) ("Ordinarily, a district court order is final if it affirms or reverses a final bankruptcy court order.").

Smart Capital timely appealed the District Court Order to this Court on November 16, 2021 by filing its Notice of Appeal within thirty (30) days of the entry date of the District Court Order. ER 208; FRAP 4(a)(1)(A). This Court has subject matter jurisdiction over this appeal under 28 U.S.C. § 158(d)(1). See In re Olshan, 356 F.3d 1078, 1082 (9th Cir. 2004) ("We have jurisdiction to review final orders of a district court acting in its bankruptcy appellate capacity under either 28 U.S.C. § 158(d) or 28 U.S.C. § 1291.").

II.

STATEMENT OF ISSUES PRESENTED

The issues on appeal are as follows:

1. Whether the Bankruptcy Court erred as a matter of law in concluding that a "default" under 11 U.S.C. § 365(b)(1) only exists if it would compel forfeiture or

termination under state law of the Lease (defined below) between Smart Capital, as landlord, and Hawkeye, as tenant.

2. Whether the District Court erred as a matter of law by affirming "the Bankruptcy Court's legal conclusion that, to constitute a default under § 365, a breach of an unexpired lease agreement must be sufficiently material to warrant the lease's termination under state law."

3. Whether the Bankruptcy Court and District Court erred as a matter of law by equating Hawkeye's motion for approval of assumption of the Lease under Section 365[2] with an unlawful detainer proceeding under state law in state court.

4. Whether the Bankruptcy Court erred as a matter of law in not considering and determining the issue of adequate assurance of future performance by applying a rule of its own creation in conflict with the plain language of Section 365.

5. Whether the Bankruptcy Court erred as a matter of law by departing from the plain language of Section 365 and engaging in the type of "common lawmaking" the Supreme Court warned against in FDIC v. Rodriguez, 140 S. Ct. 713, 716, 206 L. Ed. 2d 62, 65 (2020).

6. Whether the District Court erred in affirming the Bankruptcy Court's conclusion that notwithstanding the defaults under the Lease established by

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[2] All references to "Section" are to the Bankruptcy Code, 11 U.S.C. § 101 *et. seq.*

Appellants at trial, these breaches did not constitute "defaults" under Section 365(b)(1).

7. Whether the Bankruptcy Court erred in concluding that a late rent payment made by Hawkeye to Appellants was not a "default" as that term is used in Section 365(b)(1).

8. Whether the Bankruptcy Court erred in concluding that Hawkeye's failure to sign an estoppel certificate was not a default as that term is used in Section 365(b)(1).

9. Whether the Bankruptcy Court erred in concluding that adequate evidence existed that Hawkeye possessed insurance required by the Lease.

10. Whether the Bankruptcy Court erred by finding that Hawkeye's use and/or subletting of the Premises for religious services was not a default as that term is used in Section 365(b)(1).

11. Whether the Bankruptcy Court erred by finding that Hawkeye complied with the Conditional Use Beverage permit that applies to the premises under the Lease.

12. Whether the District Court erred in affirming the Bankruptcy Court's failure to consider the provisions of Section 365(b)(1)(A)-(C) once Appellants established that there had been a "default" under Section 365(b)(1) and by depriving

Appellants of their right to have the Bankruptcy Court consider and determine the requirement of adequate assurance of future performance.

III.

STATEMENT OF THE CASE

Smart Capital owns the real property located at 618 South Spring Street, Los Angeles, California ("Property"), and leases the first four (4) floors of the Property ("Leased Premises") to Hawkeye pursuant to a nonresidential real property lease as amended ("Lease"). ER 165-207. Smart Capital and Hawkeye are parties to the Lease. ER 004. Hawkeye operates a dance club and entertainment venue at the Leased Premises through its related entity, W.E.R.M. Investments, LLC ("WERM"). 004 and 104. The events leading up to this appeal arise from Hawkeye's motion to assume the Lease in the Bankruptcy Case.

A. The Bankruptcy Filing

On August 5, 2019, after determining that Hawkeye was in numerous defaults of the Lease, Smart Capital served Hawkeye with a Notice of Default identifying the various defaults. Smart Capital served Hawkeye with a 3-day notice on August 19, 2019. Before that three-day period expired, Hawkeye elected to commence the Bankruptcy Case on August 21, 2019. ER 004.

On October 10, 2019, Hawkeye filed its motion for an order authorizing the assumption of the Lease pursuant to Section 365 ("Lease Assumption Motion"),

which Smart Capital opposed in order to compel Hawkeye to comply with the requirements of Section 365(b)(1)(A)-(C) and, among other things, demonstrate adequate assurance of future performance. ER 004. The Lease Assumption Motion was set for evidentiary hearing for October 13-16, 2020 ("Hearing"). Id.

Prior to the Hearing, in April 2020, Hawkeye failed to pay its rent of $40,574.59 on the first of the month, as required by Article 6.1 of the Lease. After Hawkeye's motion to be excused from paying rent was denied, Hawkeye paid its April 2020 rent late on April 30, 2020. ER 009:15-18.

B. The Hearing and the District Court Ruling

The Bankruptcy Court conducted the Hearing on October 13-16, 2020. ER 004. On the last two (2) days, the Bankruptcy Court made certain oral findings of fact and conclusions of law. ER 021-091.

The Bankruptcy Court granted the Lease Assumption Motion pursuant to the Assumption Order entered on October 27, 2020. ER 017. Smart Capital timely appealed the Assumption Order to the District Court, which subsequently affirmed the Assumption Order. ER 231. The core of the District Court's affirmance was that it agreed with and affirmed "the Bankruptcy Court's legal conclusion that, to constitute a default under § 365, a breach of an unexpired lease agreement must be sufficiently material to warrant the lease's termination under state law." ER 008:7-10. This legal test created and applied by the Bankruptcy Court and adopted and affirmed by the

District Court is erroneous. Smart Capital timely appeals the District Court Order to this Court. ER 208.

IV.

SUMMARY

Subject to court approval, a debtor-in-possession in chapter 11 may assume an unexpired lease pursuant to Section 365(a). See 11 U.S.C. §§ 365(a) and 1107. Additional requirements must be satisfied, including adequate assurance of future performance, when there has been a default under the lease. The text of Section 365(b)(1) is plain and clear: "If there has been a *default* in an…unexpired lease of the debtor, the trustee may not assume such contract or lease unless…" 11 U.S.C. § 365(b)(1) (emphasis added). See L.R.S.C. Co. v. Rickel Home Ctrs., Inc. (In re Rickel Home Ctrs., Inc.), 209 F.3d 291, 298 (3rd Cir. 2000) ("If there has been a default in an executory contract or unexpired lease, the trustee may not assume it until the trustee: (1) cures or provides adequate assurance that it will promptly cure the default; (2) compensates or provides adequate assurance of prompt future compensation for actual pecuniary loss resulting from the default; and (3) provides adequate assurance of future performance under the contract or lease. 11 U.S.C. § 365(b)(1)(A), (B), (C).").

