UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF SOUTH CAROLINA

IN RE:

Heritage Leasing Corporation,

Debtor.

C/A No. 96-75946-W

JUDGMENT

Chapter 7

Based upon the Findings of Fact and Conclusions of Law as recited in the attached Order of the Court, the Trustee's objection to the proof of claim filed by Greenberg-King Associates ("GKA") is granted in part and denied in part. Greenberg-King Associates shall have an allowed administrative priority claim for the time period between August 22, 1996 and October 1, 1996 to the extent it proves the value of the actual and necessary benefit conferred upon the estate. The Court will allow the parties an additional amount of time to negotiate the amount of GKA's administrative priority claim. If the parties are unable to agree on an amount within twenty (20) days following the entry of this Order, either party may file a motion with this Court and the Court will conduct a further hearing on the matter. As to GKA's unsecured claims, the Court reserves ruling on those claims in so far as such a ruling is unnecessary to the distribution of the estate.

UNITED STATES BANKRUPTCY JUDGE

Columbia, South Carolina,
September 17, 1998.

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UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF SOUTH CAROLINA

IN RE:	C/A No. 96-75946-W
Heritage Leasing Corporation,	**ORDER**
Debtor.	Chapter 7

THIS MATTER comes before the Court upon the Chapter 7 Trustee's objection to two alternative proof of claims filed by Greenberg-King Associates pursuant to 11 U.S.C. § 502.[1] Based upon the evidence presented, the Court makes the following Findings of Fact and Conclusions of Law.

FINDINGS OF FACT

In 1995, the Debtor, Heritage Leasing Corporation ("Heritage" or "Debtor") and another company, Bucci's Interior's, Inc .("Bucci") decided to rent retail space together on Hilton Head Island, South Carolina. Heritage and Bucci had the intention of forming a South Carolina limited liability company called The Showroom, LLC to act as the tenant with Heritage and Bucci each occupying about 50% of the space. On June 1, 1995, The Showroom, LLC entered into a "triple net" Lease (the "Lease") with Greenberg-King Associates ("GKA") with Jeffrey R. Long signing the Lease as President of Heritage and Mary Jane Bucci signing as President of Bucci. The Lease was also guaranteed by Jeffrey R. Long, Mary Jane Bucci, Heritage and Bucci. However, after the Lease agreement was entered into, Mary Jane Bucci as the President of Bucci decided not to enter into this arrangement and

[1] Further references to the Bankruptcy Code, 11 U.S.C. § 101, *et seq.*, shall be by section number only.

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The Showroom, LLC was never formed as a limited liability company. The parties continued to operate pursuant to the Lease with Heritage and Bucci making monthly payments directly to GKA.

On August 22, 1996, the Debtor filed a Chapter 7 petition, discontinued its business operations and thereafter stopped paying rent to GKA. Bucci remained in the premises and continued to make monthly payments while GKA continues to seek a new tenant. On the petition date, there were forty-eight (48) months remaining on the Lease. As of August 1, 1996, the rent had increased from $5,000.00 per month to $5,147.50 pursuant to Article 2.03 of the Lease. Also, pursuant to Article 5.07 of the Lease, GKA had expended $50,000 resulting in the supplemental base rent under the Lease at $1,062.36 per month for the remaining forty-eight (48) months. GKA also anticipated $3,465.13 of annual expenses that would be passed on to The Showroom, LLC pursuant to Article 2.05 of the Lease. As of the petition date, Heritage and Bucci had not missed any monthly rental payments.

On September 30, 1996, the Trustee filed a motion to reject the Lease. The motion which was served on GKA stated that "the Trustee prays for an Order rejecting the above-described nonresidential real property lease, effective October 1, 1996, pursuant to 11 U.S.C. § 365." On November 7, 1996, after notice and a hearing to which no objections were filed, the Court entered the Order presented by the Trustee which stated "that this lease will be deemed rejected as of October 1, 1996 so that any administrative priority claims filed under this lease will not be allowed after this date."

