

Dated: December 13, 2004
The following is ORDERED:





Jennie D. Latta
UNITED STATES BANKRUPTCY JUDGE

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF TENNESSEE
WESTERN DIVISION

In re
MERIDIAN CORPORATION,
a/k/a MEDSHARES, INC.,
Debtors.

Case Nos. 99-28923-L through 99-29025-L
Chapter 11

and

In re
SYMPHONY HOME CARE SERVICES
NO. 18 - LOUISIANA, INC.,
Debtor.

Case Nos. 99-30101-L through 99-30125-L
Chapter 11
JOINTLY ADMINISTERED

In re
MEDSHARES INC.
OF SOUTH CAROLINA,
Debtor.

Case No. 99-28959-L
Chapter 11

MEMORANDUM AND ORDER
ON CROSS-MOTIONS FOR SUMMARY JUDGMENT

BEFORE THE COURT are the motion for summary judgment filed by the Debtor,
Medshares, Inc. of South Carolina, and the cross motion for summary judgment filed by HCA Inc.,

f/k/a HCA – The Healthcare Company, formerly Columbia/HCA Healthcare Corporation, and its affiliates (collectively, “HCA”). The motions relate to an underlying motion, first filed October 16, 2000, then re-filed with amendments on June 10, 2002, by HCA and its affiliate, North Trident Regional Hospital, Inc., for allowance of post-petition administrative expenses in the amount of \$189,583.92 arising from a lease of premises used as a home health agency in Charleston, South Carolina. National Century Financial Enterprises (“NCFE”), the holder of certain pre- and post-petition claims against the Debtor’s bankruptcy estate, has filed a response in support of the Debtor’s motion. Both the Debtor and HCA contend that there are no genuine issues of material fact remaining to be resolved, but each asserts that it is entitled to judgment as a matter of law. This is a core proceeding. 28 U.S.C. § 157(b)(2)(B).

FACTS

The following facts are undisputed. On September 23, 1998, Columbia/HCA Healthcare Corporation and certain of its affiliates, and Medshares Consolidated, Inc. (“Medshares”) entered into an Asset Purchase Agreement (“APA”) providing for the purchase and sale of certain home health agencies owned and operated by HCA, including a home health agency known as Columbia HomeCare Coastal Carolina (the “South Carolina Home Health Agency”) at premises known as 29 Leinbach Drive, Building D, Units 1, 2, 3, 4, and 5, Charleston, South Carolina (the “South Carolina Premises”). Pursuant to the APA, closing was to occur on or after September 30, 1998, and, with respect to leases, was to be accompanied by an assignment executed by the owner. The

APA is silent as to the assumption of the leasehold obligations of HCA by the buyer. With respect to the South Carolina Home Health Agency, the buyer was anticipated to be the Debtor.

On July 29, 1999, the Debtor and 102 affiliated companies filed voluntary petitions for relief under Chapter 11 of the United States Bankruptcy Code. On August 20, 1999, another 25 affiliated agencies filed voluntary petitions as well. On August 30, 1999, an order was entered providing for the joint administration of all the cases. On June 26, 2003, an order was entered approving the sale of substantially all the assets of the Medshares debtors to TBJG, LLC. Pursuant to the terms of sale, all administrative claimants share pro rata in a fund of \$1,250,000.00. The court is now in the process of liquidating the remaining administrative expense claims so that payments can be made pursuant to the terms of sale.

The proof of claim filed by HCA indicates that Medshares gave notice prior to closing that it would be unable to pay the cash portion of the purchase price called for in the APA. It obtained HCA's consent to a 14-day deferral for the payment, but never made the payment. Further, Medshares defaulted on payment due HCA under a note given for the balance of the purchase price. HCA has allocated to the Debtor a portion of the amounts due by Medshares for each of these obligations. In addition, HCA claims that pursuant to the APA, Medshares and the Debtor assumed certain obligations which were not performed by the Debtor. HCA claims an undetermined amount as a pre-petition claim against the Debtor as the result of failure to perform assumed obligations. The type of obligation encompassing all of this undetermined amount is identified in Exhibit A to HCA's proof of claim as "Lease on Real Property." Finally, HCA claims that it is owed an

undetermined amount from the Debtor pursuant to a Collection Agreement entered into with Medshares and related debtors including the Debtor in this case.

In addition to its pre-petition claim, HCA has filed a motion for allowance of post-petition administrative expenses. HCA claims that it is owed \$189,583.92 as the result of the Debtor's failure to pay post-petition rent. The motion claims that HCA paid rent on the Debtor's behalf and thus provided a benefit to the bankruptcy estate. Further, HCA claims that by paying the rent owed, it is subrogated to the rights of the landlord, including the right to pursue an administrative expense claim.

