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Provability of Claims for Future Rent or Damages Against the Trustee in Bankruptcy or a Receiver of an Insolvent Tenant Upon Abandonment of the Leased Premises, Measure of Damages in Federal Court Receiverships.

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NOTES AND COMMENTS

PROVABILITY OF CLAIMS FOR FUTURE RENT OR DAMAGES AGAINST THE TRUSTEE IN BANKRUPTCY OR A RECEIVER OF AN INSOLVENT TENANT UPON ABANDONMENT OF THE LEASED PREMISES, MEASURE OF DAMAGES IN FEDERAL COURT RECEIVERSHIPS. After publication of the article[1] appearing under the above title in the November issue of the LAW REVIEW, a decision[2] was handed down by the United States District Court for the Western District of Washington, Northern Division, which justifies this supplemental note written at the request of the LAW REVIEW

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[1] (a) The title in the November issue of THE REVIEW should read as it appears above—"Provability of Claims for Future Rent or Damages * * *" instead of "for Damages". (b) The quotation from the case of *Hines Yellow Pine Trustees v. Martin*, 268 U. S. 458, 69 L. Ed. 1050 (1925) appearing in footnote 15, p. 310, is incomplete, the proper quotation being as follows:

> "Both the meaning of statutes of a state and the rules of the unwritten law of a state affecting property within the state are peculiarly questions of local law, to be ascertained and established by the state courts. For that reason Federal courts ordinarily hold themselves bound by the interpretation of state statutes by the state courts. * * *
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> "When questions affected by the interpretation of a state statute or a local rule of property arise in a Federal court, that court has the same authority and duty to decide them as it has to decide any other questions which arise in a cause; and where state decisions are in conflict, or do not clearly establish what the local law is, the Federal court may exercise an independent judgment and determine the law of the case. * * *"

[2] *Republic Supply Company of California v. Richfield Oil Company of California*, Cause No. 793, decision by Judge Jeremiah Neterer, District Judge, on exceptions to a Special Master's findings and conclusions on proof of claims based upon disaffirmance of leases, decision filed December 14, 1932.

The facts of the case are briefly as follows In January, 1931, the Richfield Oil Company of California went into the hands of a receiver, ancillary proceedings being instituted in the State of Washington at the same time. In April, 1931, the receiver disaffirmed several leases of filling stations, disaffirmance becoming effective April 30, 1931, to which date rent was paid in full. Claims were filed for damages sustained from April 30, 1931, to the end of the lease terms, the unexpired terms being of various lengths, up to 12 years.

A Special Master was appointed by the district judge to hear proof of claims, all of which were referred to him.[3] In proof of claims based on disaffirmance of leases, expert testimony was offered to show the damages sustained, namely, the difference between the rentals reserved in the leases for the unexpired terms, and the rental value of the premises for the same period, following *Oldfield v. Angeles Brewing & Malting Company*,[4] reviewed in the previous article. The rental value for the balance of the lease terms was less than 50 per cent of the rental provided for in the leases. An outstanding realty expert called by counsel for the receiver could not controvert much of the testimony, but testified that present conditions were abnormal, that rental values would revive with improved economic conditions, that testimony as to future rental value was speculative and conjectural. He was inclined to agree with claimants' experts that no marked improvement in rental values could be expected within three years.

The Special Master concluded in each case that—"the claimant has failed to establish by any evidence acceptable to the Special Master any damage sustained beyond the period of three years," and—"that the amount which may be received by the claimant from and after said date of May 1, 1934, has not been established with a sufficient degree of accuracy to satisfy the mind of the Special Master." Damages for the period of the unexpired terms subsequent to May 1, 1934, were disallowed.

Upon the filing of the Special Master's findings of fact and conclusions of law in the United States District Court exceptions thereto were taken by three claimants[5] whose leases had been disaffirmed. The unexpired terms of claimants' leases ran respectively until September 20, 1937, August 31, 1940, and December 31, 1943. The principal ground of the exceptions in each case was the allowance of damages for a period of three years only, to May 1, 1934 instead of for the full term to the expiration of the lease. It was contended that this conclusion was without precedent and contrary to the rule of the *Oldfield* case.

The district court in handing down its decision affirmed the rule that federal courts follow decisions of the state courts as to the measure of damages in cases of this sort, as outlined in the pre-

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[3] The Honorable Clay Allen, recently appointed Judge of the Superior Court for King County.

77 Wash. 158, 137 Pac. 469 (1913).

[5] George Goodner, claim No. W139· B. F Reed, claim No. W216, Administration Improvement Company claim No. W127A.

ceding article,[6] held that the burden rested upon the claimants to prove the damages for the unexpired terms of the lease[7], and said.

> "Claimants cannot hope to recover damages which have not been proven by something of relevant consequence, and not be vague, uncertain, incompetent, or irrelevant, not carrying the quality of proof, or having the fitness to produce conviction and be such that reasonable persons may fairly differ as to whether or not it proves the fact in issue. Some substantial evidence must be presented to carry conviction to establish the fact.[8] The chancellor may judicially know that prevailing economic forces have interrupted normal conditions and have affected every material economic level."