GKA takes the position that Heritage and Bucci were partners of The Showroom, LLC and because it was not effectively incorporated as a LLC, it was therefore a partnership and

Heritage is jointly liable with Bucci on the Lease. On January 13, 1997, GKA filed a priority administrative proof of claim pursuant to § 503(b) in the amount of $78,233.45 representing twelve (12) months of the base rent at $61,770.00, twelve (12) months of the supplemental base rent at $12,748.32, twelve (12) months of the additional rent at $3,465.13 and attorney's fees in the amount of $250.00. The amount appears based upon the one (1) year limit of rent pursuant to § 502(b)(6). Also on January 13, 1997, GKA filed an alternative unsecured claim in the amount of $294,586.86 based upon the theory that if the Debtor is jointly and severely liable as a partner of The Showroom, LLC for all that The Showroom, LLC is liable to GKA, the amount of the claim is the base rent through August 31, 2000 of $247,080.00, $50,993.28 representing the supplemental base rent through August 31, 2000, an additional rent through August 31, 2000 of $13,860.52, and attorney's fees in the amount of $250.00 less any amounts realized on liquidation of five hundred (500) shares of stock which were pledged by the Debtor at the time when the lease was entered. Another alternative theory of collection by GKA as an unsecured claimant is based upon the Debtor's guarantee liability which is $120,000.00.

CONCLUSIONS OF LAW

Pursuant to § 365, generally a Chapter 7 trustee can either accept or reject a lease entered into by a debtor and if the lease is rejected, pursuant to § 502(g) and § 365(g), the lessor will have a prepetition unsecured claim. In this particular instance, GKA takes the position that the Lease at issue was not between it as lessor and the Debtor but was between GKA as lessor and The Showroom as lessee. According to GKA's argument, because The Showroom was never effectively incorporated as a limited liability corporation, The

Showroom is a partnership between Heritage Leasing and Bucci and the actions of the Trustee, as the successor partner in The Showroom, in rejecting the Lease and leaving the premises caused a postpetition breach of lease. Therefore GKA argues that its claim is not limited to an unsecured claim but that it is entitled to an administrative expense priority claim pursuant to § 503(b)(1). The Court does not agree.[2]

Section 503(b) of the Code defines six specific types of claims that qualify for first priority administrative expenses. GKA takes the position that it is entitled to an administrative expense for providing the actual and necessary costs for preserving the estate pursuant to § 503(b)(1)(A).

> After notice and a hearing, there shall be allowed administrative expenses ..., including(1)(A) the actual, necessary costs and expenses of preserving the estate, including wages, salaries, or commissions for services rendered after the commencement of the case.

11 U.S.C. § 503(b)(1)(A). However, administrative expense priority claims are to be narrowly construed and the burden of proof is upon the claimant.

> Generally, a claim for an administrative expense status will qualify under 11 U.S.C. § 503 if the right to payment arose from a post-petition transaction with the debtor estate rather than from a prepetition transaction with the debtor, and the conduct giving rise to the payment was beneficial to the estate of the debtor. Hemingway Transport, 954 F.2d at 10; Jartran, 732 F.2d at 587; Mammoth Mart, 536 F.2d at 954. The burden of proving entitlement to an administrative expense priority rests with the party requesting it. Hemingway Transport, 954 F.2d at 10; Drexel Burnham, 134 B.R. at 489. Additionally, administrative expense

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[2] It is unnecessary to this ruling to determine if the Debtors' obligations as a partner may constitute an executory contract which may be rejected by the Trustee or deemed rejected by virtue of § 365(d)(1). See In re Catron, 25 F.3d 1038 (4th Cir. 1994)(Unpubl.), In re Catron, 158 B.R. 629 (E.D.Va. 1993) and In re Catron, 158 B.R. 624 (Bkrtcy. E.D.Va. 1992).

> priorities are to be narrowly construed to foster the paramount principle in bankruptcy of equitable distribution among creditors. McFarlin's, 789 F.2d at 100; Jartran, 732 F.2d at 586; Mammoth Mart, 536 F.2d at 953.

In re New York Trap Rock Corp, 137 B.R. 568 (Bkrtcy.S.D.N.Y. 1992).

The definition of actual and necessary in the context of § 503(b)(1)(A) has been expanded by the Supreme Court which has held that actual and necessary costs of administration include damages to parties resulting from the postpetition negligence of a Chapter 11 debtor-in-possession or trustee. Reading Co. v. Brown, 88 S.Ct. 1759, 391 U.S. 471 (1968).

