SO ORDERED.

Dated: February 2, 2012

Charles G. Case, II, Bankruptcy Judge

U.S. BANKRUPTCY COUR[T]

FOR THE DISTRICT OF ARIZ[ONA]

In re: **MOUNTAINSIDE FITNESS CENTERS OF GILBERT, LLC,** **Debtor.**	In Chapter 11 proceedings Case No.: 2:10-bk-23734-CGC
R.S. LOTS, LLC, **Plaintiff.** **v.** **MOUNTAINSIDE FITNESS CENTERS OF GILBERT, LLC; THOMAS J. HATTEN and BRIGID HATTEN; and HATTEN HOLDINGS, INC.** **Defendants.**	**Adv. No.: 2:10-ap-01664-CGC** **UNDER ADVISEMENT DECISION REGARDING MOUTAINSIDE FITNESS CENTERS OF GILBERT, LLC; THOMAS J. HATTEN and BRIGID HATTEN; and HATTEN HOLDINGS, INC.'S LIABILITY WITH RESPECT TO COMMERCIAL LEASE WITH R.S. LOTS, LLC.**

This proceeding concerns Mountainside Fitness Centers of Gilbert, LLC ("Mountainside"), Hatten Holdings, Inc. ("Hatten Holdings"), and Thomas Hatten's liability for rent and other charges accrued under a breached lease with R.S. Lots, LLC ("R.S. Lots") from April 2, 2011 through November 3, 2011. The issues needing determination are: (1) whether R.S. Lots accepted Mountainside's surrender of the lease; (2) whether R.S. Lots mitigated its damages from Mountainside's breach by engaging in reasonable efforts to try to re-let the premises; and (3) whether the Hattens' community property is liable under the guaranty to the extent of Thomas Hatten's contribution to the marital community.

I.Background

Debtor/Defendant Mountainside agreed to lease commercial real property at 725 W. Warner Blvd. in Gilbert, AZ from Plaintiff R.S. Lots on March 3, 2003, expiring on March 31, 2018 (the "Lease"). Thomas Hatten and Hatten Holdings each guaranteed Mountainside's payment and obligations under the Lease. Mountainside abandoned the premises in June 2009 and has not made any payments under the Lease since September 1, 2009. R.S. Lots retained commercial real estate broker Bruce Milton to find a replacement tenant for the premises, and his efforts resulted in three offers: (1) Desert Fitness Centers of Arizona, LLC ("Desert Fitness") made an offer for a 5 year lease at $4.50 per square foot; (2) CR Entertainment, LLC ("CR Entertainment") made an offer for a 5 year lease at $5.50 per square foot; and (3) Phoenix Theatre Company, Inc. ("Phoenix Theatre Company") made an offer for a 20 year lease at $22.50 per square foot with $ 2,000,000 for tenant improvement paid by R.S. Lots. R.S. Lots found each of these offers insufficient.

Mountainside filed for Chapter 11 protection on July 28, 2011. R.S. Lots made a proposal to lease the premises to the Fitness Factory for 10 years at $8.00 per square foot on August 31, 2010, which was rejected; no counteroffer was made. R.S. Lots sued Mountainside, Thomas Hatten, and Hatten Holdings (the "Defendants") in state court seeking damages for accrued rent under the Lease, and Mountainside removed the suit to this Court. On June 17, 2011, this Court entered judgment in favor of R.S. Lots and against Mountainside, Thomas Hatten, and Hatten Holdings for $414,336.62 for all rent accrued through April 1, 2010, without prejudice to pursue claims due under the Lease from and after that date. The Court found that R.S. Lots made reasonable efforts to re-let the premises and that the three offers made were below the market rate established by R.S. Lots. Order Grant. Part. Summ. J. 5, ECF No. 33. This proceeding concerns only Mountainside's liability from April 1, 2011 through November 3, 2011. .