This appeal arises from the Bankruptcy Court applying a new legal standard of its own creation in order for a default under a lease to constitute a

"default" under Section 365(b). This legal error resulted in the Bankruptcy Court depriving Smart Capital of its right to have the court consider and determine adequate assurance of future performance under the Lease before approving assumption. In affirming the Assumption Order, the District Court adopted the Bankruptcy Court's test that in order for a default under a lease to be a "default" under Section 365(b)(1), the breach must rise to a level that would warrant termination of the Lease under state law. Accordingly, both courts incorrectly equated an unlawful detainer proceeding under California law with a lease assumption matter under Section 365. Both courts erred as a matter of law by creating and applying an erroneous legal standard to define "default" under Section 365(b)(1) in conflict with the plain language of the statute.

"It is well established that 'when the statute's language is plain, the sole function of the courts--at least where the disposition required by the text is not absurd -- is to enforce it according to its terms." Lamie v. U.S. Tr., 540 U.S. 526, 534, 124 S. Ct. 1023, 1030 (2004). Notwithstanding the clear mandate to enforce the plain language of a statute, the lower courts here failed to apply the plain language of Section 365(b)(1) and follow precedent. Instead of following the cannons of statutory interpretation as set forth by this Court, the Bankruptcy Court departed from the statute's plan language and created, and District Court adopted, a new legal test to limit "default" under Section 365(b)(1) to only include those defaults which would serve to warrant termination of a lease in an unlawful detainer action under state law.

As established by precedent though, courts cannot rely on their equitable powers to create new legal standards for Section 365(b)(1) in contravention of the plain language of the Bankruptcy Code.

The failure to properly apply Section 365(b)(1) deprived Smart Capital of the protections afforded to it under Section 365(b)(1)(A)-(C), including the right to have the court consider and determine adequate assurance of future performance under the Lease (which the Bankruptcy Court failed to do). "Section 365(b) creates a significant, but limited, exception to the Bankruptcy Code's priority scheme. It allows the debtor's counterparty on an executory contract to demand the cure of any pre-petition defaults, as well as 'adequate assurance of future performance,' before that contract may be assumed. See 11 U.S.C. § 365(b)(1)(A)-(C)." Tutor Perini Bldg. Corp. v. N.Y. City Reg'l Ctr. (In re George Washington Bridge Bus Station Dev. Venture LLC), 2021 U.S. Dist. LEXIS 146040, *15 (S.D.N.Y. 2021). The Bankruptcy Court failed to consider and determine the requirement of adequate assurance of future performance prior to authorizing assumption of the Lease. Smart Capital requests that the Court reverse the District Court Order and remand the Lease Assumption Motion back to the Bankruptcy Court for further proceedings consistent with a proper application of the legal standard under Section 365(b)(1) to the facts of this case.

V.

STANDARDS OF REVIEW

The Ninth Circuit reviews "de novo a district court's judgment on appeal from a bankruptcy court" and applies "the same standard of review applied by the district court, reviewing the bankruptcy court's legal conclusions de novo and its factual determinations for clear error." In re Olshan, 356 F.3d 1078, 1082 (9th Cir. 2004) (internal case citations omitted). Mixed questions of law and fact are subject to de novo review. Murray v. Bammer (In re Bammer), 131 F.3d 788, 792 (9th Cir. 1997). "A mixed question of law and fact occurs when the historical facts are established; the rule of law is undisputed …and the issue is whether the facts satisfy the legal rule." Id. "Mixed questions presumptively are reviewed by us de novo because they require consideration of legal concepts and the exercise of judgment about the values that animate legal principles. Id.

No deference is given to the district court's decision, however. See AFI Holding, Inc. v. Mackenzie, 525 F.3d 700, 702 (9th Cir. 2008). And "[t]his court reviews de novo the bankruptcy court's interpretation of the bankruptcy code." Smith v. U.S. IRS (In re Smith), 828 F.3d 1094, 1096 (9th Cir. 2016) (internal citations omitted).

Issues on appeal nos. 1-5 address the lower courts' erroneous application of a legal standard in conflict with the Bankruptcy Code and are subject to de novo

review. Issues on appeal nos. 6-12 relate to whether the established facts at the Hearing show that there was a "default" under Section 365(b)(1) requiring consideration and determination of adequate assurance of future performance, assuming the correct legal test had been applied, and are therefore mixed questions of law and fact also subject to de novo review.

VI.

ARGUMENT

A. The Statutory Framework For Assuming An Unexpired Lease

Subject to court approval, a trustee may assume an unexpired lease pursuant to Section 365(a), which states:

> (a) 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.

11 U.S.C. § 365(a). In chapter 11, a debtor, acting as debtor-in-possession, has substantially similar rights and powers as a trustee. See 11 U.S.C. § 1107(a). The deadline for a debtor-in-possession, as a lessee, to assume a nonresidential lease is the earlier of one hundred twenty (120) days[3] or the date of entry of the plan confirmation order. Cukierman v. Uecker (In Re Cukierman), 265 F.3d 846, 849 (9th Cir. 2001); 11 U.S.C. § 365(d)(4)(A). "Until the trustee assumes or rejects an unexpired lease of

[3] Subject to extension under 11 U.S.C. § 365(d)(4)(B).

nonresidential real property, the trustee must perform obligations under that lease in accordance with 11 U.S.C. § 365(d)(3)." Cukierman, 265 F.3d at 849; Towers v. Chickering & Gregory (In re Pacific-Atlantic Trading Co.), 27 F.3d 401, 403 (9th Cir. 1994) (Section 365(d)(3) provides in relevant part that "[t]he trustee shall timely perform all the obligations of the debtor, except those specified in section 365(b)(2), arising from and after the order for relief under any unexpired lease of nonresidential real property, until such lease is assumed or rejected …."). The decision to assume a commercial lease is left to the business judgment of the debtor-in-possession. See also In re Pomona Valley Med. Group, Inc. 476 F.3d 665, 670 (9th Cir. 2007).

An important limitation on a debtor-in-possession's ability to assume a nonresidential lease is found in Section 365(c)(3), "The trustee may not assume … any… unexpired lease of the debtor… if… such lease is of nonresidential real property and has been terminated under applicable nonbankruptcy law prior to the order for relief." "The phrase 'applicable nonbankruptcy law' means applicable state law." In re Windmill Farms, Inc., 841 F.2d 1467, 1469 (9th Cir. 1988). Accordingly, in cases where there is a dispute about whether the lease has terminated (no such dispute existed in the instant case), courts apply the following test:

> We conduct a two-part inquiry to determine whether a particular lease may be assumed by the debtor-in-possession. First, we must determine whether the lease was terminated under applicable state law prior to the filing of the bankruptcy petition… Second, if we find that the lease was terminated, we must determine whether the termination could have been

> reversed under a state anti-forfeiture provision or other applicable state law.

In re Waterkist Corp., 775 F.2d 1089, 1091 (9th Cir. 1985) (citations omitted). If a lease has been terminated prepetition and relief from forfeiture under California law is unavailable, the subject lease cannot be assumed. "Simply put, if a lease of nonresidential real property has been terminated under state law before the filing of a bankruptcy petition, there is nothing left for the trustee to assume." Windmill Farms at 1469 (citation omitted); "If the contract had already terminated according to its terms, of course, the trustee would have nothing to assume." In re Sigel & Co., 923 F.2d 142, 145 (9th Cir. 1991), citing Moody v. Amoco Oil Co., 734 F.2d 1200, 1212-13 (7th Cir.), cert. denied 469 U.S. 982 (1984), and In re Bronx Westchester Mack Corp., 4 B.R. 730, 733 (Bankr. S.D.N.Y. 1980). While the lower courts treated the term "default" as if termination or forfeiture of the Lease were at issue in the underlying proceeding, they were not.