GKA posits that the Trustee's actions, similar to the receiver's actions in Reading, give rise to an administrative priority claim because the Trustee's actions in sending a letter to GKA about terminating The Showroom Lease and the abandonment by the Trustee of the premises resulted in a breach of a Lease between GKA and The Showroom. GKA takes the position that as a partner of The Showroom with Bucci, the Trustee could have filed a Chapter 7 petition for The Showroom partnership and then the Trustee for The Showroom could have properly rejected the Lease pursuant to § 365.

The Court does not agree with GKA's argument for three reasons. In Reading Co. v. Brown, the Supreme Court was concerned with fundamental fairness.

> The Court [Reading Co. v. Brown] held that considerations of fundamental fairness and logic required the allowance of a claim of administrative priority for damages resulting from the postpetition negligence of a receiver in a Chapter XI case because such damages were "actual and necessary costs" of administration. The Court stated that "actual and necessary costs" should "include costs ordinarily incident to operation of a business, and not be limited to costs without which rehabilitation would be impossible." The

> Court reasoned that allowing the administrative claims of the tort claimants would allocate the burden of the tort damages arising from the operation of the debtor postpetition to the prepetition creditors, who, according to the Court, are the parties for whom a debtor's rehabilitation is pursued.

4 Collier on Bankruptcy, ¶ 503.06[3][c][i] (15th ed. rev. 1997). The facts within are significantly different from the facts in Reading Co. v. Brown.

Initially, the actions of the receiver in Reading Co. v. Brown involved negligence. The Reading Co. v. Brown standard was further expanded by the First Circuit Court of Appeal in In re Charlesbank Laundry, 755 F.2d 200 (1985) to include intentional torts committed by a Chapter 11 debtor-in-possession. However, in the case before the Court, there was no proof that the actions of the Chapter 7 trustee amounted to negligence or the commission of an intentional tort. The wrong asserted by GKA appears at most to be based upon an allegation of a breach of a contract. Additionally, under the facts before the Court, there do not appear to be circumstances which amount to a "fundamental unfairness" to GKA. Whether the Trustee could effectively reject the Lease pursuant to § 365 or not, it is clear that neither the Debtor nor the Chapter 7 Trustee had funds with which to pay the Lease nor had any further need to use the premises, certainly not for the full term of the Lease. In making the effort to reject the Lease (which was fully noticed to GKA and to which it did not file a response), the Trustee was certainly making a timely effort to vacate the premises and make them available to the lessor. There was no convincing evidence that the Trustee had any intention to, nor took any action under which he should be presumed to, assume the Lease postpetition. Similarly, there was no competent evidence that the Trustee acted negligently or intentionally to harm GKA. Unfortunately for GKA, it entered into a prepetition contract with a party which at some point

became insolvent and could not perform in the future. Not only is this case distinguishable from Reading Co. v. Brown, but it would be fundamentally unfair to assert a liability for such a prepetition contract against a Chapter 7 Trustee under the theory espoused by GKA.

Secondly, Reading Co. v. Brown involved the postpetition actions of an ongoing Chapter 11 business, not a liquidating Chapter 7 as in the case before the Court. Some courts have held that Reading Co. v. Brown and In re Charlesbank Laundry should not be applied in the situation of a liquidating, non-operating Chapter 7 case.

> Neither Reading Co. v. Brown, 391 U.S. 471, 88 S.Ct. 1759, 20 L.Ed.2d 751 (1968) (Post-petition tort of Chapter 11 trustee is an administrative expense.) nor In re Charlesbank Laundry, Inc., 755 F.2d 200 (1st Cir.1985) (Contempt judgment for debtor-in-possession's post- petition violation of injunction requiring it to abate a nuisance is an administrative expense.) requires a different result because neither of these applies to a Chapter 7 trustee.

In re Microfab, Inc., 105 B.R. 161 (Bkrtcy.D.Mass.1989). The reason for not applying the Reading Co. v. Brown type claim in a Chapter 7 liquidating case is because of the lack of an on-going business.

