IN THE UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF TENNESSEE
WESTERN DIVISION

IN RE:

RACHELS INDUSTRIES, INC. BK #88-27271-WHB
Chapter 11

Debtor.

MEMORANDUM OPINION AND ORDER REGARDING THE APPLICATION OF UPS TRUCK LEASING, INC. FOR ALLOWANCE AND PAYMENT OF ADMINISTRATIVE CLAIM

At issue in this core proceeding[1] is whether all or part of the claim of UPS Truck Leasing, Inc. ("UPS") against the debtor's estate may be allowed as an administrative expense claim. The following constitutes findings of fact and conclusions of law pursuant to Bankruptcy Rule 7052.

The record reflects that the debtor filed its voluntary petition for Chapter 11 relief on October 5, 1988. At that time, the debtor, through its Alco Manufacturing division, was the lessee of vehicles from the movant.

On April 17, 1989, the Court approved the sale of the debtor's operating divisions outside the ordinary course of business. Among these divisions was Alco Manufacturing, the division for whose use and benefit the vehicles were leased. In conjunction with the sale, on May 4, 1989, the debtor and the purchaser of Alco executed an "Assignment and Assumption Agreement" whereby the debtor assigned its interest in the truck leases to the purchaser. Pursuant to this agreement, the purchaser agreed to be liable for any obligation for the lease payments which accrued after May 3, 1989. Monetary obligations, arising out of the assigned leases, which accrued prior to May 3, 1989, were to remain the liability of the debtor. No specific court action on the assumption of the leases is found in the record. Neither is there any indication that UPS

[1] 28 U.S.C. §157(b)(2)(B).

objected to this assignment. In fact, the record indicates that UPS subsequently agreed to this assignment via letters of May 25, 1989 and August 4, 1989.

According to the evidence presented at the hearing on this matter, the briefs submitted and the statements of counsel, the total amount of the claim at issue is $81,847.29. Of this amount, $27,903.96 is claimed for prepetition rentals due and owing for the leased vehicles; $33,876.74 is the alleged value of a leased vehicle which has been deemed a total loss; $16,998.59 is the claimed amount of rental charges due on the destroyed vehicle from the date of the invoice for the destroyed vehicle through August 17, 1989; and $3,068.00 is claimed for attorney's fees for services rendered in connection with these claims.

It is essentially the movant's position that these amounts are entitled to administrative expense status because payment of such is required in order for the debtor to assume and assign the leases. UPS also asserts a benefit to this estate from the leases.

Section 503 of the Bankruptcy Code governs the allowance of administrative expenses which are afforded first priority in payment under §507(a)(1). Section 503(b) provides, in pertinent part,

> (b) 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 . . .

(Emphasis added)

According to some Courts which have construed this section, the "purpose of these provisions . . . is to facilitate the rehabilitation of insolvent businesses by encouraging third parties to provide those businesses with necessary goods and services." In re United Trucking Service, Inc., 851 F. 2d 159, 161 (6th Cir. 1988), citing In re Mammoth Mart, Inc., 536 F. 2d 950, 954 (1st Cir. 1976). However, these same Courts caution that "[o]nly those debts . . . that arise after the filing of the bankruptcy petition may be accorded administrative expense status." Id. (Emphasis in original) Moreover, the general rule appears to be that:

> [i]n order to qualify a claim for payment as an administrative expense a claimant must prove that the debt (1) arose from a transaction with the

> debtor-in-possession as opposed to the preceding entity (or, alternatively, that the claimant gave consideration to the debtor-in-possession); and (2) directly and substantially benefitted the estate. [In re Mammoth Mart, Inc. 536 F. 2d] at 954.
>
> A creditor provides consideration to the bankrupt estate only when the debtor-in-possession induces the creditor's performance and performance is then rendered to the estate. If the inducement came from a prepetition debtor then consideration was given to that entity rather than to the debtor-in-possession. In re Jartran, Inc., 732 F. 2d 584 (7th Cir. 1984). However, if the inducement came from the debtor-in-possession then the claims of the creditor are given priority. Id. at 586.