"Pursuant to § 365(b)(1)(A), if there has been a default in an unexpired lease of the debtor, the trustee may not assume such lease unless, at the time of assumption, the trustee: (1) cures or provides adequate assurance that it will promptly cure the default; (2) compensates or provides adequate assurance of prompt future compensation for actual pecuniary loss resulting from the default; and (3) provides adequate assurance of future performance under the lease." In re Filene's Basement, LLC, 2014 Bankr. LEXIS 2000, *32 (Bankr. D. Del. 2014), citing L.R.S.C. Co. v.

Rickel Home Centers, Inc. (In re Rickel Home Centers, Inc.), 209 F.3d 291, 298 (3d Cir. 2000), and 11 U.S.C. §365(b)(1). Section 365(b)(1) states:

> (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—
>
> (A) cures, or provides adequate assurance that the trustee will promptly cure, such default other than a default that is a breach of a provision relating to the satisfaction of any provision (other than a penalty rate or penalty provision) relating to a default arising from any failure to perform nonmonetary obligations under an unexpired lease of real property, if it is impossible for the trustee to cure such default by performing nonmonetary acts at and after the time of assumption, except that if such default arises from a failure to operate in accordance with a nonresidential real property lease, then such default shall be cured by performance at and after the time of assumption in accordance with such lease, and pecuniary losses resulting from such default shall be compensated in accordance with the provisions of this paragraph;
>
> (B) compensates, or provides adequate assurance that the trustee will promptly compensate, a party other than the debtor to such contract or 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.

11 U.S.C. § 365(b)(1). In Section 365(b)(2), the Bankruptcy Code enumerates certain limited exceptions to the term "default" used in Section 365(b)(1). The exceptions are defaults that are caused by a breach of a provision related to financial condition, the bankruptcy case, or the appointment of a trustee or custodian. 11 U.S.C. §

365(b)(2)(A)-(C). Moreover, Section 365(b)(1)(A) specifically exempts "a default that is a breach of a provision relating to the satisfaction of any provision (other than a penalty rate or penalty provision) relating to a default arising from any failure to perform nonmonetary obligations under an unexpired lease of real property, ..." 11 U.S.C. § 365(b)(1)(A); see also 11 U.S.C. § 365(b)(2)(D) (Providing for a carve-out from Section 365(b)(1) of "a default that is a breach of a provision relating to -- … the satisfaction of any penalty rate or penalty provision relating to a default arising from any failure by the debtor to perform nonmonetary obligations under the executory contract or unexpired lease."). There is no such carve-out for defaults under a lease that are not a basis for termination or forfeiture of the lease under state law as required under the novel legal test created and applied by the lower courts in this matter.

B. The Correct Meaning Of "Default" In Section 365(b)(1) Under Established Ninth Circuit Law

The Bankruptcy Court deprived Smart Capital of its right to have the court consider and determine adequate assurance of future performance under the Lease based on an erroneous application of the term "default" in Section 365(b)(1). The Bankruptcy Court stated that "[t]his motion to assume... the main question here, initially, is whether it is in default, and we would move on to other questions under 365 if a default is found[.]" ER 026:14-20. The Bankruptcy Court declined to move on to the other questions (i.e., adequate assurance of future performance) because it erred in rejecting the plain language of the statute and concluding that a default would

only be counted as "default" under Section 365(b)(1) only when it would warrant forfeiture or termination of the lease under state law. The District Court Order adopted the test the Bankruptcy Court created incorrectly circumscribing the meaning of "default" under Section 365(b)(1). ER 005-009.

1. Cannons for Interpreting the Bankruptcy Code

The Ninth Circuit recently had the opportunity to explain how courts should interpret the Bankruptcy Code. In Stevens v. Whitmore (In re Stevens), 15 F.4th 1214 (9th Cir. 2021), the Ninth Circuit applied the plain language of 11 U.S.C. § 554(c) in determining the meaning of the word "scheduled" as found in that statute. Id. at 1217. Section 554(c) states:

> Unless the court orders otherwise, any property scheduled under section 521(a)(1) of this title not otherwise administered at the time of the closing of a case is abandoned to the debtor and administered for purposes of section 350 of this title.

11 U.S.C. § 554(c). In Stevens, a dispute arose over whether a pending lawsuit was abandoned by the chapter 7 trustee per Section 554(c) after the case was closed. Id. at 1215-16. The lawsuit was not listed on the debtor's bankruptcy schedules, but it was disclosed in the Statement of Financial Affairs ("SOFA") and the trustee had actual knowledge of the lawsuit. Id. at 1216.

Determining the meaning of the word "scheduled" as found in Section 554(c), the Ninth Circuit began with the plain language of the Bankruptcy Code. "Because 'our inquiry begins with the statutory text, and ends there as well if the text

is unambiguous,' we start with the text of the Bankruptcy Code…And we read its words in context." Id. at 1217 (internal case citations omitted). This Court noted that "scheduled" was not defined by the Bankruptcy Code under Section 101 (definitions) so it turned to the ordinary meaning of the term when Congress enacted the statute. "When terms used in a statute are undefined, we give them their ordinary meaning… And we look to the ordinary meaning of the term when Congress enacted the statute." Id. (citations omitted). The Court applied the "established canon of construction that similar language contained within the same section of a statute must be accorded a consistent meaning." Id. at 1218 (citations omitted). The Court looked to neighboring provisions that used the word "schedule" and applied the following cannon of statutory construction, "When we read a statute as a whole and see that it uses nearly identical terms in different places, we give those terms similar meanings." Id. at 1218 (citations omitted). Applying these rules of statutory interpretation, the Ninth Circuit held that, "absent Trustee or court action, to be abandoned under § 554(c), property must be scheduled on a schedule, not just listed on the SOFA." Id. at 1217.

The cannons of statutory interpretation set forth by the Ninth Circuit in Stevens are consistent with the prior rulings of the U.S. Supreme Court and this Court regarding the proper interpretation of the Bankruptcy Code. "It is well established that 'when the statute's language is plain, the sole function of the courts--at least where the disposition required by the text is not absurd -- is to enforce it according to its terms."

Lamie v. U.S. Tr., 540 U.S. 526, 534, 124 S. Ct. 1023, 1030 (2004); Blausey v. U.S. Tr., 552 F.3d 1124, 1132 (9th Cir. 2009) (citing Lamie v. U.S. Tr.) (interpreting the term "income" in 11 U.S.C. § 101(10A)). "We cannot ignore the plain and ordinary meaning of the words actually used by Congress… In fact, if the language of a statute is clear, we look no further when we seek to ascertain its meaning." Salazar v. McDonald (In re Salazar), 430 F.3d 992, 995 (9th Cir. 2005) (citations omitted) (interpreting the term "deposit" found in 11 U.S.C. § 507(a)(6)). See also U.S. v. Ron Pair Enter., Inc., 489 U.S. 235, 242, 109 S. Ct. 1026 (1989) ("The plain meaning of legislation should be conclusive, except in the 'rare cases [in which] the literal application of a statute will produce a result demonstrably at odds with the intentions of its drafters.'") (quoting Griffin v. Oceanic Contractors, Inc., 458 U.S. 564, 571, 102 S. Ct. 3245 (1982)).