> Most decisions employing the Reading rationale have arisen in the context of reorganization proceedings. See, e.g., In re Microfab, Inc., 105 B.R. 161, 168 n. 20 (Bankr.D.Mass.1989) (Reading-Charlesbank rationale inapplicable in liquidating chapter 7 case). But cf. In re Pierce Coal & Constr., Inc., 65 B.R. at 530 (Reading applicable where chapter 7 trustee operated business of debtor). Application of the Reading-Charlesbank rationale in the context of an ordinary, nonoperating liquidation proceeding appears extremely problematic, as one fundamental justification for the priority is that general creditors stand to benefit from the postpetition operation of the debtor's business, either through the immediate generation of operating profits or through the ultimate reorganization of the debtor as a viable business entity.

In re Hemingway Transport, Inc., 954 F.2d 1 at Fn. 5 (1st Cir. 1992). While conceivably Reading Co. v. Brown could be applied in certain Chapter 7 cases, such as one where the Trustee is operating a business or takes actions in bad faith, the particular activities of this Chapter 7 Trustee in the liquidation and collection of assets for distribution do not meet that criteria. Therefore, this Court declines to apply the Reading Co. v. Brown rationale to this Chapter 7 case.

Finally, the fact that the liability being asserted by GKA is grounded upon the breach of a prepetition, unassumed contract of a Chapter 7 debtor distinguishes it from the reasoning of Reading Co. v. Brown and § 503.

> For a claim to qualify as an administrative expense, (1) the claim must arise out of a post-petition transaction between the creditor and the debtor-in-possession (or trustee) and (2) the consideration supporting the claimant's right to payment must be supplied to and beneficial to the debtor-in-possession in the operation of the business. Trustees of Amalgamated Ins. Fund v. McFarlin's, Inc., 789 F.2d 98, 101 (2d Cir.1986); Nostas Assocs. v. Costich (In re Klein Sleep Prods., Inc.), 173 B.R. 296, 298-99 (S.D.N.Y.1994).

In re Stewart Foods, Inc., 64 F.3d 141 (4th Cir. 1995). Also see Cumberland Farms, Inc. v. Florida Dept. of Environmental Protection, 116 F.3d 16 (1st Cir. 1997) citing In re Hemingway Transport, Inc., 954 F.2d at 4,5. The Second Circuit has stressed the importance of the postpetition nature of the transaction to the applicability of § 503.

> The statutory objective of 11 U.S.C. § 503 is to "keep the business afloat" for the benefit of the debtor's creditors. David G. Epstein, Steve H. Nickles, and James J. White, Bankruptcy, § 7-11 at 463 (West 1993). As the Second Circuit has noted:
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> > Congress granted priority to administrative expenses in order to facilitate the efforts of the trustee or debtor in possession to rehabilitate the business for the benefit of all the estate's creditors *

> * *. Congress reasoned that unless the debts incurred by the debtor in possession could be given priority over debts which forced the estate into bankruptcy in the first place, persons would not do business with the debtor in possession, which would inhibit rehabilitation of the business and thus harm creditors.
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> Trustees of Amalgamated Insurance Fund v. McFarlin's, 789 F.2d 98, 101 (2nd Cir.1986). Here, the trustee's attempt to pursue Beyond Words' claim against appellant has nothing to do with the post-petition operation of Beyond Words' business.

In re Beyond Words Corp., 193 B.R. 540 (D.N.D.Cal. 1996). It appears that under usual circumstances, the assertion of a postpetition breach of a lease entered into prepetition is considered a prepetition liability.[3]

> Nonetheless, regardless of the nature of the contract (executory or non-executory), if at the time of the bankruptcy filing the debtor has an obligation under the contract to pay money to the non-debtor party, that obligation is handled as a prepetition claim in the bankruptcy proceedings. In re Stewart Foods, Inc., 64 F.3d 141 (4th Cir. 1995)... However, the fact that the payments became due after the bankruptcy filing does not alter the conclusion that the payments are prepetition obligations. Chiasson v. J. Louis Matherne & Assocs. (In re Oxford Management, Inc.), 4 F.3d 1329, 1335 n. 7 (5th Cir. 1993) ("A claim is not rendered a postpetition claim simply by the fact that time for payment is triggered by an event that happens after the filing of the petition."); United States through Agricultural Stabilization & Conservation Serv. v. Gerth, 991 F.2d 1428, 1433 (8th Cir. 1993) ("[D]ependency on a postpetition event does not prevent a debt from arising prepetition."); Braniff Airways, Inc. v. Exxon Co., U.S.A., 814 F.2d 1030, 1036 (5th Cir. 1987) ("The character of a claim is not transformed from prepetition to postpetition simply