851 F. 2d at 162, citing In re White Motor Corp., 831 F. 2d 106, 110 (6th Cir. 1987).

From this language it is evident that ordinarily the focus of administrative expense claim controversies is on the inducement of the debtor-in-possession which causes the creditor to part with goods and services. Id. However, an apparent exception to this general rule may be available in cases where the debtor-in-possession has, postpetition, engaged in wrongful acts or breached its prepetition agreement with a creditor. Id. In such instances, at least in the Sixth Circuit, the creditor's claim may be afforded §503 priority to the extent of "actual value conferred on the bankruptcy estate." Id. at 162.

Thus, for example, in the United Trucking case, the prepetition lessor of truck trailers to the debtor was allowed to file an administrative expense claim for the amount of actual damages it incurred due to the debtor's postpetition breach of its lease obligation to maintain and repair the trailers upon the deemed rejection of the lease. 851 F. 2d at 164. However, according to the Sixth Circuit Court of Appeals, "[s]ection 503 priorities should be narrowly construed in order to maximize the value of the estate preserved for the benefit of all creditors. (citations omitted) . . . Only post-filing damages may be treated as an administrative expense. . ." In re United Trucking Service, Inc., 851 F. 2d at 164.

In reaching its conclusion that the creditor in the United Trucking case was entitled to an administrative expense claim for actual postpetition damages, the Court partially relied on the following language found in the case of American Anthracite & Bituminous Coal Corp. v. Leonardo Arrivebene, S.A.,

280 F. 2d 119 (2d Cir. 1960), which was decided pursuant to the former Bankruptcy Act but also involved a disputed administrative expense claim.

> The right to priority in the event the trustee or debtor-in-possession receives benefits under the [executory] contract during the interval between the filing of the debtor's petition and rejection of the contract 'is an equitable right based upon the reasonable value' of the benefits conferred rather than the contract price. . . [T]he purpose of according priority in these cases is fulfillment of the equitable principle of preventing unjust enrichment of the debtor's estate, rather than the compensation of the creditor for the loss to him. Id. at 124, 126.

In re United Trucking Service, Inc., 851 F. 2d at 162.

In the case sub judice, UPS asserts that its claims are entitled to administrative expense priority because they come within the above exception to the general requirements for establishment of an administrative expense claim. In addition, according to this creditor, its claim for $27,903.96 in prepetition rentals is entitled to administrative expense priority because the debtor-in-possession assigned and consequently assumed the lease of the vehicle pursuant to 11 U.S.C. §365,[2] and cure of the preassumption defaults is required as a condition to assumption and assignment by §365(b).

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[2] Section 365 provides in pertinent part:

(a) Except as provided in . . . subsections (b), (c) and (d) of this section, the trustee[*], subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor.

(b)(1) If there has been a default in an executory contract or unexpired lease of the debtor, the trustee may not assume such contract or lease, unless at the time of assumption of such contract or lease, the trustee

(A) cures, or provides adequate assurance that the trustee will promptly cure, such default; . . .

(f)(2) The Trustee may assign an executory contract or unexpired lease of the debtor only if -

(A) the trustee assumes such contract or lease in accordance with the provisions of this section; . . . .

* §1107 confers the rights of a trustee, with some exceptions, on the debtor-in-possession.

As noted above, the leases here were assigned by the debtor-in-possession in conjunction with the sale of the debtor-in-possession's Alco Manufacturing division to the purchaser of that division. This assignment was accomplished by the execution of an agreement between the debtor-in-possession and the purchaser which was not filed with this Court except as an exhibit pertinent to the instant controversy. No formal motion for assumption and assignment of these leases pursuant to §365 has ever been brought before this Court and the evidence supports a finding that UPS ultimately agreed to the assignment and, in fact, executed a letter agreement to that effect with the purchaser.

