

ORDERED.



Dated: February 09, 2011

Eileen W. Hollowell

EILEEN W. HOLLOWELL
U.S. Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
DISTRICT OF ARIZONA

In re:
HUACHUCA CONCRETE, INC.,
Debtor.

Chapter 11 Proceedings

Case No. 4:10-bk-18362-EWH

**MEMORANDUM DECISION RE:
DAMAGES FOR DEBTOR'S BREACH OF
LEASES**

I. INTRODUCTION

Creditor, WPP, LLC, seeks an administrative claim arising from the Debtor's rejection of certain leases related to its mining activities. For the following reasons, the creditor is entitled to administrative treatment for some, but not all, of its claims.

II. FACTS AND PROCEDURAL HISTORY

Huachuca Concrete, Inc. ("Huachuca" or "Debtor") manufactures ready mix concrete for the Arizona market. As part of its pre-petition operations, it mined raw materials from three sites in Benson, Tucson, and Sierra Vista, Arizona. Title to the Sierra Vista site is held by Kino Properties, LLC, an entity controlled by principals of the Debtor.¹ Huachuca previously held title to the Benson and Tucson sites. It

¹ According to Huachuca, the owner of the Sierra Vista property is Kino Properties, LLC whose

1 subsequently transferred title to those sites to WPP, LLC (“WPP” or “Creditor”). On
2 December 18, 2009, Huachuca entered into a mining lease with WPP (the “Mining
3 Lease”) to continue its mining operations at the Tucson and Benson sites. The Mining
4 Lease gave Huachuca the right to conduct its operations, which included mining,
5 processing, and transporting raw materials, for a ten-year period. The Mining Lease
6 obligated Huachuca to pay monthly royalties to WPP on mined raw materials at a rate
7 of one dollar per ton,² pay some other charges, and furnish a monthly report to WPP
8 accounting for the amount of raw materials mined, shipped, transported across, and
9 processed at the Tucson and Benson sites.
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11 Huachuca was conducting similar operations at the Sierra Vista site pursuant
12 to a lease with Kino Properties, LLC. Huachuca entered into a written agreement on
13 December 18, 2009 with WPP, granting WPP a royalty deed (the “Royalty Deed”) to
14 minerals extracted from the Sierra Vista site. The Royalty Deed gave WPP a royalty
15 interest in the raw materials Huachuca extracted from the Sierra Vista site:
16

17 The royalty interest . . . granted by [Huachuca] to [WPP] shall apply
18 to any and all Minerals Produced from the Property. [Huachuca]
19 hereby covenants and agrees to pay [WPP] [a] production royalty of
20 50 cents (\$0.50) per ton up to 700,000 tons. . . . The Royalty
21 granted herein shall run with the lands³

22 Like the Mining Lease, the Royalty Deed required Huachuca to produce
23 monthly reports of the minerals extracted as the basis for the royalty payments.

24 Debtor filed a Chapter 11 petition on June 11, 2010 (the “Petition Date”). WPP
25 moved for relief from the automatic stay on July 29, 2010 (the “Motion for Relief”) so it

26 members are Ramona DeAnda and Abelardo DeAnda. Mr. DeAnda is one of Huachuca’s principals.

27 ² As set forth in the Mining Lease, the rate was to increase annually. The 2010 rate was to be one
dollar per ton.

28 ³ Mot. for Relief from the Automatic Stay, July 29, 2010, Ex. 3, ECF No. 50.

1 could obtain an injunction in state court against the Debtor to prevent it from
2 extracting any further minerals subject to the Royalty Deed. WPP also claimed that
3 the Debtor failed to perform under both the Mining Lease and the Royalty Deed by
4 failing to make post-petition lease and royalty payments.