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[3] While the Fourth Circuit Court of Appeals has held that for purposes of relief from stay motions, a postpetition breach of a contract is a postpetition action, Bellini Imports, Ltd. v. Mason and Dixon Lines, Inc., 944 F.2d 199 (4th Cir. 1991), unlike the facts within, that case involved a contract that was entered into postpetition by a Chapter 11 debtor. Additionally, the case relied upon by the Fourth Circuit, In re York, 13 B.R. 757 (Bkrtcy.D. Me. 1981) involved a personal injury claim that arose post-confirmation of a debtor's Chapter 13 plan.

> because it is contingent, unliquidated or unmatured when the debtor's petition is filed."). In re Stewart Foods, Inc., 64 F.3d at 146.

In re Cordero, 95-71920-W, C-95-8299 (Bkrtcy.D.S.C. 1/16/96).

One recent opinion from the Ninth Circuit declined to award an administrative expense claim to a creditor who received a postpetition state court award for attorney's fees because the underlying agreement, similar to the agreement within, was entered into prepetition.

> Appellant argues that the Reading exception should apply in this case because [Claimant] was "injured" by the debtor-in-possession's postpetition decision to continue defending the trial court judgment rather than conceding its invalidity in the Oregon Supreme Court. Yet the source of the estate's obligation remains the prepetition fee provision. For that reason the First Circuit rejected Hayden's very argument in In re Hemingway Transport, Inc., 954 F.2d 1 (1st Cir.1992).

In re Abercrombie, 139 F.3d 755, 757-758 (9th Cir. 1998). In the Hemingway Transport, Inc. opinion cited by the Ninth Circuit, the First Circuit Court of Appeals found that a creditor was not entitled to a priority claim incurred in defending against a Chapter 7 trustee's postpetition action because the right to the attorney's fees arose from a prepetition contract. Based upon the authority cited within, it appears that the right to payment asserted by GKA arises not from a postpetition transaction with the Trustee but is based upon a liability incurred by the Debtor prepetition; that being, the Lease. The Lease and the agreements to form this limited liability corporation were prepetition agreements and the Debtor's default under the Lease was triggered by the Debtor's insolvency and its filing of the bankruptcy petition, not some postpetition action on the part of the Chapter 7 Trustee. The Trustee took no action to induce GKA to extend a benefit to the estate postpetition.

Furthermore, this Court finds support for its ruling in In re Merry-Go-Round Enterprises, Inc. 208 B.R. 637 (Bkrtcy. D.Md. 1997). In that case, the landlord sought to assert a Chapter 7 administrative expense claim for damages, including a future rent claim, incurred due to a breach of a lease which had been assumed postpetition in a Chapter 11 case before it was then rejected by a Chapter 7 Trustee after conversion of the case.

> The Landlord's argument carries too far. Merely because the Chapter 7 Trustee did not perform the Cutler Ridge Mall lease that was entered into postpetition, but preconversion, by MGRE as debtor in possession does not mean such failure created a Chapter 7 administrative damage claim for breach of the lease. For the Landlord's claim to constitute a Chapter 7 administrative claim, first, the claim must have arisen out of a postconversion transaction between the Landlord and the Chapter 7 Trustee, and second, the consideration provided by the Landlord must (a) have been supplied to the Chapter 7 Trustee and (b) have been beneficial to the Chapter 7 estate. See, In re Stewart Foods, Inc., 64 F.3d 141, 145 n. 2 (4th Cir. 1995) (dicta). Only the rent due for the short period that the Chapter 7 Trustee used the Cutler Ridge Mall store for the G.O.B. sale safely passes this test.
>
> The Landlord's future rent damage claim for breach of the Cutler Ridge Mall lease fails both prongs of the test for qualifying as a Chapter 7 administrative expense. First, the claim arises out of a lease transaction entered into by MGRE as debtor in possession during administration of the Chapter 11 case, and not by the Trustee. Second, the consideration supplied by the Landlord was the lease to MGRE for the benefit of the Chapter 11 estate. The lease was not supplied to the Chapter 7 Trustee, and the lease contract was not beneficial to the Chapter 7 estate. This Chapter 7 Trustee did not even have the power under Section 365 to assume and assign the Landlord's postpetition lease.

