

§ 553
collateral estoppel

constructive eviction
res judicata

In re Sanford's, Inc. No. 384-01642-P7
Clackamas Town Center Assoc. v. Hartvig U.S.D.C. No. 91-65-PA

3/20/91 Judge Panner reversing in part and affirming in part
Judge Luckey

During negotiations concerning a shopping center lease, the debtor's lessor promised not rent additional space in the center to competing businesses. The lessor subsequently did lease to a competing business. The debtor abandoned the premises and filed bankruptcy. The trustee obtained a judgment against the lessor in state court. The landlord asserted its claim for unpaid rent in bankruptcy court.

The defense of res judicata was unavailable to the debtor because the parties consented to piecemeal litigation. Nevertheless, collateral estoppel applied to bar the creditor's claim for prepetition rent for the period during which the debtor occupied the premises. The landlord's constructive eviction by renting to a competing business relieved the debtor of any duty to pay post-abandonment rent.

In dicta, the court suggested that even if the lessor had an allowed claim for the unpaid rent, the lessor could not setoff that claim against the trustee's judgment if it would be inequitable to allow setoff.

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IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF OREGON

In re:

SANFORD'S, INC., an Oregon
corporation, dba Sanford's
Children's Wear,

Debtor.

CLACKAMAS TOWN CENTER ASSOCIATES,

Appellant,

v.

DONALD H. HARTVIG, INC.,
Bankruptcy Trustee,

Appellee.

Bankruptcy No.
No. 384-01642-P7

USDC No. 91-65-PA

OPINION

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/ / /

1 - OPINION

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10 PANNER, J.

11 Clackamas Town Center Associates (CTCA) and Donald H.
12 Hartvig, Inc., the bankruptcy trustee for debtor Sanfords,
13 Inc., appeal from a bankruptcy court order partially allowing
14 CTCA's claim for unpaid rent and denying CTCA's claim for
15 setoff.

16 This appeal shows why parties should try claims arising
17 from common facts in the same proceeding. The parties managed
18 to convert a straightforward claim into a factual and
19 procedural mess by splitting CTCA's claim for rent from the
20 trustee's claims for misrepresentation and breach of promise.

21 The issues are (1) is CTCA entitled to rent?; (2) if CTCA
22 is entitled to rent, can CTCA set off its rent claim against
23 the state court judgment?; and (3) is CTCA entitled to
24 attorney's fees and interest? I conclude that CTCA is not
25 entitled to unpaid rent or a setoff, and decline to address
26 issues CTCA raises for the first time on appeal. I reverse
the bankruptcy court in part and affirm in part.

2 - OPINION

1
2 BACKGROUND

3 Debtor owned a chain of children's clothing stores. In
4 January 1981, debtor signed a thirteen-year lease with CTCA to
5 open a branch store in Clackamas Town Center Shopping Mall
6 (Center). During the lease negotiations, debtor emphasized
7 that it would not open a store unless it was the only
8 children's clothing store in the Center. CTCA repeatedly
9 promised debtor that it would not lease to any competing
10 stores. Donald H. Hartvig, Inc. v. Clackamas Town Center
11 Assocs., 101 Or. App. 79, 81-83, 789 P.2d 679, review denied,
12 310 Or. 393, 798 P.2d 672 (1990). Debtor opened its store in
13 April 1981.

14 Despite its promises to debtor, CTCA "intended from the
15 start to have two or three such stores." Id. at 84-85. In
16 December 1981, CTCA leased space to Lads and Lassies. Id. at
17 83. Lads and Lassies opened its store in March 1982.

18 In March 1983, debtor filed an action against CTCA in
19 Clackamas County Circuit Court for breach of promissory
20 estoppel, negligent misrepresentation, misrepresentation,
21 rescission, and unjust enrichment. That month, debtor
22 abandoned the store. CTCA leased debtor's space to another
23 tenant on October 31, 1983.