It is clear from the language of §365 that "cure" of default is indeed required for the assumption and assignment of unexpired leases or executory contracts in the bankruptcy context. And, given that §503(b)(1)(A) provides that administrative expenses are those expenses necessary for the preservation of the bankruptcy estate, it follows that in most instances, administrative expense priority will be available as a form of "cure" for defaults for purposes of assumption under §365. However, if there is an issue of default and curing thereof, that must be presented to the bankruptcy court for determination prior to an assumption, and §365(a) requires court approval of the terms of an assumption or rejection. Obviously, the Court should pass upon §365 issues prior to an assumption/rejection. Here, the Court was not involved in the assignment by the debtor-in-possession. As previously noted, the Assignment and Assumption Agreement, signed only by attorneys for Rachels and Acme Manufacturing Company, was only presented to this Court as an Exhibit to pleadings in the present contested matter. The Court has reviewed its Order of April 17, 1989, wherein the Court approved the sale of the Alco division and other divisions of the debtor, and the Court recalls the hearing leading to that Order. There was no discussion at the hearing nor in the Order concerning the specific terms of UPS lease assumptions or assignments. The Order contains language in its ordering clause, paragraph 3, that the debtor's attorney was

> "authorized and directed to execute any and all additional agreements, documents and instruments contemplated by the Sales Agreements and to execute and deliver such additional conveyances, assignments, agreements, instruments, amendments, schedules and documents as may be necessary or

> proper to consummate the proposed sales and effect the transactions contemplated by the Sales Agreements and this Order."

The Order refers to the sales agreements as being exhibited to the Order; however, the Alco agreement is not an exhibit. Therefore, the Court has looked to the debtor's motion to approve the sales, which does exhibit a letter agreement for purchase of Alco, which agreement is not specific on terms of any assumption or assignment with UPS. In fact, that agreement, in part, states:

> "7. REQUIREMENTS OF LEASE AGREEMENTS-Not Applicable."

Attached to the agreement is a list of leased assets, referring to UPS Truck Leasing. However, only the May 4, 1989, assignment and assumption agreement contains specific terms, and the Court had obviously not seen this letter agreement at the time of its April 17, 1989, Order. Therefore, the Court and creditors did not approve the May 4, 1989, agreement.

From this record, the Court concludes that the language in its April 17, 1989 Order, quoted hereinabove, is generic and not intended by the Court or parties to constitute a finding or conclusion under §365. The Court was never called upon to make a §365 ruling until the present motion for administrative expenses. There was no notice and opportunity for hearing concerning a §365 assumption at the time of the sale of Alco. On the other hand, UPS was a party to the assignment. If UPS entertained any questions about the curing of defaults, those questions should have been addressed to the Court prior to UPS's consent to the assignment. For example, UPS could have filed a motion, prior to its approval of the assignment, to require the debtor-in-possession to obtain Court authorization to assume the lease.

Further, prepetition default cures are not necessarily viewed as necessary for the preservation of the bankruptcy estate, particularly since they may provide no benefit to the postpetition debtor-in-possession, trustee or estate. In re United Trucking Service, Inc., supra. This is not to say that prepetition defaults need not be cured or adequate assurance of such given in order for Court approval of assumption of an unexpired lease to occur. Nor is it to say that the granting of administrative expense priority to a claim for a prepetition default is never available as a form of "cure" for such a default. However, it appears that given the absence of

prior court approval of any cure terms in this case, and in particular, given the creditor's agreement to the assignment, "cure" of the prepetition default via the elevation of the claim for such to administrative expense status has been waived. Therefore, the application to allow this part of the claim as an administrative expense claim is denied.