The lease for the South Carolina Premises (the "Lease") which is the subject of HCA's motion is dated March 31, 1995. The parties are Brilliant-Estes as landlord (the "Landlord"), and North Trident Regional Hospital as tenant (the "Prior HCA Tenant"). A complete copy of the Lease was attached to HCA's motion for allowance of administrative expense claim and to the Affidavit of Thomas F. Ramsey. Debtor and HCA agree that pursuant to an addendum to the Lease, the monthly rental payment was \$10,397.08 from October 1, 1995, throughout the term of the Lease. The Lease as amended terminated on September 14, 2000. As of September 14, 2000, the Debtor had not rejected the Lease but continued in occupancy of at least part of the premises through March of 2001. The effective date of the order approving Debtor's rejection of the Lease was April 16, 2001. From the date of filing the petition (July 29, 1999) through September 14, 2000, the Debtor occupied the premises as assignee of the Lease. The Debtor clearly assumed the Lease as of July 19, 1999, when it executed the Consent to Assignment and Estoppel Certificate. *See Ramsey Aff.*

Exh. E. The terms of the Debtor's tenancy from September 15, 2000, through March 31, 2001, can be ascertained from the provisions for holdover in the Lease which the Debtor assumed. The Lease provides, in paragraph 18, "Holdover," that,

[s]hould tenant remain in possession of the leased premises . . . after the expiration of the term of this Lease, such holding over shall, unless otherwise agreed in writing, constitute a month to month tenancy only, and Tenant shall pay as monthly rental the then reasonable value of the use and operation of the leased premises which shall not be less, however, [than] the rent to be paid for the last month of the term hereof.

According to the Debtor, on December 31, 2000, Landlord relet suites 4 and 5 and reduced the Debtor's rent to \$8,454.18 (plus parking) and on February 2, 2001, Landlord relet suite 1 and further adjusted the Debtor's rent to \$8,456.59. This means that there are four distinct periods of post-petition, pre-rejection obligations on the part of the Debtor. From July 29, 1999 (date of petition), to September 14, 2000 (termination of Lease), rent due under the assumed Lease was \$10,397.08 per month due on the first of each month. From September 14, 2000 (expiration date of the Lease), to December 12, 2000 (when Debtor asserts that it vacated suites 4 and 5), rent due pursuant to the holdover provision of the assumed Lease was "reasonable value" not less than the amount paid under the last month of the term – i.e., not less than \$10,397.08 per month. From January 1, 2001, through February 2, 2001, the period when the Debtor occupied only suites 1, 2, and 3, the Debtor asserts that it had an agreement with the Landlord to pay \$8,454.18 per month (plus parking). From February 2, 2001, through the rejection of the Lease effective April 16, 2001, the Debtor asserts that it had an agreement with the Landlord to pay \$8,456.59 per month. The Debtor included the Lease

among those that were rejected by order entered October 29, 2001, which specifies that rejection was effective as of April 16, 2001.

The Debtor asserts that the amount of rent due under the Lease with the Prior HCA Tenant for the post-petition period was \$166,348.74. The court cannot determine how this number was derived. When the Debtor is given credit for post-petition rent it alleges that it paid in the amount of \$161,139.57, a balance of \$5,209.17 remains unpaid according to the Debtor.

HCA asserts that the correct amount of post-petition rent is either \$218,338.68, based upon the effective date of the rejection order (April 16, 2001), or \$280,721.16, based upon the date of entry of the order (October 29, 2001). HCA asserts that the monthly rent due under the Lease was \$10,397.08, and that the Debtor should be charged with payment of twenty-one full months' rent for the post-petition period rather than the twenty and one-half months that the Debtor actually occupied the premises. HCA makes no mention of the Debtor's alleged arrangements for rent reductions in the final months of its occupancy as the Debtor began to move out unit by unit. HCA claims that it paid \$55,047.43 in post-petition rent, parking expenses, and HVAC maintenance: five months' rent at \$10,397.08; \$234.00 for parking for September 1999; and \$2,828.03 for HVAC maintenance for September 1999.

ANALYSIS

A. Standards for Considering Motions for Summary Judgment

Federal Rule of Civil Procedure 56(c), as incorporated by Federal Rule of Bankruptcy Procedure 7056, governs motions for summary judgment in adversary proceedings in bankruptcy.