5 In the Motion for Relief, WPP asserted that both the Mining Lease and the
6 Royalty Deed were “unexpired leases of nonresidential property where Debtor is the
7 lessee within the meaning of Bankruptcy Code § 365(d)(3).”⁴ The Debtor responded
8 to the Motion for Relief on August 16, 2010. Debtor argued that the issue was not
9 whether WPP was entitled to stay relief but was instead “an assumption or rejection
10 issue within the scope and meaning of 11 U.S.C. § 365.”⁵ Debtor further stated that it
11 intended to reject both the Mining Lease and the Royalty Deed.
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13 The court held a hearing on October 7, 2010 in which the parties disagreed
14 about the nature of any administrative claim flowing from the Debtor’s rejection of the
15 Mining Lease and Royalty Deed. They also disagreed about the effect of rejection on
16 the Debtor’s continuing obligations, if any, under the Royalty Deed. WPP maintained
17 that it retained an interest in the royalties extracted from the Sierra Vista site under
18 the Royalty Deed which had to be paid in full post-petition and post-rejection.
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20 On November 3, 2010, the court entered an order (the “Order”) denying the
21 Motion for Relief. The Order, which was drafted by counsel for WPP, stated that both
22 the Mining Lease and the Royalty Deed were “deemed rejected pursuant to 11 U.S.C.
23 § 365(a)” as of November 3, 2010 (the “Rejection Date”). The Order directed the
24 parties to file additional briefing “regarding the effect of the rejection of the [Mining
25 Lease and Royalty Deed], and the amount and priority of any claim in favor of WPP
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28 ⁴ Mot. for Relief from the Automatic Stay, July 29, 2010, ECF No. 50, at 2.

⁵ Debtor’s/Resp’t Reply to Mot. for Relief from the Automatic Stay, Aug. 16, 2010, ECF No. 61, at 1.

1 arising therefrom” The Debtor subsequently stopped mining operations at the
2 Tucson and Benson sites and surrendered possession of those sites to WPP. The
3 Debtor continues mining at the Sierra Vista site.

4 The parties filed simultaneous briefs on December 10, 2010. WPP took the
5 position that it was entitled to an administrative priority claim for post-petition royalties
6 under both the Mining Lease and the Royalty Deed. WPP also argued, for the first
7 time, that the Royalty Deed is not an executory contract that could be rejected under
8 the Bankruptcy Code. Alternatively, WPP argued that the Debtor needs to continue to
9 perform under the Royalty Deed because a rejection only breached the contract but
10 did not terminate it. According to WPP, royalties continue to accrue as the Debtor
11 continues to mine and the court should award it an administrative priority claim in
12 those accumulating royalties.
13

14 The Debtor did not disagree that WPP is entitled to claims against the estate,
15 including administrative claims, but asserts that there was a calculation error in one of
16 the statements it sent to WPP such that the amount of the administrative claim is
17 much less than the amount claimed by WPP. It also argued that WPP was not
18 entitled to injunctive relief under the Royalty Deed and that the Royalty Deed was only
19 intended to be a “rider” to the Mining Lease.⁶ Because the parties filed simultaneous
20 briefs, the Debtor’s brief does not address WPP’s newly raised claim that the Royalty
21 Deed is not an executory contract or WPP’s claim that royalties must be paid for as
22 long as the Debtor conducts mining operations at the Sierra Vista site.
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26 ⁶ To resolve the Debtor’s “rider” argument, the court would be required to hold an evidentiary hearing to
27 interpret the agreements consistently with the intent of the parties. The parties previously agreed,
28 however, that all matters related to the rejection of the Mining Lease and Royalty Deed could be
resolved solely by the briefing. Accordingly, the court will not address that argument. This
memorandum decision also renders issues related to injunctive relief irrelevant.

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III. ISSUES

(1) Is WPP entitled to an administrative claim against the estate for the Debtor’s rejection of the Mining Lease?

(2) Did the Order terminate WPP’s rights to royalties for the minerals mined by the Debtor at the Sierra Vista site?

IV. JURISDICTIONAL STATEMENT

Jurisdiction is proper under 28 U.S.C. §§ 157(b)(2)(B) and 1334.

