

UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF TENNESSEE

IN RE:

WASHINGTON MANUFACTURING COMPANY;
WASHINGTON INDUSTRIES, INC., and
KSA, INC.,

Debtors.

Case Nos. 388-01467-WHB
388-01468
388-01469

Chapter 11
Jointly Administered
Judge William Houston Brown

MEMORANDUM OPINION AND ORDER ON
TRUST COMPANY BANK'S MOTION FOR ALLOWANCE
OF ADMINISTRATIVE EXPENSE CLAIM

This core proceeding¹ is before the Court on Trust Company Bank's ("Bond Trustee") Motion for Allowance of Claim for Administrative Expense and the Bankruptcy Trustee's objection thereto. At issue is the determination of the amount, if any, of Trust Company Bank's allowable administrative expense claim. The following constitutes findings of fact and conclusions of law pursuant to F.R.B.P. 7052.

FACTUAL SUMMARY

The record reflects that Washington Manufacturing Company and its affiliates ("debtor") filed voluntary chapter 11 petitions on March 1, 1988. Prior to commencement of the jointly administered cases, the debtor was a manufacturer of finished textiles. At commencement of the case, the debtor used a facility located at 3600 Trousdale, Nashville, Tennessee for warehousing and shipment of some of its finished textile goods. It is the Chapter 11 Bankruptcy Trustee's ("Bankruptcy Trustee") postpetition use and occupancy of the Trousdale facility that gives rise to the claim asserted here by the Bond Trustee.

¹ 28 U.S.C. §157(b)(2)(B).

The essential facts necessary for resolution of the issues presented are contained in written stipulations that have been mutually agreed upon by counsel for both parties. The efforts of counsel in arriving at these stipulations are commendable and the Court adopts² them as factual findings relevant to this proceeding.

In 1981, the Industrial Development Board of the Metropolitan Government of Nashville and Davidson County, Tennessee (the "Board") acquired the real property located at 3600 Trousdale Drive, Nashville, Tennessee (the "Trousdale Property"), and entered into the "Lease" (defined below) with the Debtor for the possession, use and occupancy of the Trousdale Property by the Debtor. Bonds were issued to facilitate the property's acquisition.³

Specifically, on November 24, 1981, the Debtor and Board entered into that agreement entitled Lease, dated as of November 24, 1981, whereby the Board granted the Debtor the right to possess, use, and occupy the Trousdale Property for a period of 15 years. Pursuant to Article IV of the Lease, the Debtor agreed to pay as Basic Rent on February 24, 1982, and on each February 24, May 24, August 24 and November 24, thereafter through November 24, 1997, an amount equal to the principal and interest installments due on the Bonds on such dates; provided that, until the Bonds were paid in full, all rent payments were to be made to the Bond Trustee, as assignee of the Board's rights as Lessor, pursuant to the Deed of Trust (defined below). The Debtor further agreed to pay the Bond Trustee as Additional Rent or otherwise under the Lease, all other amounts, liabilities, and obligations assumed under the Lease, including, but not limited to: (a) costs and expenses arising out of the possession, operation, maintenance, alteration, repair, rebuilding, or use of the Trousdale Property; (b) all real estate taxes, personal property taxes, income taxes, business taxes, license

² The chronology in which the stipulations were presented by counsel and their references to specific aspects of exhibits may be modified slightly in this opinion.

³ See court's prior opinion dated October 19, 1992, referred to at page 10 of this opinion.

fees, water charges, sewage charges, assessments, and all other kinds of governmental taxes, and charges; (c) payments-in-lieu of taxes that otherwise would have been assessed against the Trousdale Property; (d) utility services; (e) the Bond Trustee's fees and expenses, including reasonable attorney's fees and expenses relating to the Trousdale Property, as well as repossession of same; (f) interest at the annual rate of 18% on all overdue installments of Basic Rent; and (g) other similar costs and expenses.

The rights of the Board under the Lease were assigned to the Bond Trustee, pursuant to that document entitled Indenture Of Mortgage And Deed Of Trust dated as of November 24, 1981 (the "Deed of Trust"). Stip. Ex. 1 & 2 (Lease & Deed of Trust).