In an analogous analysis of a word appearing in Section 365, the Seventh Circuit stated that "[w]hether the word "lease" in a federal statute [Section 365] has a formal or a substantive connotation is a question of federal law; it could not be otherwise." United Airlines, Inc. v. HSBC Bank USA, N.A., 416 F.3d 609, 612 (7th Cir. 2005), citing Reves v. Ernst & Young, 494 U.S. 56, 71, 110 S. Ct. 945 (1990), and Bryant v. Yellen, 447 U.S. 352, 370-71, 100 S. Ct. 2232 & n. 22 (1980). Here, the lower courts incorrectly and unnecessarily turned to state law, instead of applying the plain meaning of the statute. Further, as discussed below, the lower courts

erroneously failed to recognize that even under California law, upon which they purported to rely, there are defaults under a lease that do not warrant forfeiture or termination.

2. The Proper Application of "Default" in Section 365(b)(1)

Had the Bankruptcy Court and District Court followed Stevens, they would have reached a different legal conclusion regarding the meaning of "default" in Section 365(b)(1). First, "default" is not defined in Section 101 of the Bankruptcy Code, just like Stevens. The lower courts should have applied the "ordinary meaning of the term when Congress enacted the statute." Stevens, 15 F.4th at 1217-18. As the Ninth Circuit has done, the District Court should have determined the ordinary meaning of the term by beginning with the dictionary definition of the word. See Stevens, 15 F.4th at 1217-18 (reviewing Webster's New World Dictionary and Oxford Compact Dictionary); Salazar, 430 F.3d at 995 (turning to Black's Law Dictionary, Webster's Second Int'l Dictionary, Webster's Third New Int'l Dictionary, and Encarta World English Dictionary); Blausey, 552 F.3d at 1133 (citing Webster's Third New International Dictionary and Black's Law Dictionary).

A default is "[a]n omission of that which ought to be done… Specifically, the omission or failure to perform a legal duty…. to observe a promise or discharge an obligation, or to perform an agreement[.]" Black's Law Dictionary 505 (4th ed. 1968). Webster's defines default as, "failure to do something required by duty or law[.]"

Merriam-Webster Dict. Online (2022), https://www.merriam-webster.com/dictionary/default [as of Jan. 22, 2022]. "Fault, neglect, omission, the failure to perform a duty or obligation; the failure of a person to pay money when due or when lawfully demanded." Ballentine's Law Dictionary (3rd ed. 2010). The term "default" is defined as, "a flexible term for the omission of that which a person ought to do." The Law Dictionary (7th ed. 2002). See In re Metromedia Fiber Network, Inc., 335 B.R. 41, 49 (Bankr. S.D.N.Y. 2005) (turning to Black's Law Dictionary and Webster's Collegiate Dictionary, and finding "default" to mean the "failure to perform or fulfill some obligation or duty imposed by law and contract). In short, the ordinary meaning of the term "default" means the failure to perform any duty or obligation, and for Section 365(b)(1) purposes, means the failure to perform any duty or obligation in the subject unexpired lease to be assumed. The proper legal standard for "default" in a lease under Section 365(b)(1) is not limited to those warranting forfeiture or termination of the lease.

The Bankruptcy Appellate Panel for the Ninth Circuit ("BAP") has previously supported this interpretation of the word "default" in Section 365(b)(1). In ECPG (Peoria) Assocs. Ltd. Pshp. v. Bldg. Block Child Care Ctrs., Inc. (In re Bldg. Block Child Care Ctrs., Inc.), 234 B.R. 762, 765 (B.A.P. 9th Cir. 1999), the BAP examined whether "the debtor was required under § 365 to cure prepetition defaults owed to a former landlord in order to assume its lease with a successor landlord,

where the former landlord specifically retained the right to receive cure payments upon assumption." The BAP analyzed the word "default" within that context and rejected any argument that "grafted" a distinction into the statute with regard to defaults owed to former or current landlords because the "plain language of § 365(b)(1)(A) contains no distinction between 'former' and 'current' landlords[.]" Id. at 766. The BAP found that "[t]he language of § 365(b)(1) clearly and unambiguously requires the cure of ***all defaults*** before a lease may be assumed," including those defaults owed to former landlords. Id. at 765 (emphasis added). Notably, in reversing the bankruptcy court's order, the BAP did not require the debtor to only cure those defaults owed to the former landlord that rose to the level of lease forfeiture or termination under state law, and lease forfeiture and termination were not even mentioned in the decision.

Further support for this understanding of "default" is found within the context of Section 365(b)(1): "If there has been a default *in an…unexpired lease* of the debtor, the trustee may not assume such contract or lease unless…" 11 U.S.C. § 365(b)(1) (emphasis added). The plain language of the Bankruptcy Code here directs courts inquiring whether there has been a default to look "in" the unexpired lease. There is no qualifying language here that any default in the underlying unexpired lease can only be considered for Section 365(b)(1) purposes if the default rises to the level of lease forfeiture or termination under state law. Further, the statutory

language applies if there has been a default, regardless of when that default existed or is continuing.

This interpretation of the term "default" comports with the legislative history of Section 365(b)(1) in which Congress stated, "Subsection (b) requires the trustee to cure ***any default*** *in the* contract or *lease* and to provide adequate assurance of future performance if there has been a default, before he may assume." 1 Collier Pamphlet Edition 11 U.S.C. § 365 (2021) [Senate Report No. 95-989, 95th Cong., 2d Sess. 58–59 (1978)] (emphasis added). Here, the landlord was erroneously stripped of its right to have the court consider and determine adequate assurance of future performance under the Lease because the bankruptcy court applied an incorrect legal standard. This resulted in the court ignoring the plain language of the Bankruptcy Code and the defaults under the Lease, including the late payment of rent, that the court concluded would not warrant forfeiture of termination of the Lease in a state court unlawful detainer action.

The lower courts' application of an erroneous legal standard in conflict with the plain language of the statute compels reversal and remand. As the leading bankruptcy law treatise Collier explains:

> Section 365(b) applies to contracts for which default has occurred either before or after the commencement of the case. The other party to the contract or lease that the trustee proposes to assume is entitled to insist that ***any defaults***, whenever they may have occurred, be cured, that appropriate compensation be provided, and that, a past default having occurred, adequate assurance of future performance is available.

3 Collier on Bankruptcy P 365.06 (16th Ed. 2021)(citations omitted, emphasis added).

That Congress intended the term "default" to mean "any default" is further supported by reading Section 365(b)(1) in context alongside Section 365(b)(2). In Section 365(b)(2), Congress carved out a limited number of defaults that do not constitute "defaults" under Section 365(b)(1). See 11 U.S.C. § 365(b)(2) ("Paragraph (1) of this subsection does not apply to a default that is a breach of a provision relating to…"); In re Senior Care Ctrs., LLC, 607 B.R. 580, 588 (Bankr. N.D. Tex. 2019) ("…Congress enumerated in § 365(b)(2) specific instances which do not constitute a default under § 365(b)(1)[.]"). As stated above, these limited exceptions include: (A) insolvency or financial condition of the debtor; (B) commencement of the bankruptcy case; (C) appointment of a trustee or custodian; and (D) a penalty or penalty rate relating to a default arising from failure to perform nonmonetary obligations. 11 U.S.C. § 365(b)(2)(A)-(D).

