

Dated: May 20, 2009
The following is ORDERED:



Jennie D. Latta

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UNITED STATES BANKRUPTCY JUDGE

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF TENNESSEE
WESTERN DIVISION

In re LEE'S LANDING COMMERCIAL, LLC

Case No. 09-21281-L

Debtor.

Chapter 11

MEMORANDUM OF DECISION

BEFORE THE COURT are three motions filed by Lee's Landing Garage, LLC ("Lee's Landing Garage") seeking to compel Lee's Landing Commercial, LLC (the "Debtor") to immediately pay post-petition rent with respect to the so-called Commercial Lease and Parking Lease, and seeking relief from the automatic stay. Objections to the motions were filed by the Debtor and by Seedco Financial Services, Inc. ("Seedco"). The motions raise questions concerning the interpretation of section 365(d)(3) of the Bankruptcy Code and the written agreements between the parties. The court conducted a hearing to consider the motions on May 13, 2009. Having carefully considered the testimony of the witnesses and reviewed the trial exhibits and case record, the court makes the following findings of fact and conclusions of law. Fed. R. Bankr. P. 7052. In summary, because the Debtor appears to be administratively insolvent, the court concludes that the motions for immediate payment will be denied, but the motion for relief from the automatic stay will be granted. These are core proceedings. 28 U.S.C. § 157(b)(2)(A) and (G).

BACKGROUND

Certain background facts are not in dispute. Lee's Landing Garage is a Delaware limited liability company formed for the purpose of developing, constructing, owning and operating a parking garage in downtown Memphis, Tennessee on real property owned by the City of Memphis, but leased to Beale Street Development Corporation, and in turn subleased to Performa Entertainment Real Estate, Inc. ("Performa Real Estate"). Tr. Ex. 4, § 2.3; Tr. Ex. 1, p. 1. Lee's Landing Garage subleased the real property from Performa Real Estate on May 22, 2004 in order to develop the Parking Garage. Tr. Ex. 1, p. 1. Lee's Landing Garage then entered into two agreements with the Debtor, also a Delaware limited liability company described as an affiliated company, with respect to approximately 14,317 square feet of commercial space to be developed on the ground floor of the Parking Garage. The first is a Sublease Agreement (Commercial) dated September 30, 2005 (Tr. Ex. 1)(the "Commercial Lease") and the second is a Master Parking Agreement (Commercial) dated December 30, 2005 (Exhibit 3 to Proof of Claim 2-1) (the "Parking Lease").

Pursuant to the Commercial Lease, the Debtor subleased the approximately 14,317 square feet of commercial space on the ground floor of the Parking Garage and agreed to design and build tenant improvements therein within three months after delivery of the leased premises to it by Lee's Landing Garage. Tr. Ex. 1, § 5(a). Seedco provided construction financing to enable the Debtor to build out three tenant bays, two of which are presently occupied while the third is vacant. The terms and conditions of the Commercial Lease are discussed more fully below.

Pursuant to the Parking Lease, the Debtor leased 60 parking spaces in the Parking Garage for a term lasting until the earlier of 15 years from November 13, 2006, the date of the opening of the Parking Garage, or the payment in full of a loan from Sun Life Assurance of Canada ("Sun

Life”) to Lee’s Landing Garage. Sun Life provided construction and permanent financing to Lee’s Landing Garage. The Debtor does not dispute that the loan to Sun Life remains unpaid. The applicable rent under the Parking Lease is \$9,000 per month, which is due on or before the fifth day of the month. The Parking Lease was intended to provide adequate parking for the employees and guests of the tenants of the Debtor.

The Commercial Lease and the Parking Lease were both signed by John A. Elkington (“Elkington”) as managing member for both Lee’s Landing Garage and the Debtor. In the fall of 2008, Mr. Elkington resigned as managing member of Lee’s Landing Garage in the face of a threatened foreclosure by Sun Life. Michael E. Dumas, president of the Board of Directors for Garage, testified at the hearing that the investors in Lee’s Landing Garage were able to raise sufficient funds to avoid foreclosure. Mr. Dumas further testified that the Debtor has failed to make payments required under the Commercial Lease and the Parking Lease.

The Debtor filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code on February 5, 2009. No trustee has been appointed and the Debtor remains in possession of its property. The Debtor acknowledges that it has not paid post-petition rent under either agreement with Lee’s Landing Garage. It filed a motion to reject the Parking Lease on April 6, 2009. An objection to the motion was filed by Seedco. Seedco claims that rejection of the Parking Lease by the Debtor may cause the Debtor to be in default of its tenant subleases, which serve as additional security for the loan from Seedco. The parties have reached a settlement concerning these issues.