The creditor next asserts that its claim of $33,876.74 constitutes the value of a leased vehicle (number 30151) that was destroyed in an accident postpetition and that this is entitled to administrative expense priority. It is the debtor-in-possession's and unsecured creditors' position that UPS is only entitled to the maximum amount of insurance proceeds available due to the vehicle's loss on this claim. According to the creditor, the debtor is liable for the difference between its claim amount and the available insurance proceeds because the debtor breached the lease agreement by failing to have the vehicle insured for its full claim amount, and because the prepetition debtor agreed to a contract value in the lease agreement between the prepetition debtor and UPS which requires that the lessee maintain insurance coverage on its leased vehicles in amounts equal to the depreciated value shown on an attachment to the lease known as "Schedule A." However, the apparent maximum amount of insurance proceeds tendered by the debtor's insurer for the vehicle's loss is $26,000.00 which the insurer and the debtor contend was the vehicle's fair market value. The debtor argues that it was only required to maintain insurance coverage equal to the vehicle's fair market value.

The pertinent provisions of the lease agreement provide:

> Paragraph 15.B. Physical Damage; Insurance
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> > Customer shall, subject to the provisions below, as to each vehicle bear all risk of loss and shall relieve UPS of all liability, and pay all costs of repair or replacement of vehicles in Schedule(s) A for leased vehicles, or the fair market value for a substitute, interim or additional vehicle, from any cause including, without limitation,
> > . . . collision . . . Also, [customer] shall, unless permitted by UPS to be self insured, obtain and maintain in effect at all times collision and comprehensive insurance in form and with insurers satisfactory to UPS with a deductible satisfactory to UPS, protecting UPS against such loss or damage, provided customer's indemnity of UPS hereunder shall be in full in respect to any insurance deductible . . . .

> In the event of total loss of any vehicle, the lease as to that vehicle shall terminate only when UPS receives all accrued rental and other charges when UPS provides the insurance and, in addition, the depreciated Schedule A value, if CUSTOMER provides the Physical Damage Insurance.

(Tr. Ex. 1)

Based upon this language, the debtor contends that it was only required to maintain insurance coverage equal to the depreciated value or the fair market value of the vehicle. Moreover, the debtor asserts that because UPS was to be satisfied with the "form" and "deductible amount" of any insurance coverage obtained by the debtor, UPS should be estopped from now claiming that the insurance coverage was inadequate. On the other hand, the creditor argues that the provision which specifically refers to the "total loss of any vehicle" requires that the debtor provide it with the depreciated Schedule A value of the vehicle in the event that the debtor is providing the physical damage insurance.

There is no dispute that the debtor here provided the physical damage insurance. Nor is there any dispute that this creditor is entitled to the insurance proceeds payable due to the vehicle's loss[3]. The dispute is whether the difference between the available insurance proceeds and the amount claimed by the creditor is entitled to administrative expense claim priority.

As noted above, this portion of the claim arises out of the postpetition loss of a vehicle leased pursuant to a prepetition agreement. Thus, the lease agreement was induced and executed by the debtor prior to its existence as a debtor-in-possession. As previously noted, there is no evidence that the lease of this vehicle was formally assumed by the debtor-in-possession. Therefore, even if the debtor was in breach of the prepetition agreement, under the reasoning of In re United Trucking Service, Inc., 851 F. 2d 159, 162, the right to priority "'is an equitable right based upon the reasonable value' of the benefits conferred, rather than

[3] The Court has previously entered an order on October 31, 1989, permitting UPS to obtain the insurance proceeds.

upon the contract price." Quoting American Anthracite & Bituminous Coal Corp. v. Leonard Arrivabene, S.A., 280 F. 2d 119, 124.

This debtor-in-possession did not use the vehicle after its destruction, which occurred soon after the bankruptcy filing. The argument that this estate benefitted from the truck is therefore weak. In this instance, the reasonable value of the benefits conferred on the estate could only be the difference between what it cost the debtor-in-possession to insure the vehicle at fair market value and what it would have cost the debtor-in-possession to insure the vehicle at the depreciated Schedule A value, or perhaps the use value between the date of bankruptcy filing and the date of the wreck[4]. The Court has no proof of these amounts and consequently, even if the creditor is given the benefit of the doubt and the agreement construed in its favor, the Court has no evidence of what, if any, additional amount may be allowed as an administrative expense claim due to the loss of this vehicle. Therefore, the creditor having been allowed to negotiate with the insurance carrier for its claim for proceeds, the Court concludes that UPS will be allowed only an administrative expense claim equal to the amount payable by the insurer.