There is no exception identified in the statute for defaults that do not warrant forfeiture or termination of the lease under state law. Nor is there any other basis for such an exception. Accordingly, under the plain language of Section 365(b), any default of an unexpired lease that is not a "breach of a provision relating to" the specific items listed under Section 365(b)(2), is a default under Section 365(b)(1).

C. The District Court Committed Reversible Legal Error By Adopting The Bankruptcy Court's Test Incorrectly Limiting A "Default" In Section 365(b)(1)

The analysis under Section 365(b)(1) is not triggered unless there has been a "default": "*If* there has been a *default* in an…unexpired lease of the debtor, the trustee may not assume such contract or lease unless…" 11 U.S.C. § 365(b)(1) (emphasis added). This initial step was recognized by the District Court as it stated in its order that "if a 'default' has occurred on the executory contract or unexpired lease, then the debtor in possession must provide certain cures and assurances before it may assume the contract or lease …." ER 006:1-4. The District Court veered off course, however, by adopting and affirming "the Bankruptcy Court's legal conclusion that, to constitute a default under § 365, a breach of an unexpired lease agreement must be sufficiently material to warrant the lease's termination under state law." ER 008:7-10. This constitutes reversible legal error because, as explained above by the Ninth Circuit in Stevens, the District Court was required to apply the ordinary meaning of "default." The definition adopted by the District Court is anything but the ordinary meaning of the term "default," as discussed below, and this approach adopted by the lower courts is inconsistent with the limited exceptions set forth in the statute itself.

1. Legal Error- Failure to Follow Cannons of Statutory Interpretation

Both the District Court and Bankruptcy Court failed to follow the cannons of statutory interpretation as explained by Stevens to interpret the term

"default" in Section 365(b)(1). Rather than enforce the plain language of the Bankruptcy Code, both courts immediately turned to state law to interpret the term "default" without any analysis or application of the cannons of statutory interpretation of the Bankruptcy Code. Ignoring Smart Capital's argument that the plain language of the statute should be applied, the District Court asserted that, "in the absence of any authority by Smart Capital that the court is precluded from looking to state law here, the court will look to California law to construe the term 'default.' " ER 008:24-26, 026:21-027:25. The District Court's reasoning was incorrect because it chose to adopt the Bankruptcy Court's test in conflict with the plain language of the statute. Further, authority regarding the proper interpretation of the Bankruptcy Code exists in Stevens, Salazar, and Blausey, and a court's interpretation of the Bankruptcy Code is reviewed de novo. This alone was reversible legal error.

2. Legal Error- Reasoning Based on Reliance on Inapplicable Case Law

A second legal error was committed by the District Court because its legal relied on cases that actually don't support its position that "state law is to be applied in the interpretation of undefined terms in § 365", rather than enforcing the plain language of the Bankruptcy Code. ER 008:11-12. The Bankruptcy Court committed the same legal error because both lower courts relied on the same case law. ER 026:21-027:25. As explained below, the cases cited by the District Court are

inapplicable under Section 365(b)(1) analysis; instead, this case law addresses Windmill Farms situations in which courts must determine whether an unexpired lease terminated prepetition. Prepetition termination of the Lease was not was not at issue in connection with the Lease Assumption Motion.

By way of brief summary,[4] a trustee may not assume an unexpired lease of the debtor if the lease has been terminated before the bankruptcy case, and to determine whether a lease was terminated prepetition, courts turn to state law including anti-forfeiture laws. See In re Windmill Farms, Inc., 841 F.2d 1467, 1469 (9th Cir. 1988). Unlike Windmill Farms, however, in this case, the prepetition termination of the Lease was never asserted or at issue during the Lease Assumption Motion nor raised by Smart Capital in its opposition. See generally ER 091-164 (Hearing Briefs). As a result, no sort of Windmill Farms analysis of anti-forfeiture statutes was ever required. Moreover, as the Seventh Circuit has explained, "[s]tate procedures do not matter in bankruptcy. State law defines property rights, but federal law prescribes the hoops through which the litigants must jump. California could not enact a law saying: '§ 365 always must be applied to documents with the form of leases unless the debtor takes specified steps before entering bankruptcy.'" United Airlines, Inc. v. HSBC Bank USA, N.A., 416 F.3d at 617-18. Similarly, the meaning

[4] Windmill Farms was discussed in greater detail above in Section VI.A.

of "default" under Section 365(b) is not defined by and limited to those defaults warranting lease forfeiture or termination in California unlawful detainer proceedings. If that was the correct approach, "default" in Section 365(b) could mean something different depending on what state law was being applied to govern the federal Bankruptcy Code term "default" in Section 365(b). This could eliminate any semblance of uniformity in this federal bankruptcy law provision. See U.S. CONST. art. I, § 8, cl. 4 (The Congress shall have power "[t]o establish … uniform laws on the subject of Bankruptcies throughout the United States."); see also, e.g., Reves v. Ernst & Young, 494 U.S. 56, 71, 110 S. Ct. 945, 954 (1990) ("We are unpersuaded that Congress intended the Securities Acts to apply differently to the same transactions depending on the accident of which State's law happens to apply.").

Yet, the District Court relied on cases dealing with Windmill Farms analysis that were irrelevant for interpreting "default" in Section 365(b)(1). First, the District Court cited the following language in a footnote in In re Cochise Coll. Park, Inc., 703 F.2d 1339, 1348 n. 4 (9th Cir. 1983): "Although whether a given contract is 'executory' under the Bankruptcy Act is an issue of federal law … the question of the legal consequences of one party's failure to perform its remaining obligations under a contract is an issue of state contract law." ER 008:12-17.

As a preliminary point, Cochise was not a lease assumption case. It dealt with an executory contract, not an "unexpired lease" as was the case here. In any

event, the District Court reliance on this case was incorrect. The analysis in *Cochise* involved whether an executory contract existed, which required an analysis of whether a breach by one side excused the obligations by the other. On that issue, the *Cochise* court stated that the way to determine if a contract is executory is to determine if, under applicable state law, a failure to perform by one side would give rise to a material breach excusing performance by the other party. *Cochise*, *supra* at 1348. This analysis is analogous to the legal issue addressed in Windmill Farms - determining whether the unexpired lease (or executory contract) terminated prepetition. While the existence of underlying property rights are correctly determined by state law, that is not at issue in the appeal. At the heart of this appeal is the correct application of the term "default" under Section 365(b) and not the existence, forfeiture or termination of property rights determined by state law. Nonetheless, the lower courts misguidedly relied on decisions involving determining property rights and not applying plain language of the Bankruptcy Code.