The Debtor acknowledges that it is indebted to Seedco in the amount of \$1,470,000, and that this indebtedness is secured by the Debtor’s leasehold interest in the Parking Garage. Seedco also claims to hold a properly perfected security interest in all of the Debtor’s rents, including tenant rents pursuant to an assignment of Leases and Rents dated May 21, 2007. Seedco claims that tenant

rents constitute cash collateral, which the Debtor may not use without its consent. Seedco objects to the use of cash collateral to pay post-petition rent to Lee's Landing Garage and claims that, pursuant to a Subordination and Attornment Agreement dated October 6, 2008, Lee's Landing Garage subordinated its rights under the Commercial Lease and the Parking Lease to amounts owed to Seedco by the Debtor. At the hearing, counsel for Lee's Landing Garage announced that it is the position of Lee's Landing Garage that the Subordination and Attornment Agreement is invalid because the board of directors for Lee's Landing Garage did not approve it. The Attornment Agreement was signed by Mr. Elkington as managing member for each of the parties to the agreement: Lee's Landing Garage, Lee's Landing Commercial (the Debtor) and Performa Real Estate. For purposes of this opinion only the court assumes that the agreement is valid and enforceable.

Horizon Construction Group, LLC ("Horizon"), claims that it entered into two general contracts with the Debtor pursuant to which it provided tenant improvements for two of the bays in the commercial space. It claims that it was not paid for this work and filed notices of lien and actions to enforce its liens in the Chancery Court of Shelby County, Tennessee. Mechanics' and materialmen's lien bonds were provided by The Hanover Insurance Company ("Hanover") and Hanover was made a party defendant to the actions in the Chancery Court prior to the filing of the Debtor's bankruptcy petition. Horizon claims that it is owed \$103,616.98 for the so-called King Biscuit Project and \$229,551.37 for the so-called Ground Zero Project. Horizon has pending a motion for relief from the automatic stay to permit it to go forward in the Chancery Court to obtain judgment against the bonds.

The Debtor's bankruptcy schedules reflect that its assets consist of its leasehold interests in the Parking Garage valued at \$1,470,000; deposit accounts and security deposits in the amount of

\$11,467.98; accounts receivable in the amount of \$112,224.96; and surety bonds for the Horizon Litigation in the amount of \$333,167.00. The total value claimed for its assets is \$1,926,859.94. The Debtor acknowledges the secured debt to Seedco in the amount of \$1,470,000; unsecured priority debts in the amount of 6,027.30; and unsecured debts to Horizon, John and Valerie Elkington, Lee's Landing Garage, Performa Real Estate, Performa Entertainment, LLC, and River City Electrical Contractors ("River City") in the total amount of \$1,686,718.98. The debts to Horizon and River City are listed as unliquidated and disputed. The Debtor lists debts in the total amount of \$2,989,995.57.

Joe Calabretta, the Debtor's acting controller, testified on behalf of the Debtor that the Debtor's sole source of income is tenant rent from Red Rooster, the successor to King Biscuit, in the amount of approximately \$7,000 per month; the other tenant, Ground Zero is not paying rent at this time; and the third bay in the commercial space is not occupied. Mr. Calabretta further acknowledged that the Debtor is obligated to pay Seedco \$12,000 per month. He testified that since the filing of the bankruptcy case, the Debtor has accumulated all income received, which totals approximately \$21,000 and is on deposit in the debtor-in-possession account.

The crux of the dispute between Lee's Landing Garage and the Debtor concerns the interpretation of the Commercial Lease. Lee's Landing Garage claims that the Debtor is obligated to pay \$1,000 per month as base rent and \$8,555.20 as additional rent. The Debtor acknowledges the obligation to pay base rent, but argues that the obligation to pay \$8,555.20 is not rent, but payments on a loan.

The key provisions of the Commercial Lease for purposes of the pending motions are paragraphs 3(a), (h), (i) and (m), which provide:

- (a) Commencing upon the opening of the Garage, but not later than October 1.

2006, the Lessee shall remit to Lessor annual rent of Twelve Thousand Dollars (\$12,000), payable in equal monthly installments, such amount to increase to Twenty-Four Thousand Dollars (\$24,000) on January 1, 2011, and to Thirty-six Thousand Dollars (\$36,000) on January 1, 2017 (the "Fixed Rent"). Fixed Rent shall be prorated for any partial year. For calendar years 2017 and thereafter, the Lessee shall also remit to Lessor, annually, rent equal to fifteen percent (15%) of the Gross Sales (hereinafter defined), less the Fixed Rent (the "Percentage Rent"), generated from the Leased Premises each such calendar year. Fixed Rent and Percentage Rent payable from Lessee under this Section 3(a) shall be hereinafter collectively be referred to as "Rent." The Lessee shall submit to Lessor by the twentieth (20th) day of each consecutive month the monthly installment of Fixed Rent due to Lessor for such month. . . .