Summary judgment is proper if “the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law.” Fed. R. Civ. P. 56(c). When a court reviews a motion for summary judgment, “the evidence, all facts, and any inferences that may be drawn from the facts must be viewed in the light most favorable to the nonmoving party.” *In re Morris*, 260 F.3d 654, 665 (6th Cir. 2001) (citing *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 587 (1986)). The non-moving party must present enough evidence to show that there is a genuine issue of material fact in order to prevail. *Klepper v. First Am. Bank*, 916 F.2d 337, 342 (6th Cir. 1990). “A mere scintilla of evidence is insufficient; ‘there must be evidence on which the jury could reasonably find for the [non-movant].’” *In re Morris*, 260 F.3d 654, 665 (quoting *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 252 (1986)). Summary judgment should be entered “against a party who fails to make a showing sufficient to establish the existence of an element essential to that party's case, and on which that party will bear the burden of proof at trial.” *Celotex Corp. v. Catrett*, 477 U.S. 317, 322 (1986). Where both parties file motions for summary judgment, the standard for determining whether summary judgment is appropriate is not altered. “[T]he court must evaluate each party’s motion on its own merits, taking care in each instance to draw all reasonable inferences against the party whose motion is under consideration.” *Lansing Dairy, Inc. v. Espy*, 39 F.3d 1339, 1347 (6th Cir. 1994) (quoting *Taft Broadcasting Co. v. United States*, 929 F.2d 240, 248 (6th Cir. 1991)).

B. The Interplay of Sections 365(d)(3) and 503(b)(1)

Upon the filing of the bankruptcy case, the Debtor became a debtor in possession, and was empowered to either assume or reject any executory contract or unexpired lease. *See* 11 U.S.C. §§ 365(a) and 1107(a). The post-petition debtor in possession elected to reject the Lease, and its election, effective April 16, 2001, was approved by the court by order entered October 29, 2001. Pursuant to 11 U.S.C. § 365(g), the rejection of an unexpired lease by a debtor constitutes a breach of the lease immediately before the filing of the petition. Damages flowing from the rejection of a lease become a pre-petition claim against the bankruptcy estate. *See* 11 U.S.C. § 502(g). Pursuant to Federal Rule of Bankruptcy Procedure 3002, a claim arising from the rejection of an unexpired lease may be filed within such time as the court directs. HCA originally filed its proof of claim on October 16, 2000, for \$58,738.68, and subsequently revised its claim to \$189,583.92 on June 10, 2002, with all claims arising out of the Lease. No one has objected to the timeliness of the HCA claim.

A debtor in possession is obligated to timely perform the obligations of the debtor during the administration of a Chapter 11 case until a lease is assumed or rejected. *See* 11 U.S.C. § 365(d)(3). In this case, the debtor in possession paid some of the rent that accrued after the filing of the case; according to the Debtor, it paid \$161,139.57, and it concedes that a balance of \$5,209.17 remains unpaid.

Section 503(b)(1)(A) provides for allowance of claims representing the “actual, necessary costs and expenses of preserving the estate.” The Debtor argues that, notwithstanding the plain

language of § 365(d)(3), HCA must show a benefit to the estate before its claim for post-petition rent will be entitled to administrative priority.

The timely-performance requirement was added to § 365 in 1984. The Bankruptcy Code specifies no remedy for failure to timely perform. *See Cannery Row Co. v. Leisure Corp. (In re Leisure Corp.)*, 234 B.R. 916, 923 (B.A.P. 9th Cir. 1999). Nevertheless, the Court of Appeals for the Sixth Circuit has held that a debtor in possession or trustee is obligated to pay all obligations that come due under an unexpired lease prior to the assumption or rejection of the lease. *See Koenig Sporting Goods, Inc. v. Morse Road Co. (In re Koenig Sporting Goods, Inc.)*, 203 F.3d 986, 989 (6th Cir. 2000). Further, the Sixth Circuit indicates in a footnote that the debtor's obligation should be determined without regard to the principles governing administrative claims under § 503(b)(1); a landlord need not demonstrate a benefit to the estate in order to be entitled to be paid post-petition, pre-rejection rent. *Id.* at n.2.

The specific question answered by the court in *Koenig* was whether a debtor would be obligated to pay the full month's rent that came due prior to rejection, or only a pro rata share representing the period of the debtor's occupancy. The debtor in *Koenig* rejected a lease effective the second day of the month. Under the terms of its lease, monthly rent was due in advance on the first day of the month. The debtor argued that it was obligated to pay a pro rata share of the rent representing its two days' occupancy. The court rejected this argument and held that the debtor was obligated to pay the full month's rent. *Koenig*, 203 F.2d at 989.