24 In May 1984, an involuntary bankruptcy petition was filed
25 against debtor. In July 1984, debtor was adjudged bankrupt
26 and the trustee was appointed. The trustee was substituted as
27 plaintiff in the state court action.

1 CTCA filed a counterclaim for unpaid rent in the state
2 court action. On October 16, 1984, the trustee's attorney
3 notified CTCA that the trustee would not stipulate to relief
4 from the automatic stay, 11 U.S.C. § 362:

5 As I analyze the case, relief from the stay
6 is not in order. We have alleged rescision [sic]
7 and breach of agreement. If we prevail on either
8 basis, the counter-claim is immaterial. If
9 rescision is allowed, there is no claim for rent.
10 If breach is proved, Sanford's is excused from
11 performance. If neither of Sanford's claims
12 prevails, you are in the same position as if you
13 were proving an independent claim for rent in the
14 bankruptcy court.

15

16 It would be in the interest of all creditors to
17 adjudicate your claim for rent in the bankruptcy
18 court.

19 For both of these reasons, I think it is
20 inappropriate to stipulate to a relief from stay.
21 If you feel that my position is incorrect or if
22 you have grounds of which I am unaware, please let
23 me know so that I can reconsider this position.

24 Excerpt of Record (E.R.) 13-14. CTCA withdrew its
25 counterclaim and filed a claim in the bankruptcy proceeding.
26 It never sought relief from the automatic stay.

On May 11, 1988, the state court jury found for the
trustee on the intentional misrepresentation claim, awarding
damages of \$24,742.40 for rent and common area maintenance
charges, \$52,800 for tenant improvements, \$22,950 for interest
on a bank loan, and \$400,000 punitive damages. E.R. 36-37.
The jury apparently reviewed the trustee's third amended
complaint, which sought \$71,010.49 for rent and common
charges, \$95,303.60 for tenant improvements, \$49,846.63 for

1 interest, and \$31,252.60 for ending inventory. E.R. 29-30.
2 The jury found defendant not liable for breach of promise, and
3 the trustee withdrew its claim for negligent
4 misrepresentation, unjust enrichment, and rescission. The
5 trial court granted CTCA's motion for judgment notwithstanding
6 the verdict on the punitive damages award. However, the
7 Oregon Court of Appeals ordered the verdict reinstated, and
8 the Supreme Court denied review. Donald H. Hartvig, Inc. v.
9 Clackamas Town Center Assocs., 101 Or. App. 79, 789 P.2d 679,
10 review denied, 310 Or. 393, 798 P.2d 672 (1990).

11 In its bankruptcy claim, CTCA seeks \$56,745.11 in unpaid
12 rent and interest from debtor. Of that amount, \$19,744.28
13 covers rent allegedly owing through March 31, 1983, when
14 debtor abandoned the leased space, and \$34,874 covers rent
15 allegedly owing from March 31, 1983 to October 31, 1983, when
16 CTCA leased debtor's space to another tenant.

17 On August 28, 1990, Bankruptcy Judge C.E. Luckey allowed
18 CTCA's unsecured claim for \$19,744.28 unpaid rent, and
19 disallowed the remaining \$34,874. Judge Luckey denied CTCA's
20 request to set off its claim for unpaid rent against its
21 obligation to the trustee on the state court judgment.
22 CTCA appeals the disallowance of its claim for \$34,874 unpaid
23 rent and the denial of setoff. The trustee cross-appeals the
24 allowance of CTCA's claim for \$19,744.28 unpaid rent.

25 / / /

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1 STANDARDS

2 The district court reviews the bankruptcy court's
3 findings of fact for clear error. Daniels-Head & Assocs. v.
4 William M. Mercer, Inc. (In re Daniels-Head & Assocs.), 819
5 F.2d 914, 918 (9th Cir. 1987). It reviews the bankruptcy
6 court's conclusions of law de novo. Id.