(h) If the Lessor shall make any expenditure for which the Lessee is responsible or liable under this Sublease, or if the Lessee shall become obligated to Lessor under this Lease for any sum other than Percentage Rent as hereinabove provided, except as otherwise provided herein, the amount thereof shall be deemed to constitute additional rent ("Additional Rent") and shall be due and payable to Lessee by Lessor together with all applicable sales taxes thereon, if any, simultaneously with the next succeeding monthly installment of Rent or at such other time as may be expressly provided in this Sublease for the payment of the same. For the purpose of this Sublease, the term "Rent" shall mean and be defined as all Percentage Rent and Additional Rent due from Lessee to Lessor hereunder.

(i) Each of the foregoing amounts of Rent and other sums shall be paid to Lessor without demand and without deduction or off-set except as otherwise provided in this Sublease

(m) In addition to the rent provided herein, Lessee agrees to pay to Lessor Nine Hundred Twenty Four Thousand and Sixty Dollars (\$924,060) on the same terms and conditions as the permanent financing for the Parking Garage, which amount shall include its pro rata construction period interest and other cost associated with the construction of the Parking Garage. Lessee agrees to secure such amount by executing loan documents on the same terms and conditions as the loan documents for the permanent financing for the Parking Garage.

Tr. Ex. 1, pp.4-6. The Commercial Lease has a choice of law provision that declares it to be a Tennessee contract, to be construed under the laws of the State of Tennessee. Tr. Ex. 1, § 55.

Both Lee's Landing Garage and the Debtor agree that the amount specified in subparagraph (m) was subsequently amended to \$985,385, and the monthly amount to be paid by the Debtor is \$8,555.20. The parties further agree that the \$985,385 amount reflects the pro rata construction

costs for the Parking Garage related to the “core and shell” for the commercial space. The parties disagree about whether the monthly obligation is to be characterized as Additional Rent or something else. Garage asserts that this amount is Additional Rent pursuant to subparagraph (h). The Debtor asserts that this amount represents interest payments on a loan obligation that is unsecured as the result of the failure of the Debtor to execute the loan documents described in subparagraph (m). The Debtor has made no payments with respect to this obligation. According to Mr. Dumas, it is being carried on the books and records of Lee’s Landing Garage as a long-term debt with interest only accruing monthly. Likewise, according to Mr. Calabretta, the obligation is recorded on the Debtor’s books as a “house loan” amortized over 15 years with payments owed of interest only.

Lee’s Landing Garage demands immediate payment of \$19,332.00 (as of March 15, 2009) under the Commercial Lease and \$18,000 under the Parking Lease or vacation of the premises. Lee’s Landing Garage filed its motions to compel immediate payment and for relief from the automatic stay on March 30 and April 8, 2009, respectively. The Debtor counters that it is obligated to pay no more than \$1,000 per month as post-petition rent under the Commercial Lease and that, as the result of its rejection the Parking Lease, it has no post-petition obligation under that lease.

The court heard extensive testimony concerning the pre-petition claims of Lee’s Landing Garage from both Mr. Dumas and Mr. Calabretto. The court assumes that this testimony was offered in order to clarify the amount that would be required to bring current the Commercial Lease in the event that the Debtor desires to assume it. The testimony may also have been offered in support of the motion for relief from the automatic stay. As the court pointed out at the hearing, however, Lee’s Landing Garage has filed proofs of claim with respect to both leases, and the Debtor has not objected to the claims. As a result, the claims are deemed allowed and the court need not

make a determination for purposes of this opinion of the amounts of Lee's Landing Garage's prepetition claims. *See* 11 U.S.C. § 502(a)(a claim or interest, proof of which if filed under section 501, is deemed allowed unless a party in interest objects).

DISCUSSION

The Motions to Compel Immediate Payment

Lee's Landing Garage seeks to compel the Debtor to make immediate payments of post-petition rent pursuant to section 365(d)(3) of the Bankruptcy Code. That section provides:

The trustee shall timely perform all the obligations of the debtor, except those specified in section 365(b)(2), arising from and after the order for relief under any unexpired lease of nonresidential real property, until such lease is assumed or rejected, notwithstanding section 503(b)(1) of this title. The court may extend, for cause, the time for performance of any such obligation that arises within 60 days after the date of the order for relief, but the time for performance shall not be extended beyond such 60-day period. This subsection shall not be deemed to affect the trustee's obligations under the provisions of subsection (b) or (f) of this section. Acceptance of any such performance does not constitute waiver or relinquishment of the lessor's rights under such lease or under this title.