V. DISCUSSION

1. WPP’s Administrative Claim for Breach Under the Mining Lease

Under the Bankruptcy Code, a debtor in possession may, subject to court approval, assume or reject an executory contract or unexpired lease. 11 U.S.C. § 365(a). The deadline for assumption of an unexpired lease for nonresidential property is 120 days. 11 U.S.C. § 365(d)(4). The debtor in possession must timely perform all its obligations under such a lease until the lease is rejected. 11 U.S.C. § 365(d)(3). If the lease is rejected, then the Bankruptcy Code deems the rejection a breach of the lease as of the date immediately before the debtor filed for bankruptcy, making the lease rejection damages a pre-petition general unsecured claim. 11 U.S.C. § 365(g)(1). If the debtor in possession fails to timely perform its obligations under such a lease, the lessor has an administrative claim for post-petition, pre-rejection breach. In re Nat’l Refractories & Minerals Corp., 297 B.R. 614, 616 (Bankr. N.D. Cal. 2003).

Accordingly, WPP is entitled to an administrative claim under the Mining Lease for unpaid post-petition obligations and a general unsecured claim for all of the

1 Debtor's pre-petition and post-rejection obligations. However, the court cannot
2 calculate the amount of either claim because the evidence of the amount of those
3 claims is in dispute. Accordingly, a status hearing will be held on March 14, 2010 at
4 10:00 a.m. to discuss whether an evidentiary hearing must be set to determine the
5 amount of WPP's general unsecured and administrative claims arising out of the
6 rejection of the Mining Lease.

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8 2. WPP's Rights Under the Royalty Deed

9 The court will not consider WPP's argument that the Royalty Deed is not an
10 executory contract under the Bankruptcy Code. While there was some discussion
11 about the nature of the Royalty Deed in the October 7, 2010 hearing, the original
12 Motion for Relief asserted that the Royalty Deed was an unexpired lease for
13 nonresidential property. The Order, which was drafted by WPP's counsel,
14 unequivocally stated that the Royalty Deed was "deemed rejected" under the
15 Bankruptcy Code. WPP did not subsequently ask the court to revisit the Order under
16 Federal Rules of Civil Procedure 59 or 60.⁷ Therefore, under the "Law of the Case"
17 doctrine, the Royalty Deed is a rejected lease of nonresidential property.
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19 Section 365(g) of the Bankruptcy Code explains that a rejection of an
20 executory contract or unexpired lease "constitutes a breach of such contract or lease,"
21 but a breach under § 365(g) is not the same as a contract termination. In re Bergt,
22 241 B.R. 17, 25 (Bankr. D. Alaska 1999). Because a rejected contract is not
23 terminated, the non-breaching party retains the right to unsecured claims for a
24 debtor's future non-performance. Id. In the case of most non-residential real property
25 leases, rejection results in the termination of the lease because the breach by the
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28 ⁷ Fed. R. Civ. P. 59 and 60 are made applicable in bankruptcy proceedings through Fed. R. Bankr. P. 9023 and 9024, respectively.

1 debtor-lessee results in a surrender of possession of the non-residential real property.
2 See, e.g., In re Bryant Universal Roofing, 218 B.R. 948 (Bankr. D. Ariz. 1998). Here,
3 however, there is nothing to surrender to WPP. Thus, the Debtor's continued mining
4 operations at the Sierra Vista site will create continuing breaches, but WPP's claim for
5 these breaches will be treated as a general unsecured claim. See 11 U.S.C. § 365(g).
6 WPP's administrative claim for royalties under the Royalty Deed is limited to amounts
7 which became due between the Petition Date and the Rejection Date.
8

9 **V. CONCLUSION**

10 The foregoing constitutes the court's findings of fact and conclusions of law.

11 An order consistent with this memorandum decision will be entered this date.

12 Notice to be sent through the
13 Bankruptcy Noticing Center "BNC"
to the following

14 Huachuca Concrete, Inc.
15 423 S. Schrader Road
16 Sierra Vista, AZ 85635

17 Joseph E. Cotterman
18 Lindsy M. Weber
19 Gallagher & Kennedy, P.A.
2575 E. Camelback Rd.
Phoenix, AZ 85016-9225

20 Robert M. Charles, Jr.
21 Jeffrey L. Sklar
1 S. Church Ave., Suite 700
22 Tucson, AZ 85701-1611

23 Office of the U.S. Trustee
24 230 North First Ave., Suite 204
Phoenix, AZ 85003
25
26
27
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