II.R.S. Lots Did Not Accept Mountainside's Surrender of the Lease

When a lessee of a commercial lease abandons the premises, the lessor has two options: (1) accept the surrender and terminate the lease, recovering damages; or (2) refuse to accept the surrender and wait until the end of the lease term, recovering any amounts due at that time. See Tempe Corp. Office Bldg. v. Ariz. Funding Servs., Inc., 807 P.2d 1130, 1134-35 (Ariz. Ct. App. 1991); Roosen v. Schaffer, 621 P.2d 33, 36 (Ariz. Ct. App. 1980). Under general Arizona law principles, "if a lease is not terminated, the landlord may recover unpaid rent due prior to re-letting the premises and future rent due for the balance of the lease term, subject to the landlord's duty to mitigate the damages by re-letting the premises." Tempe Corp. Office Bldg. 807 P.2d at 1135; see Stewart Title & Trust of Tuscon v. Pribbeno, 628 P.2d 52, 53 (Ariz. Ct. App. 1981). The landlord's actions following a tenant's abandonment give rise to the question of whether the landlord accepted the surrender only "in the absence of any provision of the lease touching on the problem." See Riggs v. Murdock, 458 P.2d 115, 118 (Ariz. Ct. App. 1969).

In the instant case, the Lease contained specific provisions addressing such an issue. It provides that the landlord can terminate the Lease by written notice to the tenant. Tenant Lease 27.2(d), ECF No. 75-1. In this scenario, the landlord can recover: (1) attorneys' fees; (2) the cost of recovering the premises; and (3) the value of the excess rent still owed over the reasonable rental value of the premises. Id. However, no act or conduct of the landlord, whether consisting of reentry, taking possession or re-letting the premises prior to the expiration of the Lease is considered an acceptance of the tenant's surrender. Id. Acceptance of the tenant's surrender must be made by the landlord and evidenced by a written acknowledgment. Id. at 27.5, ECF No. 75-1.

It is clear here that Mountainside abandoned the Lease with R.S. Lots. Per Arizona law, R.S. Lots could have either accepted the surrender, thereby terminating the Lease, or it could have refused to accept the surrender. According to the Lease, R.S. Lots could only accept Mountainside's surrender through written notice made by R.S. Lots. Since R.S. Lots did not provide written notice acknowledging acceptance of

Mountainside's surrender, it did not accept the surrender. Thus, per the Lease and Arizona law, R.S. Lots had only one option since it did not accept Mountainside's surrender: not terminate the lease, but try to re-let the premises.

III.R.S. Lots Mitigated its Damages from Mountainside's Breach by Engaging in Reasonable Efforts to Re-let the Premises

If a landlord refuses to accept the surrender of the lease, the lease is not terminated. The landlord can recover possession, but he must try to re-let the premises and is "under a duty to make reasonable efforts to rent the premises at a fair rental." Roosen, 621 P.2d at 36; see also Dushoff v. Phoenix Co., 528 P.2d 637, 641 (Ariz. Ct. App. 1974). The law only requires a landlord's efforts to be reasonable and not heroic. Wingate v. Gin, 714 P.2d 459, 461-62 (Ariz. Ct. App. 1985); see also Dushoff, 528 P.2d at 641. If a landlord makes reasonable but unsuccessful efforts to re-let the premises, he is entitled to the full amount of the rent due under the lease. Tempe Corp. Office Bldg., 807 P.2d at 1135; see Stewart Title, 628 P.2d at 53. The reasonableness of the landlord's efforts to re-let is "determined by an examination of the totality of the circumstances giving due regard to the efforts of the landlord in renting the abandoned premises, and the number of units he has for rent." Wingate, 714 P.2d at 462 (citing Dushoff, 528 P.2d at 641).

If a defaulting tenant claims that the landlord has failed to satisfy the duty to mitigate damages, the tenant must show "that the reletting efforts and the asking rental price were not reasonable . . . . " Wingate, 714 P.2d at 462. This burden requires the tenant to present evidence from a realtor, leasing agent, or other person to dispute the reasonableness of the landlord's re-letting efforts. In the absence of this evidence, the landlord is entitled to judgment. Id.

In the instant case, the law of the case doctrine becomes an important analytical tool. According to this doctrine, a court should follow prior decisions entered in the same case unless: "(1) the decision is clearly erroneous and its enforcement would work

a manifest injustice; (2) intervening controlling authority makes reconsideration appropriate; or (3) substantially different evidence was adduced at a subsequent trial." Alimalo v. U.S., 645 F.3d 1042, 1049 (9th Cir. 2011); see Hegler v. Borg, 50 F.3d 1472, 1475 (9th Cir. 1995).