11 U.S.C. § 365(d)(3). In a Chapter 11 case, the debtor in possession performs the functions and duties of a trustee. 11 U.S.C. § 1107(a). Section 365(d)(3) requires the debtor in possession to “perform all the obligations owing under a lease - particularly the obligation to pay rent at the contract rate - until the lease is rejected.” *Pacific Shores Dev., LLC v. At Home Corp. (In re At Home Corp.)*, 392 F.3d 1064, 1068 (9th Cir. 2004). This section was part of the so-called “Shopping Center Amendments” contained in the Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98 Stat. 333(1984), and makes clear that the amount of rent to be paid under a lease of nonresidential real property during the pre-rejection period is specified by the contract and not limited to the “actual, necessary costs and expenses of preserving the estate” as otherwise provided for administrative expenses at section 503(b). *At Home Corp.*, 392 F.3d at 1068. The

debtor is obligated to pay the full amount of obligations that come due in the post-petition, pre-rejection period without proration. *Koenig Sporting Goods v. Morse Road Co. (In re Koenig Sporting Goods, Inc.)*, 203 F.3d 986 (6th Cir. 2000); *In re Krystal Co.*, 194 B.R. 161, 163 (Bankr. E.D. Tenn. 1996).

The Commercial Lease - Fixed Rent

Under section 365(d)(3), the Debtor as debtor in possession must timely perform all the obligations arising under an unexpired lease from and after the order for relief until rejection. There is no question that the Debtor has failed to perform the most basic requirement of the Commercial Lease requiring the payment of \$1,000 in Fixed Rent per month. The Debtor's bankruptcy petition was filed February 5, 2009. The Commercial Lease calls for payments of \$1,000 to be made monthly on the twentieth day of each consecutive month. Tr. Ex. 1, § 3(a). Since the filing of the bankruptcy petition, three such payments have been missed. The Debtor is obligated to make these payments pursuant to section 365(d)(3).

The Commercial Lease - Additional Obligations

Lee's Landing Garage claims that it is also entitled to three payments of \$8,555.20 as Additional Rent pursuant subsections 3(h) and (m) of the Commercial Lease. The Debtor argues that subsection (m) references a loan, but not an obligation for Additional Rent. The court must therefore determine the proper interpretation of the Commercial Lease. Because the Commercial Lease is to be interpreted according to the law of Tennessee, the court looks to the decisions of the Tennessee Supreme Court for guidance.

In a recent decision, the Tennessee Supreme Court reiterated some timeless principles of contract interpretation:

The cardinal rule for interpretation of contracts is to ascertain the intention of the parties and to give effect to that intention, consistent with legal principles. If the language of the contract is clear and unambiguous, the literal meaning controls the outcome of the dispute. In such a case, the contract is interpreted according to its plain terms as written, and the language used is taken in its ‘plain, ordinary, and popular sense.’ The interpretation should be one that gives reasonable meaning to all of the provisions of the agreement, without rendering portions of it neutralized and without effect. . . . [O]n occasion, a contractual provision may be susceptible to more than one reasonable interpretation, rendering the terms of the contract ambiguous. Ambiguity, however, does not arise in a contract merely because the parties may differ as to the interpretations of certain of its provisions. A contract is ambiguous only when it is of uncertain meaning and may fairly be understood in more ways than one. The court will not use a strained construction of the language to find an ambiguity where none exists.

Maggart v. Almany Realtors, Inc., 259 S.W.3d 700, 703-04 (Tenn. 2008)(internal quotations not indicated and internal citations omitted).

In this case, both of the parties claim that their reading of the Commercial Lease is the correct reading. Neither points to an ambiguity in the language of the agreement, however, only to a disagreement as to its interpretation. In order for Lee’s Landing Garage to prevail, the obligation created in subsection (m) must be treated as Additional Rent for purposes of subsection (h). Subsection (h), however, anticipates that not all obligations arising under the Commercial Lease will be Additional Rent. It specifically indicates that “except as otherwise provided herein” obligations arising under the Commercial Lease other than Percentage Rent shall be deemed Additional Rent. So, while it is true that the obligation created under subsection (m) is not Percentage Rent, it is equally true that it may be an obligation otherwise provided for under the Commercial Lease. In fact, the language of subsection (m) suggests that it is just such an obligation.

Subsection (m) begins, “[i]n addition to the rent provided herein, Lessee agrees to pay” In subsection (h), “Rent” is a defined term: “For the purpose of this Sublease, the term “Rent” shall mean and be defined as all Percentage Rent and Additional Rent due from Lessee to Lessor

hereunder.” Tr. Ex. 1, § 3(h). Each of the subsections following subsection (h) gives further explanation of the treatment and payment of “Rent” under the agreement. For example, subsection (i) begins, “Each of the foregoing amounts of Rent and other sums shall be paid to Lessor without demand . . .” Subsection (j) provides, “If Lessee fails to make any payment of Rent or any other sums or amounts to be paid by Lessee hereunder” Subsection (k) states, “All Rent shall be payable without demand” Finally, subsection (l) provides, “In the event Lessee shall pay any real estate or ad valorem real property taxes . . . under this Sublease . . . the Rent payable under this Sublease shall be reduced” In each of these subsections, it is clear that Rent is the term defined in subsection (h) to mean Percentage Rent and Additional Rent. The final subsection of section 3, subsection (m) follows immediately after the quoted subsections, but does not capitalize the term “rent.” Either this is a scrivener’s error, and “rent” is intended to be “Rent” as defined in subsection (h) or “rent” is to be taken in its ordinary and usual sense, in which case it should include all obligations denominated as rent under the Commercial Lease including Fixed Rent, Percentage Rent, and Additional Rent. In either case, the obligation created under subsection (m) is distinguished from Additional Rent. This reading is bolstered by the fact that the obligation is described as a set amount that is related to the permanent financing for the Parking Garage, includes amounts not usually related to rent such as “construction period interest” and “other costs associated with construction,” and the Debtor agreed to “secure” it by executing “loan documents.” Taken as a whole, the language of subsection (m) unambiguously creates a loan obligation, an obligation “in addition to” the obligation to pay rent. The obligation created under subsection (m) is not Additional Rent for purposes of the Commercial Lease. Because the Commercial Lease is not ambiguous with respect to the obligation created by subsection (m), the court need not look beyond