In addition, the other cases cited by the District Court lend no support for the erroneous legal test created by the Bankruptcy Court limiting the term "default" under Section 365(b). First, Super Nova 330 LLC v. Gazes, 693 F.3d 138, 145 (2d Cir. 2012), held "that a lease is 'unexpired' for purposes of [Section 365(d)(3)] of the Bankruptcy Code where the tenant has the power to revive the lease under applicable state law." (internal citations omitted). This is squarely within a Windmill Farms

analysis of determining whether a lease had was terminated prepetition and therefore no longer was in existence, and is inapplicable here. The District Court's citation to Brattleboro Hous. Auth. v. Stoltz (In re Stoltz), 197 F.3d 625, 629 (2d Cir. 1999), for the proposition that property interests are created by state law is also misplaced because Hawkeye's property rights were not at issue in this case since Smart Capital never argued that the Lease and/or Hawkeye's interest in the Lease was terminated, forfeited, or was not property of the bankruptcy estate.

The state law cases relied upon by the District Court evidence the lower courts' error in equating the lease assumption matter at issue to an unlawful detainer proceeding under California law. Like Windmill Farms, these cases are not applicable here because they involved whether breaches rose to the level of lease forfeiture or termination, which is what is at issue in an unlawful detainer action. See Superior Motels, Inc. v. Rinn Motor Hotels, Inc., 195 Cal. App. 3d 1032, 241 Cal. Rptr. 487 (1987) (explaining materiality requirement on defaults in unlawful detainer actions because the harsh remedy – termination -- is final and affords the tenant no opportunity to cure); NIVO 1 LLC v. Antunez, 217 Cal. App. 4th Supp. 1, 5, 159 Cal. Rptr. 3d 922 (2013) ("The law sensibly recognizes that although every instance of noncompliance with a contract's terms constitutes a breach, not every breach justifies treating the contract as terminated."). As this Court explained in Windmill Farms, such reference to state law is relevant for determining whether a lease has terminated

prepetition under Section 365(c)(3) and that statute specifically references state law as "applicable nonbankruptcy law." Id. at 1469. Section 365(c)(3) was never at issue, however, in connection with the Lease Assumption Motion.

Under California law, "[t]he unlawful detainer act governs the procedure for landlords and tenants to resolve disputes about who has the right to possess real property." Stancil v. Superior Court, 11 Cal. 5th 381, 394 (2021). The right to possess the real property, forfeiture, and termination of the Lease, however, were never at issue before the Bankruptcy Court or the District Court in the instant matter. Thus, the District Court based its legal reasoning on case law that was inapplicable in this matter. The District Court's legal conclusion that "to constitute a default under § 365, a breach of an unexpired lease agreement must be sufficiently material to warrant the lease's termination under state law" was reversible legal error because state law regarding termination of a lease in an unlawful detainer action has no applicability to a lease assumption matter in bankruptcy court and does not supersede the plain language of Section 365(b)(1).

D. The Lower Courts Erred By Creating And Adopting A New Legal Standard For Section 365(b)(1)

The Bankruptcy Court and the District Court committed further legal error by creating and adopting a new legal standard for Section 365(b)(1). The lower courts lack the authority to contravene the specific language of the Bankruptcy Code and cannot engage in the type of "common lawmaking" the Supreme Court warned

against in FDIC v. Rodriguez, 140 S. Ct. 713, 716, 206 L. Ed. 2d 62, 65 (2020) ("The cases in which federal courts may engage in common lawmaking are few and far between."). Both the District Court and Bankruptcy Court unjustifiably injected equitable considerations into this matter by introducing the constrained concept of "materiality" into their analysis and adopting the following definition: "to constitute a default under § 365, a breach of an unexpired lease agreement must be sufficiently material to warrant the lease's termination under state law." ER 008:7-10, 009:5-9, 019:20-21, 027:4-18. By finding that the defaults that Smart Capital identified did not rise to the level of lease forfeiture, i.e., it would be inequitable to forfeit or terminate the Lease (neither of which was sought by Smart Capital nor was at issue in the lease assumption matter) based on the identified defaults, the lower courts created a new equitable legal standard for "defaults" in Section 365(b)(1). ER 031:1-4 ("So, even if it could be considered a default…it certainly doesn't justify forfeiture of the lease on that kind of technicality, also where no harm has been shown."); 042:13-15 ("It's not of any significance that can be warranted forfeiting the lease. It's just hard to (indiscernible) this kind of material."); 068:7-12 ("That's a pretty minor issue that could have been worked out, in light of all these issues, to forfeit a lease of this magnitude…"). Once again, it should be noted that the question of forfeiture or termination of the Lease was never at issue in the lease assumption matter that is the subject of this appeal.

This was reversible error because equity cannot be used to contravene the plain language of the Bankruptcy Code. See Law v. Siegel, 571 U.S. 415, 421, 134 S. Ct. 1188, 1194 (2014) ("We have long held that "whatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of" the Bankruptcy Code."); Lamie v. U.S. Tr., 540 U.S. 526, 538, 124 S. Ct. 1023, 1032 (2004) ("Our unwillingness to soften the import of Congress' chosen words even if we believe the words lead to a harsh outcome is longstanding. It results from "deference to the supremacy of the Legislature, as well recognition that Congressmen typically vote on the language of a bill.") (internal citations omitted); In re Shoreline Concrete Co., 831 F.2d 903, 905 (9th Cir. 1987) ("It is true that bankruptcy courts sit as courts of equity…However, a fundamental principle of equity jurisprudence is that 'equity follows the law.' ").

Specifically rejecting any contention that equitable considerations are relevant when interpreting the term "default" in Section 365(b)(1), the BAP stated:

> Contrary to the debtor's assertion in the proceedings below, a bankruptcy court's status as a court of equity ***does not entitle it to elevate equitable considerations over the clear dictates of the Code.*** *See U.S. v. Ron Pair Enterprises*, 489 U.S. 235, 242, 103 L. Ed. 2d 290, 109 S. Ct. 1026 (1989)(stating that "The plain meaning of legislation should be conclusive, except in the "rare cases [in which] the literal application of a statute will produce a result demonstrably at odds with the intentions of its drafters." (citation omitted)).

Bldg. Block Child Care, 234 B.R. at 765 (emphasis added); In re: Senior Care Ctrs., LLC, 607 B.R. 580, 588 (Bankr. N.D. Tex. 2019) (holding that that materiality is not a

factor under Section 365(b)(1) and that the word "material" does not appear in the statute and Congress enumerated in Section 365(b)(2) specific instances which do not constitute a default).

Imposing a new, judicially-created equitable legal standard to limit "defaults" in Section 365(b)(1) not only contravenes the plain language of the Bankruptcy Code, it also prejudice lessors and negates the balance that Congress intended to strike between the interests of debtors and lessors in Section 365(b)(1):

> As the BAP stated, "the purpose behind § 365 is to balance the state law contract right of the creditor to receive the benefit of his bargain with the federal law equitable right of the debtor to have an opportunity to reorganize."…Section 365, in conjunction with the automatic stay provision of section 362, accordingly suspends, once the bankruptcy petition is filed, the termination of a lease that is in default; it extends a debtor lessee's opportunity to cure any defaults until the debtor has the chance to decide whether to assume the lease….The lessor will then get the benefit of its bargain upon assumption, when the debtor lessee must cure the defaults. See 11 U.S.C. § 365(b)(1).