The Debtor argues that *Koenig* does not apply in its case because it never assumed the Lease. The court is not persuaded, and finds that the Debtor did assume the Lease, as noted *supra*, on July 19, 1999. The Debtor apparently admits that it has some liability under the Lease because it paid rent in the post-petition period, although not in the full amount due under the Lease.

The court is persuaded that *Koenig* does apply to the present case, and that the Debtor is obligated to pay post-petition rent for the period of its occupancy. The requirements of § 503(b)(1) are not applicable here, meaning that in order to be entitled to post-petition, pre-rejection rent, the Landlord is not required to show a benefit to the estate. The court must determine the amount of the obligation of the Debtor during that period. If the pre-petition debtor assumes a lease, as here, then the terms of the lease control.

C. Does Date of Order Entry or Effective Date of Rejection Determine Debtor's Obligation?

The order approving the Debtor's rejection of the Lease was entered October 29, 2001. The order specifically provides that rejection "shall be effective as of the Closure Effective Date/ Effective Date to Reject"; in the case of the Lease, that date was listed in an attachment to the order as April 16, 2001. Neither the Landlord nor HCA objected to the entry of this order. In connection with this and related motions, the court directed the parties to prepare a chart setting forth their various factual contentions and claims (the "Location Payment History Chart"). HCA argues that "the enforcement of a retroactive rejection order in this case would eviscerate the statutory protection provided to non-residential real property lessors and would inflict harm upon HCA."

Location Payment History Chart, n. 3. In support of its policy-based argument, HCA cites several cases, including *Thinking Machines*, for the proposition that “a rejection is effective only upon court approval of the decision to reject the lease.” *Id.* (citing *In re Revco Drug Stores, Inc.*, 109 B.R. 264, 269 (Bankr. N.D. Ohio 1989) (holding that the rejection process was designed to “provide a degree of factual certainty in determining the actual date of rejection”); and *In re Federated Department Stores, Inc.*, 131 B.R. 808, 815-16 (S.D. Ohio 1991) (holding that setting the “effective date of rejection earlier than the order approving would put the Lessor in an unfairly awkward position”). HCA failed to point out that in *Thinking Machines*, the First Circuit noted that, “we think it behooves us to make clear that nothing in our holding today precludes a bankruptcy court, in an appropriate section 365(a) case, from approving a trustee's rejection of a nonresidential lease retroactive to the motion filing date.” *In re Thinking Machines Corp.*, 67 F.3d 1021, 1028 (1st Cir. 1995). After further analysis, the First Circuit found the entry of a retroactive order to be appropriate so long as it does not penalize a creditor and so long as it promotes the purposes of § 365(d)(3). *See id.* (citing *In re Jamesway Corp.*, 179 B.R. 33, 37 (Bankr. S.D.N.Y. 1995)); *see also In re CCI Wireless, LLC*, 297 B.R. 133, 140 (D. Colo. 2003) (“the bankruptcy court has authority under section 365(d)(3) to set the effective date of rejection at least as early as the filing date of the motion to reject”). The appropriate time for HCA to raise an objection to an order’s retroactively effective date would have been immediately following the entry of the order; had such an objection been raised, the court would have considered the equities of the case for the Landlord and the Debtor. Absent timely objection, however, HCA is bound by the terms of the rejection order,

including the provision of an effective date of rejection that predated the entry of the order. The court next turns to the question of whether the Debtor is entitled to prorate rent for the month in which it vacated the property.

D. Is the Debtor Entitled to Prorate Rent for Less than a Full Month's Occupancy?

The Debtor actually occupied the premises for twenty and one-half months after the filing of its bankruptcy petition. The Debtor argues that it is entitled to prorate the rent for the month of April 2001. It vacated the premises on April 16, 2001. *Koenig* holds that a debtor must pay a full month's rent in accordance with the terms of a lease that provides for payment of rent monthly in advance. The Lease expired by its own terms on September 14, 2000, but the Lease specifies the terms of any holdover tenancy. Since the Debtor assumed the Lease, the Debtor's obligation to pay rent is measured by the terms of the Lease. The rule of *Koenig* does apply for purposes of determining rent owed and the Debtor is obligated to pay rent for the full month in which it vacated the property. The Debtor is obligated to pay the Landlord twenty-one months' rent for its post-petition use and occupancy of the premises. Is HCA, as subrogee, entitled to be paid for any portion of the Debtor's tenancy?

E. Is HCA Entitled to Be Subrogated to the Rights of the Landlord?

HCA claims that it is entitled to be subrogated to the rights of the Landlord vis-à-vis the

Debtor to the full extent of payments made by it to the Landlord. HCA paid \$55,047.43 to the Landlord during the period between the filing of the petition and the rejection of the Lease by the Debtor. The payments made by HCA consist of four checks in the amounts of \$10,631.08, \$23,622.19, \$10,397.08, and \$10,397.08. *See* Affidavit of Thomas F. Ramsey, dated November 7, 2002. The court cannot determine why the amounts paid varied from month to month.