the four corners of the agreement for its interpretation, but notes that the parties' bookkeeping practices are consistent with the court's interpretation.

Having determined that the obligation created by subsection (m) is not rent, the court nevertheless must determine whether the Debtor must make the payments called for under subsection (m) during the post-petition, pre-rejection or assumption period of its bankruptcy case. As previously stated, section 365(d)(3) requires a debtor in possession to "timely perform all the obligations of the debtor, except those specified in section 365(b)(2), arising from and after the order for relief under any unexpired lease on nonresidential real property, until such lease is assumed or rejected, notwithstanding section 503(b)(1) of this title." 11 U.S.C. § 365(d)(3). By its plain terms, section 365(d)(3) requires the timely performance of *all obligations* arising under an unexpired lease, except those specified in section 365(b)(2). Section 365(b)(2) provides:

Paragraph (1) of this subsection does not apply to a default that is a breach of a provision relating to—

- (A) the insolvency or financial condition of the debtor at any time before the closing of the case;
- (B) the commencement of a case under this title;
- (C) the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement; or
- (D) the satisfaction of any penalty rate or penalty provision relating to a default arising from any failure by the debtor to perform nonmonetary obligations under the executory contract or unexpired lease.

11 U.S.C. § 365(b)(2). None of these provisions is implicated with respect to the obligation created by subsection (m) of the Commercial Lease.

Although the Debtor is correct that subsection (m) was intended to create a loan obligation rather than an obligation to pay rent, this position ultimately is unavailing, for the Debtor is obligated to pay *all obligations* that arise under the Commercial Lease including the obligation

created by subsection (m). *See, e.g., Krystal Co.*, 194 B.R. at 163 (requirement that debtor perform all obligations under unexpired lease includes requirement to make tax reimbursement payments called for in lease). The Debtor has advanced no argument that the obligation created by subsection (m) does not *arise under* the Commercial Lease. At most, the Debtor argues that the failure of the Debtor to execute the loan documents contemplated in subsection (m) means that the obligation is unsecured rather than secured. Further, while it is true that the court cannot determine the terms of the repayment contemplated by subsection (m) from the Commercial Lease without reference to the “permanent financing for the Parking Garage,” this does not render the obligation ambiguous. The Debtor has been accruing a monthly obligation of \$8,555.20 on its General Ledger with the notation “to record current note due” since February 28, 2007. The Debtor is obligated to make these payments pursuant to section 365(d)(3).

The Parking Lease

The Debtor asserts that as the result of its decision to reject the Parking Lease, no money is owed to Lee’s Landing Garage other than its pre-petition rejection claim. The Debtor refers to Bankruptcy Code § 502(g)(1), which provides that:

A claim arising from the rejection, under section 365 of this title or under a plan under chapter 9, 11, 12 or 13 of this title, of an executory contract or unexpired lease of the debtor that has not been assumed shall be determined, and shall be allowed under subsection (a), (b), or (c) of this section or disallowed under subsection (d) or (e) of this section, the same as if such claim had arisen before the date of the filing of the petition.

11 U.S.C. § 502(g)(1). The claim that may be asserted by a lessor under section 502(g)(1) is a claim for damages arising from the breach of a lease. It is treated as if the breach occurred immediately preceding the filing of the bankruptcy case, and thus is treated as a pre- prepetition unsecured claim. *Giant Eagle v. Phar-Mor, Inc.*, 528 F.3d 455, 461 (6th Cir. 2008). Prior to the enactment of section

365(d)(3), a landlord might also recover as an administrative expense under section 503(b)(1) rent accruing for the period between the filing of a petition in bankruptcy and the rejection of a lease, but only insofar as the trustee or debtor in possession actually used and occupied the premises. *See, e.g., In re Cardinal Export Corp.*, 30 B.R. 682, 684 (Bankr. E.D.N.Y. 1983) (“The reasonable value of such use and occupancy is ordinarily, but not necessarily, determined by an allocation of rent reserved in the lease on a *pro rata* basis.”). Administrative expense priority is limited to the “actual, necessary cost or expense of preserving the estate” because it is intended to prevent unjust enrichment to the bankruptcy estate, not to compensate the creditor for its loss. *Id.*; *see* 11 U.S.C. § 503(b)(1).