As mentioned above, by not accepting Mountainside's surrender, R.S. Lots incurred a duty to make reasonable efforts to re-let the premises. Arizona law requires that the landlord's efforts be reasonable and not heroic. Mountainside argues that R.S. Lots was acting as an agent for Mountainside and was therefore required to act only for the benefit of Mountainside. While the Lease mentions that R.S. Lots can attempt to re-let the premises as an agent for Mountainside, the same provision also notes that the term and the rate for the new lease is left up to R.S. Lots to determine in its sole discretion. Tenant Lease 27.2(f), ECF No. 75-1. While Riggs notes that if the tenant agrees to let the landlord re-let the premises, the landlord acts as an agent for the tenant, the court also notes that this principle is "the law . . . in the absence of any provision of the lease touching the problem." Riggs, 458 P.2d at 118. Here, there is an express provision in the Lease that mentions that the rate and term of the re-letting will be left exclusively to the landlord. Furthermore, Riggs did not involve the issue of whether a landlord's actions in re-letting the premises were reasonable. Instead, the central issue in Riggs was whether the tenant abandoned its lease. See generally Riggs, 458 P.2d at 117-19.

Additionally, Mountainside confuses the reasonableness standard required by R.S. Lots in its efforts to re-let the premises. In its Proposed Findings of Fact and Conclusions of Law, Mountainside states that "R.S. Lots acted for its own benefit and not for the benefit of Mountainside while attempting to re-let the Premises[.]" Def.'s Prop. Findings 11, ECF No. 102. Mountainside appears to be basing this proposed conclusion on the Riggs opinion which states in pertinent part " . . . the trier of facts must . . . determine whether the dominion and control exercised by the landlord was for the landlord's own benefit or for the benefit of and on behalf of the tenant." Riggs, 458 P.2d at 118; see also Dushoff, 528 P.2d at 640. However, as mentioned above, and as noted

both in Riggs and Dushoff, this standard is used to determine "the intent of the landlord in accepting [the tenant's] abandonment . . . . ", Riggs, 458 P.2d at 118; see also Dushoff, 528 P.2d at 640, and not in determining the reasonableness of the re-letting efforts.

To put a finer point on it, Mountainside's argument is primarily based upon its interpretation of the lease and applicable law that, in a situation such as this, the lessor must act primarily for the benefit of the lessee. But, as noted above, this is neither what the law is nor what the lease says.

The Court previously found that R.S. Lots was reasonable in rejecting three offers made for the premises by Desert Fitness, CR Entertainment, and Phoenix Theater Company. Order Grant. Part. Summ. J. 4, ECF No. 33. Since there is no reason why prior decisions of this case should not be honored, these offers are deemed reasonable per the law of the case doctrine. Furthermore, the Court noted that R.S. Lots provided evidence to show that the market rate was between $8.00 and $15.00 per square foot, while Mountainside provided no evidence of a reasonable market rate. Id. at 5. The Court noted that the three offers were less than the market rent provided by R.S. Lots. Id. at 5-6.

Therefore, the only potential re-letting opportunity required to analyze here is the offer R.S. Lots made to Fitness Factory. R.S. Lots offered to lease the premises to Fitness Factory for a period of 10 years at a base rent of $10 per square foot, with 22 months of partially abated rent. Pl.'s Prop. Findings 10, ECF No. 103. Fitness Factory rejected this offer and made no counter-offer. Id. Because the rental price of $10.00 per square foot was on the low end of the market rental rate provided by R.S. Lots, the Court deems this offer was reasonable. Mountainside did not provide the testimony of another real estate broker to dispute the reasonableness of R.S. Lots' re-letting efforts. All it did was depose Bruce Milton, R.S. Lots' broker, pre-trial and cross-examine him at trial. For this reason, the Court finds that Mountainside did not meet its burden in showing that R.S. Lots did not engage in reasonable efforts to re-let the premises.

IV.The Hattens' Community Property is Liable Under the Guaranty Only to the Extent of Thomas Hatten's Contribution to the Marital Community

Under Arizona law, community property is liable for the premarital separate debts of a spouse to the extent of the value of that spouse's contribution to the community property which would have been such spouse's separate property if single. ARIZ. REV. STAT. ANN. § 25-215(B) (2011) (West); see Flexmaster Aluminum Awning Co., Inc. v. Hirschberg, 839 P.2d 1128, 1132-33 (Ariz. Ct. App. 1992). Additionally, a non-debtor spouse's interest in the community property includes a due process right to litigate the premarital debt and the value of the debtor spouse's contribution to the marital community. Flexmaster, 839 P.2d at 1133. For this reason, a creditor wanting to collect a pre-marital debt from the community property must join both spouses in its complaint, because "a nondebtor spouse is a necessary and proper party in a suit to establish the limited liability of the community . . . for separate, premarital debts." Id. Therefore, "a judgment against the marital community for a separate premarital debt is not valid unless both spouses are joined in the action." Id.