The creditor next seeks $16,998.59 in unpaid rental charges it claims are due on the wrecked vehicle from January 12, 1989, through August 17, 1989 as an administrative expense. This position is without merit. The lease on this vehicle was never assumed nor was there any proven benefit to the estate following the damage to the vehicle. See, e.g., In re United Trucking Service, Inc., 851 F. 2d at 163. Thus, it cannot be said that the estate was unjustly enriched by use of the vehicle. To the contrary, the evidence establishes that the rentals due on the vehicles prior to the accident were paid. Subsequent postpetition rentals for this insured and wrecked vehicle simply do not constitute "actual, necessary costs and expenses of preserving the estate." 11 U.S.C. §503(b)(1)(A).

Finally, the creditor asserts that it is entitled to an administrative expense claim for attorney's fees in the amount of $3,068.00 for services rendered in connection with asserting these claims as administrative

[4] See, this page, infra, wherein the proof established that postpetition but pre-wreck rentals were paid.

expenses. According to the creditor, these fees are sought as indemnification from the debtor because the debtor failed to respond to the creditor's demand for payment of the invoice for the "totalled" vehicle until the claim for administrative expenses was filed. Thus, the debtor's actions forced the creditor to retain counsel to pursue these claims as administrative expenses. From this statement, it is apparently the creditor's position that the debtor's "wrongful acts" in failing to respond to its demands necessitated the creditor's employment of counsel which somehow benefitted the estate.

According to the debtor, the invoice was dated January 31, 1989. Although efforts to settle with the insurance carrier were begun immediately after receipt of the invoice, no written offers of settlement were received from the carrier until April 25, 1989 and May 24, 1989. These were not accepted by the debtor due to the variance between the offered settlement amounts, i.e., $23,000.00 and $26,000.00 and the amount claimed by the creditor, i.e., $33,876.74.

From these facts, the Court cannot conclude that the debtor engaged in "wrongful acts" which necessitated the employment of counsel. Moreover, there is no evidence that the employment of counsel has benefitted the estate whatsoever. To the contrary, the creditor's claim has cost the estate fees and expenses for its own attorneys and those representing the Unsecured Creditors' Committee for services rendered in opposing the creditor's motion. Further, the underlying claim for administrative expense has been denied, except for the insurance proceeds portion, which was not substantially in dispute. The creditor's motion for administrative expense claim priority for its attorney's fees is denied.

The Court observes that it is not at all clear that there are or will be available funds to pay all administrative expense claims much less any general unsecured claims. If UPS wishes to amend its claim to be one for an unsecured claim in the place of the denied administrative expenses, UPS may do so; however, the debtor and other parties in interest may further object to the allowance of all or part of such an amended unsecured claim.

From the above findings and conclusions, it is **HEREBY ORDERED** that:

1. The application of UPS Truck Leasing, Inc. for allowance and payment of its $27,903.96 prepetition rental claim as an administrative expense is **DENIED**;

2. The application of UPS Truck Leasing, Inc. for allowance and payment of its claim for the loss of vehicle number 30151 as an administrative expense is **GRANTED** to the extent of available insurance proceeds only;

3. The application of UPS Truck Leasing, Inc. for allowance and payment of its claim of $16,998.59 as an administrative expense for postpetition rental for the "totalled" vehicle is **DENIED**.

4. The application of UPS Truck Leasing, Inc., for allowance and payment of its $3,068.00 claim for attorney's fees as an administrative expense is **DENIED.**

SO ORDERED this 5th day of January, 1990.

_____
WILLIAM HOUSTON BROWN
UNITED STATES BANKRUPTCY JUDGE

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