This result was changed with the enactment of section 365(d)(3), which by its terms provides a specific exception to section 503(b)(1). *See, e.g., Inland’s Monthly Income Fund, L.P. v. Duckwall-Alco Stores, Inc. (In re Duckwall-ALCO Stores, Inc.)*, 150 B.R. 965, 971 (D. Kan. 1993) and cases collected at footnote 10 (“Although these payments have been characterized by many courts . . . as “administrative expenses,” . . . lease obligations under § 365(d)(3) are not subject to the requirements of § 503 for payment of administrative expenses.”); *Krystal Co.*, 194 B.R. at 164 (“[I]t appears that Congress specifically intended to except a tenant’s lease obligations to his landlord from the Code’s administrative expense provisions.”). Section 365(d)(3) provides more favorable treatment to landlords than was previously provided under section 503(b)(1). This section requires the timely payment of all obligations that arise under a lease during the period in which the debtor is given the opportunity to determine whether it will assume or reject an unexpired lease. This obligation ends when the debtor rejects the lease. The Debtor is obligated to pay the amounts that come due under the Parking Lease during the pre-rejection period.

The court turns to a consideration of the amount that is owed under the Parking Lease. Under section 365(d)(3), the Debtor as debtor in possession must timely perform all the obligations arising under an unexpired lease from and after the order for relief until rejection. In a voluntary case, the filing of the petition commences the case and constitutes an order for relief. 11 U.S.C. § 301(a). The bankruptcy petition in this case was filed on February 5, 2009, the day that a monthly rental payment was due under the Parking Lease. The court must determine whether the Debtor as debtor in possession is obligated to pay the rent that came due on the date of filing. The court has been unable to find any reported decision that deals with precisely this issue.

The Bankruptcy Code defines neither “obligations” nor “arising” for purposes of section 365(d)(3). The Third Circuit Court of Appeals has suggested that for purposes of this section, an obligation arises when one becomes legally obligated to perform it based upon the terms of the lease itself. *CenterPoint Props. v. Montgomery Ward Holding Corp. (In re Montgomery Ward Holding Corp.)*, 268 F.3d 205, 211 (3rd Cir. 2001) citing *In re Koenig Sporting Goods, Inc.*, 203 F.3d 986 (6th Cir. 2000).

In *Koenig Sporting Goods*, the Sixth Circuit held that a debtor in possession was obligated to pay the entire rental amount that came due on the first day of the month even though the debtor rejected the lease on the second. The lease at issue called for lease payments to be made in advance on the first day of the month for that month’s rent. The court refused the debtor’s argument that it should be entitled to pay only a pro rated amount that represented its actual use of the leased premises. The court held that section 365(d)(3) requires the payment in full of obligations that come due after the order for relief but prior to rejection, noting that it is the debtor who controls the effective date of rejection. *Koenig Sporting Goods*, 203 F.3d at 989. The court cited with approval

the decision of the bankruptcy court in *Krystal Co.*, which held that the debtor was obligated to pay its landlord all state property taxes that came due after the order for relief but prior to rejection even though some of the taxes accrued prepetition. *Id.* at 164.

The facts in the present case are similar to those in the case of *In re Garden Ridge Corp.*, 323 B.R. 136 (Bankr. D. Del. 2005). In that case, pursuant to the terms of two non-residential leases, rent was payable by the debtor monthly in advance on the first day of each month. At issue were rental payments that fell due on the Sunday before the debtor's bankruptcy petition was filed the following Monday. The landlords argued that the rent should be deemed to arise post-petition because state law permitted the payment to be made on the Monday of filing. Relying upon the decision of the Third Circuit in *Montgomery Ward*, the court held that the terms of the lease control when an obligation arises for purposes of section 365(d)(3). *Id.* at 142. Because the leases specified that rent was due on the day prior to the filing of the bankruptcy petition, the court concluded that the rental payments were prepetition obligations for purposes of section 365(d)(3) even though state law permitted the obligations to be performed at a later date. *Id.* Even so, because the rent was payable in advance, the court ordered the debtor in possession to pay for its post-petition use of the premises as an administrative expense pursuant to section 503(b). *Id.* at 142-43.

Unlike the leases in *Koenig Sporting Goods* and *Garden Ridge*, lease payments under the Parking Lease are made in arrears. Parking Lease § 1(b)(ii) ("Lessee shall pay the Garage Owner for the leased spaces on or before the fifth (5th) day of each month beginning with the fifth (5th) day of the month following the month in which the spaces are leased."). Thus the payment due on February 5, 2009 represented payment for use of the parking spaces during the preceding month. Further, payment was due on *or before* the fifth of the month, indicating that the obligation arose

prior to the last day for payment. Logically, the debtor became obligated to pay for the prior month's rent when its use of the parking spaces for that month was complete, i.e. on the first day of the following month, even though the Parking Lease provided that payment might be timely made through the fifth day of that month. Under these particular facts and circumstances, the obligation that came due on February 5 is a prepetition obligation and should be included in the prepetition claim of Lee's Landing Garage. Other obligations that have come due since the filing of the bankruptcy case must be paid until the Parking Lease is rejected.