Section 509 of the Bankruptcy Code provides:

(a) Except as provided in subsection (b) or (c) of this section, *an entity that is liable with the debtor on, or that has secured, a claim of a creditor against the debtor, and that pays such claim, is subrogated to the rights of such creditor to the extent of such payment.*

* * *

(c) The court shall *subordinate to the claim of a creditor* and for the benefit of such creditor an allowed claim, by way of subrogation under this section, or for reimbursement or contribution, of an entity that is liable with the debtor on, or that has secured, such creditor's claim, *until such creditor's claim is paid in full*, either through payments under this title or otherwise.

11 U.S. C. § 509 (emphasis added). Clearly, full payment of the debt is required by § 509 before a subrogee can receive any reimbursement for payments made, since subrogee's claim must be subordinated until the creditor is fully paid. *See In re Southwest Equipment Rental, Inc.*, 193 B.R. 276, 283-84 (E.D. Tenn. 1996) ("subrogation requires payment of the full debt"); *McGrath v. Carnegie Trust Co.*, 116 N.E. 787, 788 (N.Y. 1917) ("the equity of subrogation does not arise until the whole debt has been discharged").

HCA also asserts a right to subrogation outside of the Bankruptcy Code under principles of equitable subrogation. The question of whether § 509 and equitable subrogation are complementary, identical, or mutually exclusive has divided the courts that have considered the question. *See Pandora Industries, Inc. v. Paramount Communications, Inc. (In re Wingspread)*, 145 B.R. 784, 787 (S.D.N.Y. 1992) (describing the split of authority on the issue, identifying pertinent bankruptcy cases on point). The court in *Southwest Equipment Rentals* held that “equitable subrogation is separate and distinct from subrogation rights afforded by § 509.” *In re Southwest Equipment Rental, Inc.*, 193 B.R. at 283. The *Southwest Equipment Rentals* court went on to outline the requirements for equitable subrogation:

- (1) payment must have been made by subrogee to protect own interest;
- (2) subrogee must not have acted as a volunteer;
- (3) debt paid must be one for which subrogee was not primarily liable;
- (4) entire debt must have been paid;
- (5) subrogation must not work any injustice to rights of others.

Id. (citing *In re Flick*, 75 B.R. 204 (Bankr. S.D. Cal. 1987)). The *Southwest Equipment Rentals* court pointed out that both equitable subrogation and subrogation under § 509 require payment of the full claim by the subrogee. *In re Southwest Equipment Rental, Inc.*, 193 B.R. at 283-84.

Undoubtedly, HCA is entitled to be subrogated to the rights of the Landlord to the extent that it discharged the Debtor’s obligation to the Landlord for post-petition rent. *See* 11 U.S.C. § 509(a). HCA was liable with the Debtor to the Landlord for the value of the Debtor’s use of the property and HCA paid that claim.

The Debtor also made certain post-petition rent payments, however. At most, if indeed HCA fully discharged the obligations due the Landlord under the Lease, it is entitled to be paid the difference between the amount owed by the Debtor and the amount paid by the Debtor. It seems clear that HCA did *not* fully pay all amounts due the Landlord, but the Landlord has not asserted a claim for post-petition rent. Unfortunately, the court cannot determine the amount of rent due for the post-petition period based upon the documents submitted by the parties.

CONCLUSION

For the foregoing reasons, the Debtor's motion for summary judgment is **GRANTED** in part and **DENIED** in part; and HCA's motion for summary judgment is **GRANTED** in part and **DENIED** in part. The court will schedule an additional pre-trial scheduling conference to establish a procedure for liquidating the amount of HCA's post-petition claim. The Debtor clearly assumed the Lease. The Debtor is obligated to pay the Landlord for post-petition, pre-rejection rent due under the Lease; such rent is not subject to proration based upon the occupancy period if an obligation came due prior to the effective date of rejection. This court has the authority to enter a retroactively effective order for the rejection of a lease. The obligation to pay rent during the post-petition, pre-rejection period is not an administrative expense, but is to be paid on a par with administrative expenses. Pursuant to both 11 U.S.C. § 509 and principles of equitable subrogation, HCA is subrogated to the rights of the Landlord to the extent that it discharged the Debtor's obligation to the Landlord for post-petition, pre-rejection rent, but HCA's claims are subordinated to the Landlord's claim until the Landlord is paid in full.