The court then held that as to proof of damages for the period subsequent to May 1, 1934—

> "The burden not being sustained, the Master could not speculate, nor can the court supersede this finding. * * *
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> "This, as the other claims, does not present testimony carrying a quality of proof, or having fitness to produce conviction of any damages beyond this period."[9]

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[6] Citing *Hines etc. v. Martin, supra* (note 1) *Oldfield v. Angeles, etc. Co., supra* (note 4) *Brown v. Hayes*, 92 Wash. 300, 159 Pac. 89 (1916) *Munson v. Baldwin*, 88 Wash. 379, 153 Pac. 338 (1915) Note, however, that one of the courses open to a lessor in Washington, upon breach of a lease, was cut off, namely, the right to treat the lease as still in force, and collect rental each month when it accrues. Judge Neterer said:

> "The local law also provides that the lessor may refuse to accept the disaffirmed leased property and hold the lessee to the term of the lease, and this, one of the lessors, at the inception, elected to do, and declined to take the property and mitigate the damage. The Master is right in holding this he should have done. The receiver and the lessor stand in a different relation than lessor and lessee; especially so when a lessor is related to the business, as is claimant, and can take over the station, and in good conscience should do so. The receiver is the officer of the court, and the function of a court of equity is to speedily determine the controverted issues between the parties. The court, through its receiver, cannot engage in extended merchandising; it must decree rights and distribute benefits as speedily as may be done agreeable to equity, to protect the interest of all parties, and the lessor may not force the court to sell a long-time lease and sacrifice the beneficial interest, perhaps to be secured by the lessor at a sum greatly disproportionate to its value by reason of overruling economic forces, and pay the present worth of the monthly installments."

[7] Citing *Bradbury v. Higgins* (Cal.), 123 Pac. 797 (1912).

[8] Citing *United States v. Chas. A. Kerr* decided November 14, 1932 (Ninth Circuit) *United States v. Hill*, decided November 21, 1932 (Ninth Circuit) *Pennsylvania Steel Co. v. New York City Ry. Co.*, 198 Fed. 721 (1912) *Leo v. Pearce*, 54 Fed. (2d) 92 (1931) 57 Fed. (2d) 40 (1932).

[9] In awarding damages to May 1, 1934, the court further held that the allowance must be for the present worth of each claim inasmuch as the damages accrued monthly up to May 1, 1934. To fix the total damages the court applied the following formula:

"Last sum due + first sum due

$$\frac{\text{Last sum due} + \text{first sum due}}{2} \times \text{Rate} \times \text{Time} = \text{Interest.}$$

Interest + principal sum = Total damages. The present worth

This result is open to the criticism that the expert testimony had been offerd not to show a *future* rental value, which would concededly be speculative and conjectural, but to show the *present* rental value of the premises from the date of adjudication[10] to the end of the lease term, to-wit, the amount which the lessor could secure as rental if he entered into a new lease for the unexpired term. That the "market value" of the balance of the term is a determinable fact is clearly shown by the execution of long term leases for similar properties similarly located, even at present deflated rental values. The values of these leases may be determined by the same experts who testified in the cases here considered. A fact established for the purposes of the business world should be sufficiently proven for the purposes of the courts.[11]

In *Leo v Pearce Stores Co.*,[12] discussed in the previous article, the Judge of the United States District Court in Michigan met this point by saying that the evidence of value (expert testimony) for the full balance of the term does not "indicate the fair rental value of such premises during such future period," and by holding that it was the "duty" of the lessor to rent for a shorter period during this time of abnormally low values,—a new and rather startling theory, giving rise to numerous practical objections. Under what economic circumstance does this "duty" arise? Who is to determine the length of the period for which the lessor is justified in re-renting, and by what method is this to be determined?

The Special Master and the district judge in the cases under discussion reached substantially the same result by a different and more concrete route, in limiting proof of damage to a period for which the opinion of experts was convincing. We suspect that a new rule is emerging out of the extraordinary circumstances of the present day

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may be computed by the formula set out in *Aetna Life Ins. Co. v. Geher* 50 Fed. (2d) 657, which would be:

Total damages — (Times × Rate of interest + 1) = Present worth."

[10] Damages for the period from date of disaffirmance to date of adjudication are proved by showing what rentals, if any, were received by the lessor. *Curran v. Smith-Zollinger Co.*, 157 Atl. 432 (1931).

[11] Neither of the decisions referred to in this note discuss the sufficiency of a bona fide lease for the balance of the term as evidence of rental value, no such lease having been presented in either case. It is believed that a court could not resist the convincing force of such evidence, Judge Tuttle's language in *Leo v. Pearce Stores Co.* as to the lessor's "duty" to rent for a shorter period, to the contrary notwithstanding. See *Curran v. Smith-Zollinger Co.*, cited in note 10, in which the Delaware Chancery Court said: "Where the lessor, after abandonment of the lease by a receiver of the lessee, has re-let the premises for the balance of the term at a lower rent the damages provable against the receivership estate are measured by the difference between the rent stipulated in the abandoned lease during the balance of the term and the rent specified in the new one as payable over the corresponding period."

[12] Cited in note 8, and quoted pp. 316-17, November issue of THE WASHINGTON LAW REVIEW.