Thomas and Brigid Hatten entered into a prenuptial agreement on October 23, 2008 which provides that all property acquired after marriage will be the separate property of the acquiring party. Prenupt. Agmt. 3, ECF No. 9, Ex. H. However, the agreement also reserves to the parties the right to obtain property as community property. Id. The agreement also notes that the premarital debts of each party shall be paid by the separate property of the party that contracted the debt, but prohibits the community's right to reimbursement in the event that community property is used to pay premarital separate debts. Id. at 2. Additionally, the agreement requires the party who contracts the debt to indemnify the sole and separate property of the other party from the debt. Id. at 4-5.

In its Order granting partial summary judgment, the Court briefly discussed the community property issue. First, the Court held that Brigid is not liable for the guaranty to the extent of either her separate property or her interest in the community property.

Order Grant. Part. Summ. J. 6, ECF No. 33. It noted that while currently there is no community property, the agreement reserves the right to create community property. Id. Since there is a possibility that the Hattens will create community property in the future, there is a possibility that Mr. Hatten will be able to shield his separate property from the debt owed to R.S. Lots by contributing his separate property into the community property. Thus, although the Arizona statute allows R.S. Lots the limited ability to collect against the community for Mr. Hatten's premarital debts, if Ms. Hatten is not joined in the original lawsuit, constitutional due-process requirements will prevent R.S. Lots from being able to collect from the community property, if any, in the future. In sum, Brigid Hatten is only named in this judgment to allow R.S. Lots to collect from the Hatten Community only to the extent of Thomas Hatten's separate property contribution to the community, if any, in the future.

Brigid Hatten's frustration with this situation is easily understood. By contract with R.S. Lots, her sole and separate property is not liable for this debt and by contract with Thomas Hatten, they jointly agree that they do not have any community property, and, by Arizona law, any community property is only liable for the debt to the limited extent that Thomas Hatten contributes. This creates a very small window of potential liability. However, the parties also did contract that they MAY acquire community property in the future and it is that small crack in the armor that justifies this limited judgment against Brigid Hatten. Otherwise, as noted by R.S. Lots, an opportunity for mischief through transfer of assets exists.

V.Conclusion

R.S. Lots did not accept Mountainside's abandonment of the Lease. Instead, pursuant to the terms in the Lease, R.S. Lots took steps in order to re-let the premises, thereby trying to mitigate its damages. The Court previously found that R.S. Lots was reasonable in rejecting three of the offers it received for premises abandoned by Mountainside. Per the law of the case doctrine, these three offers remain reasonable.

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R.S. Lots made an offer to re-let the premises to Fitness Factory for a price per square foot that was on the low-end of what the Court found was a reasonable re-letting price. Therefore, this offer must also be considered reasonable. Fitness Factory rejected the offer and did not present a counter-offer. Both under the Lease and Arizona law, there is no requirement that R.S. Lots act as an agent for Mountainside, and re-let for the benefit of Mountainside. R.S. Lots therefore acted reasonably in trying to re-let the premises, and unfortunately was not able to find a tenant. Mountainside thus remains liable for the rent under the Lease.

Mountainside, Thomas Hatten, and Hatten Holdings are liable to R.S. Lots for rent and other charges accrued under the Lease, from April 1, 2010 through November 3, 2011in the amount of $874,378.99. Though Thomas and Brigid Hatten currently do not have any community property, their premarital agreement expressly reserves the right to create community property in the future. R. S. Lots will able to collect from the Hatten community property to the extent of Thomas Hatten's separate contribution to the community, if any. R.S. Lots will not be able to collect from Brigid Hatten's separate property or her contribution to the community.

Counsel for plaintiff is to prepare a form of judgment.

So ordered.

Dated: February 2, 2012

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CHARLES G. CASE II
UNITED STATES BANKRUPTCY JUDGE

COPY of the foregoing mailed by the BNC and/or
sent by auto-generated mail to:

all interested creditors and parties.