The Debtor filed its motion to reject the Parking Lease on April 6, 2009, but, by agreement of the parties, the motion has not yet come on for hearing. As noted previously, Seedco has objected to the motion to reject on the basis that rejection of the Parking Lease may breach the tenant subleases that provided additional security for its loan. On May 20, the parties announced that they had reached a tentative settlement of these issues, but no order has yet been entered. The decision of a trustee or debtor in possession to assume or reject an unexpired lease is subject to court approval. 11 U.S.C. § 365(a). Rejection is deemed to occur not upon the filing of a motion to reject, but only upon entry of a court order approving the rejection. *Matter of Federated Dep't Stores, Inc.*, 131 B.R. 808, 815 (S.D. Ohio 1991); *In re Revco D.S., Inc.*, 109 B.R. 264, 267 (Bankr. N.D. Ohio 1989). Thus the Debtor will be responsible for paying all obligations that arise under the Parking Lease after the order for relief but before the entry of an order approving the rejection of the lease. As of this writing, the Debtor is obligated to pay the lease payments that were payable on March, April and May 5, 2009, for a total of \$27,000.

Remedies and the Motion for Relief from the Stay

The motions filed by Lee's Landing Garage raise a final question: may the Debtor be compelled to pay the obligations arising under the leases now when it appears that the Debtor is administratively insolvent? At the hearing, the Debtor's representative testified that the Debtor had collected \$21,000 since the commencement of the case and could expect to receive no more than \$7,000 per month going forward, at least for the foreseeable future. The court has determined that the Debtor owes Lee's Landing Garage three payments of \$1,000 each and three payments of \$8,555.20 each under the Commercial Lease, three payments of \$9,000 each under the Parking Lease., and ongoing payments under the Commercial Lease pending its assumption or rejection. Debtor's counsel very candidly informed the court that it would not be financially able to make all of the necessary payments if the court found that it is liable to make the monthly payments of \$8,555.20 called for under the Commercial Lease. The total indebtedness accrued by the Debtor thus far in the administrative period of this case is \$55,665.60. Seedco has objected to the Debtor making *any* payments to Lee's Landing Garage from its cash collateral. Seedco's objection to the use of cash collateral does not obviate the Debtor's obligation to make payments under its lease agreement; it merely makes it more certain that the Debtor is administratively insolvent.

Faced with non-payment of rent during the post-petition, pre-rejection period, a landlord may pursue one of three remedies: it may ask for an order directing immediate payment; it may seek relief from the automatic stay to evict the debtor-tenant; or it may seek to convert the case to Chapter 7. *Omni Partners, L.P. v. Pudgie's Dev. of NY, Inc. (In re Pudgie's Dev. of NY, Inc.)*, 239 B.R. 688, 696 (S.D.N.Y. 1999) ("*Pudgie III*"). Lee's Landing Garage has sought an order compelling immediate payment and relief from the automatic stay. It seems clear that if the Debtor is unable

to make the required payments, cause exists for granting Lee's Landing Garage relief from the automatic stay. *See* 11 U.S.C. § 362(d)(1)(On request of a party in interest and after notice and a hearing, the court shall grant relief from the automatic stay for cause, including lack of adequate protection.). It is unclear whether the Debtor should be compelled to pay Lee's Landing Garage when it appears that the Debtor is administratively insolvent. Section 365(d)(3) is silent in this regard. *See In re Microvideo Learning Systems, Inc.*, 232 B.R. 602, 605 (Bankr. S.D.N.Y. 1999), *aff'd* 227 F.3d 474 (2nd Cir. 2000).

There are a number of approaches to the treatment of claims for rent accrued but unpaid prior to rejection. This was the subject of extensive discussion by the district court in *Pudgie III*. As that court indicated, to require immediate payment of lease obligations when there is a risk of insolvency is to give lessors a superpriority administrative expense claims. 239 B.R. at 693. The court indicated that there is a split of authority as to whether a landlord is entitled to immediate payment when the bankruptcy estate is insolvent. It identified as the majority view the position that in the event of insolvency, the landlord is paid with other administrative expense claimants on a pro rata basis. *Id.* citing *In re Amber's Stores, Inc.*, 193 B.R. 819, 825 (Bankr. N.D. Tex. 1996); *In re Joseph C. Spiess Co.*, 145 B.R. 597, 608 (Bankr. N.D. Ill. 1992); *In re J.T. Rapps, Inc.*, 225 B.R. 257, 261-63 (Bankr. D. Mass. 1998). A second approach is to require immediate payment subject to disgorgement if necessary to pay all administrative claims. *Id.* citing *In re Tel-Central Communications, Inc.*, 212 B.R. 342, 349 (Bankr. W.D. Mo. 1997); *In re Buyer's Club Markets, Inc.*, 115 B.R. 700, 701 (Bankr. D. Colo. 1990); *In re Cardinal Indus., Inc.*, 109 B.R. 738, 742 (Bankr.S.D. Ohio 1989). A third approach is to give special administrative priority to post-petition rent due under a nonresidential lease. *Id.* citing *In re Rare Coin Galleries of America, Inc.*, 72 B.R.