7 DISCUSSION

8 I. CTCA's Entitlement to Rent

9 The bankruptcy court found that CTCA was entitled to rent
10 only until debtor's abandonment on March 31, 1983, but not
11 afterwards. CTCA contends that because the lease was not
12 rescinded, debtor continued to owe rent after it abandoned the
13 store. The trustee contends that CTCA's entire claim for
14 unpaid rent is barred because CTCA failed to litigate the
15 counterclaim in the state court action.

16 A. CTCA's Entitlement to Rent Up to March 31, 1983

17 The trustee argues that CTCA's claim for unpaid rent is
18 barred by res judicata. "Res judicata" refers to two separate
19 concepts: claim preclusion and issue preclusion. Migra v.
20 Warren City School Dist. Bd. of Educ., 465 U.S. 75, 77 n.1
21 (1984).

22 Issue preclusion refers to the effect of a
23 judgment in foreclosing relitigation of a matter
24 that has been litigated and decided. This effect
25 is also referred to as direct or collateral
26 estoppel. Claim preclusion refers to the effect
of a judgment in foreclosing litigation of a
matter that never has been litigated, because of a
determination that it should have advanced in an
earlier suit.

1 Id. (citation omitted). Oregon uses the terms "claim
2 preclusion" and "issue preclusion." North Clackamas School
3 Dist. v. White, 305 Or. 48, 50, 750 P.2d 485, modified on
4 other grounds, 305 Or. 468, 752 P.2d 1210 (1988).

5 CTCA contends that the trustee acquiesced to separate
6 proceedings by encouraging CTCA to drop its state court
7 counterclaim and by refusing to stipulate to relief from the
8 automatic stay. I agree with CTCA that a party may consent to
9 piecemeal litigation. Rennie v. Freeway Transport, 294 Or.
10 319, 328, 656 P.2d 919 (1982).

11 However, even if the trustee waived its right to assert
12 claim preclusion, issue preclusion bars CTCA's claim. To
13 apply issue preclusion in Oregon, "[f]irst, there must exist
14 an identity of issue between the prior action and the action
15 in which estoppel [i.e., issue preclusion] is asserted; and
16 second, the party against whom estoppel is sought must have
17 had a full and fair opportunity to contest the issue decided
18 adversely to him." State Farm Fire & Cas. Co. v. Century Home
19 Components, Inc., 275 Or. 97, 103, 550 P.2d 1185 (1976)
20 (citation omitted). Although Oregon does not have a
21 compulsory counterclaim statute, "a party can not recover in a
22 separate action on a cause of action which he failed to plead
23 in a prior action by way of setoff or counterclaim but which
24 was necessarily adjudicated by the former judgment." Gwynn v.
25 Wilhelm, 226 Or. 606, 610, 360 P.2d 312 (1961) (emphasis
26 added).

1 CTCA contends that the jury verdict did not necessarily
2 adjudicate its claim for unpaid rent because that claim is
3 based on different facts from the trustee's claims for
4 misrepresentation and promissory estoppel. I disagree.

5 The Oregon Court of Appeals applied res judicata
6 principles to similarly conflicting claims in Shlim v.
7 Charapata, Inc., 100 Or. App. 52, 784 P.2d 452 (1989). There,
8 Shlim leased property to Charapata, and Charapata subleased to
9 CML. When Charapata defaulted on its lease with Shlim, Shlim
10 obtained a \$34,000 judgment against Charapata. Shlim served a
11 writ of garnishment on CML to collect on the judgment against
12 Charapata. CML owed Charapata \$62,000 unpaid rent and
13 property taxes, but CML won a \$44,500 judgment against
14 Charapata for breach of the sublease.

15 The trial court concluded that Shlim was entitled to the
16 \$62,000 rent CML owed Charapata, set off against \$44,500
17 judgment Charapata owed CML for breach of the sublease. On
18 appeal, CML contended that its judgment against Charapata
19 necessarily resolved Charapata's claim for unpaid rent,
20 barring Shlim from garnishing on it. The Court of Appeals
21 disagreed. It noted that Charapata had not counterclaimed for
22 rent and taxes in the breach of the lease action. More
23 importantly, the court noted that the judgment CLM obtained
24 against Charapata was "silent as to whether it adjudicates any
25 claim for rent and unpaid taxes that would bar Charapata from
26 later bringing a claim." Shlim, 100 Or. App. at 54-55.