In re Merry-Go-Round Enterprises, Inc. 208 B.R. at 642-643.

CONCLUSION

While there may be circumstances which could give rise to an administrative priority

claim pursuant to Reading Co. v. Brown, none exist in this particular case. The Trustee's motion was to limit any liability that the Chapter 7 estate of Heritage would have to GKA while at the same time, allowing and preserving GKA's rights to re-enter the premises. For these reasons, the fundamental unfairness criteria of Reading Co. v. Brown is not present. To adopt the position of GKA would be similar to making a Chapter 7 trustee liable for the breach of a contract claim when a debtor, who had been current on his payments prepetition, stops making those payments after filing for Chapter 7 relief. This was not the purpose of the Reading Co. v. Brown decision.

Furthermore, the Trustee's motion which was directed to GKA was explicit in the intentions of the Trustee and because GKA did not object to the motion, it should be estopped from asserting an administrative expense claim for its future rent damages beyond October 1, 1996 at this stage of the proceedings.

For all of these reasons, and because the claimant bears the burden of proving that its claim is entitled to priority as an administrative expense, In re Jamesway Corp., 202 B.R. 697 (Bkrtcy.S.D.N.Y. 1996), the Court finds that GKA has not met its burden of proof and is not entitled to a Reading Co. v. Brown type administrative expense claim.[4]

However, at the trial of this matter the Trustee indicated that he recognized some benefit to the estate for his use of the premises to continue to store the personal property and records of the insolvent Debtor up and until October 1, 1996. Since GKA has taken the position that it does not have a lease with the estate, it has abandoned the position that such an administrative expense should be based on the rent allocable under the Lease as provided in § 365(d)(3). The burden of

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[4] While GKA limited its administrative priority claim to a twelve (12) month period, ostensibly pursuant to § 502(g), there is authority indicating such a limit may not apply. In re Merry-Go-Round Enterprises, Inc. 208 B.R. 637 (Bkrtcy. D.Md. 1997).

proof is therefore upon GKA to demonstrate the value of the benefit which it provided the estate, if any, for the use of the premises for that limited time. In re Myrtle Beach Golf & Yacht Club, 118 B.R. 406 (Bkrtcy. D.S.C. 1990) and In re Cappelmann, 94-75599-W (Bkrtcy.D.S.C. 12/23/96)(Unpubl.). The Court will therefore allow the parties an additional amount of time to agree, if possible, upon an amount of an administrative priority claim for GKA. If the parties are unable to agree on an amount within twenty (20) days following the entry of this Order, either party may file a motion with this Court and the Court will conduct a further hearing on the matter.

Additionally, as to the objection by the Trustee to GKA's unsecured claims, in as much as the Trustee reported at trial, and the claimant agreed, that it was unlikely that there would be any dividend payable in this case to unsecured creditors, the Court believes it is unnecessary at this time to rule upon the objections to the alternative unsecured claims. Therefore, the Court reserves ruling on those matters until such time as the Trustee reports that such a ruling is necessary. For all of the reasons stated within, it is therefore,

ORDERED, that the Trustee's objection to the proof of claim filed by Greenberg-King Associates is granted in part and denied in part. Greenberg-King Associates shall have an allowed administrative priority claim for the time period between August 22, 1996 and October 1, 1996 when the Chapter 7 estate had use of its facility to the extent it proves the value of the actual and necessary benefit conferred upon the estate. The Court will allow the parties an additional amount of time to negotiate the amount of GKA's administrative priority claim. If the parties are unable to agree on an amount within twenty (20) days following the entry of this Order, either party may file a motion with this Court and the Court will conduct a further hearing

on the matter. As to GKA's unsecured claims, the Court reserves ruling on those claims in so far as such a ruling is unnecessary to the distribution of the estate.

AND IT IS SO ORDERED.

UNITED STATES BANKRUPTCY JUDGE

Columbia, South Carolina,
September 17, 1998.

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