Coleman Oil Co. v. Circle K Corp. (In re Circle K Corp.), 127 F.3d 904, 909 (9th Cir. 1997) (internal, case citations omitted). By enacting subsections (A)-(C) of Section 365(b)(1), Congress provided a specific remedy for debtors who have defaulted under an unexpired lease to nonetheless still be able to assume the lease as long the requirements of subsections (A)-(C) are met. See Tutor Perini Bldg. Corp. v. N.Y. City Reg'l Ctr. (In re George Washington Bridge Bus Station Dev. Venture LLC), 2021 U.S. Dist. LEXIS 146040, *17 (S.D.N.Y. 2021) ("*Subparagraphs (A) through (C) of § 365(b)(1)* each provide for a distinct type of

relief to which the counterparty is entitled before the debtor assumes the contract: cure of defaults, pecuniary compensation, and adequate assurance of future performance.").

E. Alternatively, Even If State Law Is Applied, The Lower Courts Erred By Equating The Lease Assumption Motion To An Unlawful Detainer Action And Misinterpreting The Term "Default" Even Under California Law

Smart Capital's primary contention is that, as matter of law, because there is no ambiguity in the term "default" in Section 365(b)(1), courts should enforce the plain language of Section 365(b)(1) and not turn to state law to interpret "default." Had the lower courts properly applied the plain language of the Bankruptcy Code in this case, they would not have interpreted "default" to mean only those defaults that rise to the level of lease forfeiture or termination in an unlawful detainer action under California law. They would have interpreted it to mean any default under the Lease. The lower courts erred in this case by equating and limiting a "default" under state law and, in turn, under Section 365(b), to those that would warrant lease termination or forfeiture in an unlawful detainer action under California law. However, as the court points out in Boston LLC v. Juarez, 245 Cal. App. 4th 75, 83 (2016), "'[e]very default by a tenant does not necessarily justify the landlord's termination of the tenancy,' and this 'is especially true when the breach involves a nonmonetary covenant in the lease.' (10 Miller & Starr, supra, § 34:181, p. 34-565.) Witkin concurs that a '[s]ubstantial [b]reach [i]s [r]equired' to invoke a 'forfeiture clause.' (12 Witkin, Summary of Cal.

Law (10th ed. 2005) Real Property, § 668, p. 785, italics omitted; id. (2015 Supp.) § 668, p. 159, citing NIVO 1, at p. Supp. 4.)."

In the event the Court disagrees with Smart Capital and believes that reference to state law is required for application of the term "default" in Section 365(b), the end result should nonetheless be the same and should result in reversal and remand in this appeal. In that scenario, the District Court and Bankruptcy Court still committed legal error by equating the Lease Assumption Motion to an unlawful detainer action under state law and failing to apply the plain meaning of the term "default" even under California unlawful detainer law. The limited definition of the term adopted by the lower courts in this case actually arises in the context of an equitable defense to lease forfeiture *after* a finding of a default in unlawful detainer actions. Accordingly, even under California law, upon which the lower courts purport to rely, there are defaults under a lease that do not warrant forfeiture or termination. The Bankruptcy Court and the District Court failed to recognize this distinction.

In unlawful detainer matters under Code of Civil Procedure ("CCP") § 1161, California courts distinguish between defaults that rise to the level of lease forfeiture or termination and defaults that do not based on an *equitable defense* to lease forfeiture in unlawful detainer actions. See Stancil v. Superior Ct., 11 Cal. 5th 381, 395 (2021) ("Section 1161 specifies a tenant of real property is guilty of unlawful detainer only in specific circumstances, …"); Boston LLC v. Juarez, 245 Cal. App.

4th 75, 82 (2016) ("Although not expressly set forth in Code of Civil Procedure section 1161, subdivision 3, the requirement that a breach be substantial is set forth in case law… That is, whether a particular breach will give a plaintiff landlord the right to declare a forfeiture is based on whether the breach is material.") (cleaned up) (citations omitted). And as mentioned above, such lease forfeiture and equitable defense considerations may have been appropriate under a Windmill Farms analysis if prepetition lease termination under Section 365(a) and (c)(3) were at issue in this case. But it wasn't.

"Because an unlawful detainer involves forfeiture of the right to remain in a home [or other premises], not only must the eviction statutes be construed with exactitude, but the right to evict must also be governed by equitable principles. Bawa v. Terhune, 33 Cal. App. 5th Supp. 1, 8 (2019) (citing Strom v. Union Oil Co. (1948), 88 Cal.App.2d 78, 82 (1948)). "Forfeitures are disfavored by courts, and contractual provisions 'must be strictly interpreted against the party for whose benefit it is created." Bawa v. Terhune, 33 Cal. App. at 8 (citing Boston LLC v. Juarez, 245 Cal.App.4th at 85, and Cal. Civ. Code, § 1442). Accordingly, in the context of breaches of contractual requirements, California law "recognizes that although every instance of noncompliance with a contract's terms constitutes a breach, not every breach justifies treating the contract as terminated." Boston LLC v. Juarez, 245 Cal. App. 4th at 82 (citation omitted). "Following the lead of the Restatements of

Contracts, California courts allow termination only if the breach can be classified as 'material,' 'substantial,' or 'total.'" Id. (citation omitted). Thus, even under California unlawful detainer law, the definition of the term "default" adopted by the lower courts in this case ("a breach of an unexpired lease agreement must be sufficiently material to warrant the lease's termination under state law") is not the definition of the term "default" in unlawful detainer actions warranting termination or forfeiture, but simply an equitable defense to lease termination as discussed above. See Bawa v. Terhune, 33 Cal. App. 5th Supp. at 8; Superior Motels, Inc. v. Rinn Motor Hotels, Inc., 195 Cal. App. 3d 1032, 1051 (1987) (The law sensibly recognizes that although *every instance of noncompliance with a contract's terms constitutes a breach*, not every breach justifies treating the contract as terminated.") (emphasis added); ER 008:7-10. Instead, California law recognizes that "default" in the unlawful detainer statute of CCP § 1161 means any default under the subject lease:

> The word "default" is not defined by the statute. But, given the context in which it is used, it is apparent the common definition, "failure to do something required by duty or law," was intended. (Merriam-Webster Dict. Online (2019) http://www.merriam-webster.com/dictionary/default [as of Jan. 30, 2019]; accord, Oxford English Dict. Online (2019) <http://www.oxforddictionaries.com/ definition/english/default> [as of Jan. 30, 2019]; see *People v. Whitlock* (2003) 113 Cal.App.4th 456, 462 [6 Cal. Rptr. 3d 389] ["To ascertain the common meaning of a word, 'a court typically looks to dictionaries'"].) A tenant has a duty to timely pay rent, and when the tenant fails to do so, the tenant defaults in the duty.

Bawa v. Terhune, 33 Cal. App. 5th Supp. 1, 6 (2019) (interpreting the term "default" in the phrase "after default in the payment of rent" found in CCP § 1161(2) (internal

citations omitted); See also IKON Bus. Sols., Inc., 94 Cal. App. 4th 130, 143 (2001) ("The word 'default' has both a broad meaning and a narrow meaning. Broadly, a 'default' is 'the omission or failure to perform a legal or contractual duty . . . .'…" (Black's Law Dict. (7th ed. 1999) p. 428.) Narrowly, the word 'default' refers to a defendant's failure to answer a complaint.") (analyzing the term "default" within the context of CCP § 473(b)) (citations omitted). Thus, like federal courts, California courts apply the ordinary meaning of a term in a statute. Accordingly, to the extent reference to California law is necessary and appropriate to determine term "default" in Section 365(b)(1), the lower courts' limiting "default" to those that warranted forfeiture in an unlawful detainer action was also in conflict with California law and erroneous.