1 Unlike the judgment in Shlim, the judgment here does
2 explicitly adjudicate rent. The trustee sought \$71,010.49 for
3 rent and common charges, and the jury awarded \$24,742.40. The
4 jury necessarily determined the amount of rent due CTCA. That
5 judgment bars CTCA from raising its rent claim here.

6 B. CTCA's Entitlement to Rent After March 31, 1983

7 The bankruptcy court found that claim preclusion did not
8 bar CTCA's claim for unpaid rent after debtor abandoned its
9 store. However, it concluded that CTCA was not entitled to
10 that unpaid rent because "there was a breach . . . which
11 should preclude damages for breach." 2 Tr. at 12. CTCA
12 appeals, contending that under Oregon's election of remedies
13 rule, debtor continued to owe rent even after abandoning the
14 premises.

15 I agree with CTCA that the trustee waived its right to
16 seek rescission of the lease. The Oregon Supreme Court has
17 described the rule clearly:

18 A party who has been induced to enter into a
19 contract by fraud, has, upon its discovery, an
20 election of remedies. He may either affirm the
21 contract, and sue for damages, or disaffirm it,
22 and be reinstated in the position in which he was
before it was consummated. These remedies,
however, are not concurrent, but wholly
inconsistent. The adoption of one is the
exclusion of the other.

23 Scott v. Walton, 32 Or. 460, 464, 52 P. 180 (1898). However,
24 I will not this extend this harsh rule unnecessarily.
25 Gentemann v. Sunaire Sys., Inc., 63 Or. App. 654, 659, 665
26 P.2d 875, review denied, 295 Or. 631, 670 P.2d 1034 (1983).

1 Rescission is not the only way that a tenant's obligation to
2 pay rent may be terminated.

3 In Kulawitz v. Pacific Woodenware & Paper Co., 25 Cal.2d
4 664, 155 P.2d 24 (1944), the California Supreme Court
5 confronted a similar issue. There, the tenant leased space
6 for a furniture store after the landlord promised the tenant
7 that it would not allow another furniture store in the same
8 building. However, the landlord then leased space to a
9 competing store. The tenant stopped paying rent, surrendered
10 the premises, and brought an action for rescission. The court
11 held that the tenant was not entitled to rescission because he
12 had not paid his rent to the date of the breach. However, the
13 court held that the landlord was entitled to rent only up to
14 the date of surrender:

15 A covenant not to let other premises in the
16 lessor's property or permit their use for certain
17 purposes during the existence of the lease with
18 the covenantee is binding and a breach thereof
19 entitles the lessee to terminate the lease.

20

21 In this case performance of the restrictive
22 covenant by the lessor was essential to the
23 beneficial enjoyment of the property by the lessee
24 for the purposes intended. It was therefore a
25 condition precedent to the lessee's performance,
26 and breach thereof may be said to amount to a
27 constructive eviction of the lessee Any
28 interference by the landlord by which the tenant
29 is deprived of the beneficial enjoyment of the
30 premises amounts to a constructive eviction if the
31 tenant so elects and surrenders possession, and
32 the tenant will not be liable for rentals for the
33 portion of the term following his eviction.

34 155 P.2d at 27 (citations omitted).

1 The reasoning of Kulawitz applies here. Oregon
2 recognizes constructive eviction. Maki v. Nikula, 224 Or.
3 180, 184, 355 P.2d 770 (1960). By leasing to a competing
4 store, CTCA substantially interfered with debtor's beneficial
5 enjoyment of its store and relieved debtor of any obligation
6 to pay rent after it abandoned its store. Although debtor did
7 not immediately abandon its store, its delay was not
8 unreasonable. Cf. Maki, 234 Or. at 185-86 (lessor's erection
9 of wall blocking lessee's alley was a constructive eviction,
10 but lessee could not wait 26 months to abandon premises).