415, 416 (D. Mass. 1987); *In re Coastal Dry Dock & Repair Corp.*, 62 B.R. 879, 883 (Bankr. E.D.N.Y. 1986). The approach ultimately adopted by the district court in *Pudgie's Development* treats pre-rejection lease payments as operational payments, to be made in the ordinary course and not subject to disgorgement if the estate is later found to be insolvent. *Id.* The court went further, however, to state that the right to “timely performance” is not equivalent to superpriority. *Id.* Thus, a landlord should not be permitted to wait until unpaid rent accrues in the hope that a later claim for lease payments would be given superpriority status. *Id.* In the examples cited by the court, the landlords had waited a significant period of time before asserting superpriority status. *See, e.g., In re J.T. Rapps*, 225 B.R. at 257 (landlord waited three years after conversion of Chapter 11 case to Chapter 7 to seek an order compelling immediate payment); *In re MJ 500*, 217 B.R. 93, 95 (Bankr. D. Mass. 1998)(landlord sought payment after case was converted to Chapter 7). Similarly, in *Pudgie III*, the landlord allowed rent to accrue almost seventeen months before moving to compel payment. 239 B.R. at 696. Under those facts, the court held that the landlord was not entitled to demand immediate payment, in effect achieving superpriority status. In the alternative, the landlord argued that it should be permitted to charge the secured creditor’s collateral for the unpaid rent pursuant to 11 U.S.C. § 506(c) on the theory that the secured creditor benefitted from the debtor’s use of the lease premises, which served as its headquarters. The district court did not reach this issue because it had not been addressed by the bankruptcy court. *Id.*

Two courts of appeals have addressed the question of the treatment to be afforded claims for unpaid rent in the event of administrative insolvency. Both the Second and the Ninth Circuit hold that section 365(d)(3) does not create an additional class of superpriority administrative claims. *In re Microvideo Learning Sys., Inc.*, 232 B.R. 602, 606 (Bankr. S.D.N.Y. 1999), *aff’d per curiam* 227

F.3d 474 (2nd Cir. 2000)(bankruptcy judge refused to grant motion to compel immediate payment in the face of administrative insolvency); *Temecula v. LPM Corp.*, 300 F.3d 1134, 1138 (9th Cir. 2002)(claims for post-petition rent arising under § 365(d)(3) entitled to administrative priority, but not super-priority over other administrative expenses in the event the case is converted to chapter 7.).

In the present case, Lee's Landing Garage acted promptly by filing its motions to compel immediate payment of rent within thirty days after the first lease payment were missed. Even at this early stage in the case, however, the possibility of administrative insolvency is apparent. Thus, while it would be inappropriate to order the Debtor to make immediate payment to Lee's Landing Garage of the accrued but unpaid rent resulting in a potential detriment to other administrative creditors, it would be equally inappropriate to permit the Debtor to continue to occupy the leased premises without paying creating the possibility of further diluting Lee's Landing Garage's share of funds available to pay administrative claims. Under these circumstances, cause exists for granting relief from the automatic stay.

CONCLUSION

For the foregoing reasons, the court finds and concludes that pursuant to section 365(d)(3) of the Bankruptcy Code and the terms of the Commercial Lease, the Debtor is obligated to pay Lee's Landing Garage both \$1,000 per month in Fixed Rent and \$8,555.20 in interest until the lease is assumed or rejected. The court finds that an obligation of \$28,665.60 has accrued under the Commercial Lease. The court further finds that an obligation of \$27,000 has accrued under the Parking Lease. But for the administrative insolvency of the Debtor, Lee's Landing Garage would be entitled to immediate payment of these amounts as operational expenses. As a result of the

administrative insolvency of the Debtor, these payments will be treated as administrative expenses. The inability of the Debtor to pay these amounts constitutes cause for terminating the automatic stay, but the court will delay the termination of the stay to permit the Debtor to explore its options.

The motions for immediate payment of these amounts will be DENIED and separate orders will be entered to this effect. The motion for relief from the automatic stay will be GRANTED effective thirty days from the entry of a separate order.

cc: Debtor
Debtor's Attorney
United States Trustee
All Creditors and Interested Parties
Attorneys of Record