F. Under A Proper Application Of Section 365(b)(1), The Lower Courts Erred By Finding That There Was No Default Of The Lease And Granting The Assumption Motion Without Even Considering Adequate Assurance Of Future Performance

Turning to statement of issues nos. 6-12, as explained above, the proper interpretation of the term "default" in Section 365(b)(1) is *any* default under the terms of the Lease without regard to whether those defaults rise to level of lease forfeiture under state law. In other words, if there is any default under the Lease, there has been a "default" under Section 365(b)(1) triggering the assuming party's burden of proof to satisfy Section 365(b)(1)(A)-(C). Broadly stated, Section 365(b)(1)(A)-(C) requires a debtor to satisfy three additional requirements if there has been a default in the

unexpired lease: cure, compensation, and adequate assurance of future performance the lease. 11 U.S.C. § 365(b)(1)(A)-(C).

In this case, the record below establishes that the Bankruptcy Court actually found that defaults under the Lease had occurred. Thus, the requirements of Section 365(b)(1)(A)-(C) should have been triggered, but because the Bankruptcy Court applied a legal standard of its own creation, limiting the term "default" in Section 365(b)(1), it never conducted the required analysis of Section 365(b)(1)(A)-(C). The District Court made the same error by adopting the Bankruptcy Court's test and affirming the Bankruptcy Court. This was legal error by the lower courts because each applied the wrong legal standard to the factual findings of this case warranting reversal of the District Court Order and remand to the Bankruptcy Court.

For example, it is undisputed that Hawkeye paid its April 2020 rent late--on April 30, 2020 instead of April 1, 2020. This is a default under the Lease which requires, in Article 6.1 of the Lease, for rent to be paid on or before the first day of each month. ER 171. The Bankruptcy Court made the factual finding that such default had occurred. ER 029:22-25 ("The first one, which is more clear-cut, and the evidence is undisputed, is that the Debtor failed to pay the rent by -- the April rent by the 4th day of April."). Additionally, a late payment on the Lease triggers a 4% late payment penalty, as set forth in Article 6.6 of the Lease. ER 029:25-030:2. When Hawkeye made its April 30, 2020 late rent payment, Hawkeye paid the base rent

amount but failed to pay this additional 4% amount. Hawkeye paid this late fee months later only after Smart Capital noted in its trial brief that Hawkeye breached the Lease by not paying this amount. ER 030:4-7. And any argument to the contrary by Hawkeye regarding the factual finding is barred since neither Hawkeye has not appealed the Bankruptcy Court's underlying factual findings. In any event, the lower courts applied the incorrect law to the Bankruptcy Court's factual findings.

Further, it should be noted that in addition to late payment constituting a default under the Lease in accordance with the terms of the Lease, the Bankruptcy Code requires timely postpetition payments under a real property lease. Section 365(d)(3) requires that "[t]he trustee shall timely perform all the obligations of the debtor, except those specified in section 365(b)(2), arising from and after the order for relief under any unexpired lease of nonresidential real property, until such lease is assumed or rejected." 11 U.S.C. § 365(d)(3). See Cukierman v. Uecker (In re Cukierman), 265 F.3d 846, 850-51 (9th Cir. 2001) ("A broad interpretation of this provision is consistent with the purpose of § 365(d)(3), which is to ensure immediate payment of lease obligations so that the landlord is not left providing uncompensated services. This purpose is evident from the legislative history of the section, which was added to the Bankruptcy Code by the Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98 Stat. 333 (1984)."); Einstein/Noah Bagel Corp. v. Smith (In Re BCE West, L.P.), 319 F.3d 1166, 1171 (9th Cir. 2003).

A primary ramification of the lower courts creating and applying an incorrect legal standard was that Smart Capital was stripped of its right to have the Bankruptcy Court consider and determine adequate assurance of future performance under the Lease. Remand will remedy this deprivation of Smart Capital's rights under Section 365(b)(1). Further, reversal and remand will provide an opportunity for the Bankruptcy Court to apply the correct legal standard to its factual findings regarding the defaults that Smart Capital identified, including (in addition to failure to timely pay rent) Hawkeye's failure to sign an estoppel certificate, failure to carry adequate insurance, allowing the Leased Premises to be used for a purpose outside of the scope of use set forth in the Lease, and Hawkeye serving alcohol improperly on the ground floor of the Leased Premises. Remanding the case will further ensure that the balance between debtors and lessors that Congress intended to strike is kept in this case, and that Smart Capital receives the benefit of its bargain by ensuring that Hawkeye satisfies the requirements of Section 365(b)(1)(A)-(C). See Coleman Oil Co. v. Circle K Corp. (In re Circle K Corp.), 127 F.3d 904, 909 (9th Cir. 1997) ("The lessor will then get the benefit of its bargain upon assumption, when the debtor lessee must cure the defaults [and provide adequate assurance of future performance]. See 11 U.S.C. § 365(b)(1).").

VII.

CONCLUSION

Rejecting the plain language of the statute, the Bankruptcy Court applied a new legal standard of its own creation that erroneously limited the term "default" under Section 365(b) of the Bankruptcy Code. This error was perpetuated by the District Court when it adopted the Bankruptcy Court's legal test that in order for a default under a lease to be a "default" under Section 365(b)(1), the breach must rise to a level that would warrant forfeiture or termination of the Lease under state law. In addition to being contrary to the plain language of the statute, the use of the legal standard applied by the lower courts is inconsistent with the limited specified exceptions to default set forth in Section 365(b)(2).

The fundamental legal error of applying an incorrect and circumscribed legal standard resulted in the Bankruptcy Court depriving Smart Capital of its right, among other things, to have the court consider and determine adequate assurance of future performance under the Lease before approving assumption. 11 U.S.C. § 365(b)(1)(A)-(C). The lower courts incorrectly equated an unlawful detainer proceeding under California law with a lease assumption matter under Section 365. Both courts erred as a matter of law by creating and applying an erroneous legal standard to define "default" under Section 365(b)(1) in conflict with the plain language of the statute. As a result, the District Court's order should be reversed and

this matter remanded to the Bankruptcy Court for application of the proper legal test in accordance with the plain language of the Bankruptcy Code.

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Respectfully submitted,

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CERTIFICATE OF COMPLIANCE WITH FEDERAL RULE OF APPELLATE PROCEDURE 32 AND NINTH CIRCUIT RULE 32-1(a)

The foregoing Appellants' Opening Brief complies with Ninth Circuit Rule 32-1(a) and contains 10,621 words according to the word-processing system used to prepare the brief, excluding the items exempted by Fed. R. App. P. 32(f). The brief's type size and typeface comply with Fed. R. App. P. 32(a)(5) and (6). I certify that this brief complies with the word limit of Cir. R. 32-1.

Dated: January 24, 2022

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UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

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