11 II. CTCA's Entitlement to Setoff

12 Because CTCA is not entitled to unpaid rent, CTCA also is
13 not entitled to a setoff. However, I address setoff because
14 it may be relevant on appeal.

15 CTCA contends that it is entitled to set off its claim
16 for unpaid rent against the trustee's judgment for
17 compensatory damages. The bankruptcy judge denied setoff.

18 The bankruptcy statutes do not affect a creditor's right
19 to offset a mutual debt owing by such creditor to
20 the debtor that arose before the commencement of
21 the case under this title against a claim of such
22 creditor against the debtor that arose before
23 commencement of the case

24 11 U.S.C. § 553(a). Section 553 does not create a new federal
25 right of setoff, but preserves existing state and federal
26 rights of setoff. Blanton v. Prudential-Bache Securities (In
re Blanton), 105 Bankr. 321, 334 (Bankr. E.D. Va. 1989).

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11 - OPINION

1 A creditor may not set off a debt that arose before the
2 bankruptcy petition against a debt that arose afterwards.
3 Cooper-Jarrett, Inc. v. Central Transp., Inc., 726 F.2d 93, 96
4 (3rd Cir. 1984). The bankruptcy court determined that CTCA's
5 debt to the trustee arose when the jury returned the verdict
6 against CTCA, four years after the bankruptcy proceedings
7 began. On appeal, CTCA contends that its debt to the trustee
8 arose by 1982, when it deceived debtor, and that the jury
9 verdict merely liquidated its debt.

10 I need not address whether the debts lacked mutuality.
11 Even if the debts were mutual and prepetition, CTCA is not
12 entitled to setoff if "it would be inequitable or contrary to
13 public policy." Federal Deposit Ins. Corp. v. Bank of Am.
14 Nat'l Trust & Sav. Ass'n, 701 F.2d 831, 836-37 (9th Cir.),
15 cert. denied, 464 U.S. 935 (1983). A creditor should not
16 benefit from inequitable behavior. See Blanton v. Prudential-
17 Bache Securities (In re Blanton), 105 Bankr. 321, 337-38
18 (Bankr. E.D. Va. 1989) (collecting decisions denying setoffs
19 that "would perpetuate wrongful acts").

20 CTCA contends that it seeks setoff only against the
21 compensatory portion of judgment, not against the punitive
22 damages. I cannot make such a fine distinction. The jury
23 awarded compensatory damages for intentional
24 misrepresentation, not breach of a promise. By awarding
25 punitive damages, the jury necessarily determined that the
26 misrepresentation was a particularly aggravated, deliberate

1 disregard of debtor's rights. Donald H. Hartvig, Inc., 101
2 Or. App. at 84. CTCA is not entitled to setoff. Cf. Browner
3 v. Rosen, 56 Bankr. 214, 218 (D. Mass. 1985) (allowing
4 creditor to set off his claims for breach of contract against
5 the trustee's claims for breach of contract, but not allowing
6 creditor to set off his claims against trustee's claims for
7 conversion, misrepresentation, and breach of fiduciary duty).

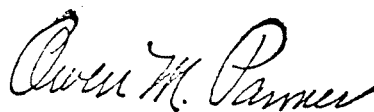
8 III. CTCA's Claims for Attorney's Fees and Interest

9 CTCA claims attorney's fees and interest due on the
10 lease. CTCA did not raise this issue before the bankruptcy
11 court. I have discretion to consider issues not presented to
12 the bankruptcy court. Consolidated Marketing, Inc. v. Marvin
13 Properties, Inc. (In re Marvin Properties, Inc.), 854 F.2d
14 1183, 1187 (9th Cir. 1988). I see no reason to consider this
15 issue.

16 CONCLUSION

17 The bankruptcy court is reversed in part and affirmed in
18 part.

19 DATED this 20 day of March, 1991.

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21 

22 OWEN M. PANNER, United States
23 District Court Judge
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26