From November 24, 1981, until February 24, 1988, the Bond Trustee collected and received from the Debtor all rents and other amounts payable under the Lease. However, on February 24, 1988, the Debtor defaulted by failing to make the required lease payments. The Bond Trustee, as lessor of the Trousdale Property, has received no rental payments from the Debtor or the Debtor's bankruptcy estate since February 24, 1988.

After the Debtor filed its voluntary petition for relief under Chapter 11 of the United States Bankruptcy Code, on March 18, 1988, Timothy F. Finley (the "Bankruptcy Trustee") was appointed trustee for the Debtor's bankruptcy estate. Mr. Finley has been succeeded in that capacity by Ronald R. Peterson.

By orders of this Court, the Bankruptcy Trustee was given until October 31, 1988, to assume or reject all non-residential real property leases of the Debtor. The Bankruptcy Trustee failed to assume or reject affirmatively this Lease by that deadline. According to the Bond Trustee, \$585,081.29 is due and payable under the terms of the Lease for the time period March 1, 1988, to October 31, 1988. This amount includes attorney's fees and appraisal costs which the Bond Trustee asserts are due under the Lease. Stip. Ex. 3 (Bond Trustee's calculations). The Bankruptcy Trustee concedes that this amount is asserted by the Bond Trustee but, of course, denies that it is due from the bankruptcy estate.

The Trousdale Property is located approximately six miles southeast of downtown Nashville. The Trousdale Property has access to rail, with Radnor Yards being nearby. Stip. Ex. 4 & 5 (area maps). The

building on the Trousdale Property consists of a one-story concrete block and brick veneer building constructed in 1967, with additions in 1972 and 1981. The building sits on approximately 8.83 acres. The area immediately surrounding the building has 2,800 square feet of concrete paving and 86,000 square feet of asphalt paving. There are 29 parking spaces for trucks and 136 parking spaces for cars. The building itself consists of a warehouse area, a main office area, an interior office area and rest rooms, and an enclosed dock area and standpipes. The building was modified for the Debtor's needs in 1981 with the installation of Sturdi-Bilt storage racks and shelving. The racks were purchased from Unarco Materials Storage. The two-story racking covers 118,805 square feet of the warehouse space.

The racking is covered with 1 1/8" plyboard and vinyl floor covering. This creates a mezzanine level to the warehouse area, with a load limit of 150 PSF. Along with the racking, materials handling equipment including a 2,292 foot long tow-veyor system was installed. The racking, shelving, and material handling equipment cost \$1.9 million. The funds used to purchase and modify the building, including the purchase and installation of the racking and tow-veyor system, were Bond proceeds.

At the time the Debtor and the Bankruptcy Trustee occupied the Trousdale Property, the total usable space in the Trousdale Property was 296,045 square feet. This square footage breaks down as follows:

High Bay Warehouse Area (w/26' ceilings)	47,127 square feet
1st Floor Racking (w/11' ceilings)	118,805 square feet
Mezzanine Racking (w/15' ceilings)	118,805 square feet
Main Office Area	3,806 square feet
Interior Office & Rest Rooms	5,342 square feet
Enclosed Dock Area & Standpipes	2,160 square feet

Stip. Ex. 6 (building sketch).

Charles Covington, a former supervisor and warehouse manager at the Trousdale Property for both the Debtor before the bankruptcy filing and the Bankruptcy Trustee thereafter, established that approximately 14,224 square feet of the High Bay Warehouse area was never actually, physically occupied by the

Bankruptcy Trustee. The parties have agreed that the maximum number of square feet occupied by the Bankruptcy Trustee was 276,000.

The Trousdale Property was used by the Debtor as both a warehouse and distribution center. The Debtor warehoused its finished goods inventory, which included shirts, pants, blouses and other similar items, in the Trousdale Property. When inventory was sold, the goods were packaged for shipment and shipped from the Trousdale Property. The finished goods were stored in the warehouse area of the Trousdale Property either as flat goods, which were stacked on shelves in the racking, or hung on hangers in the racking. Without the racking and shelving, the Trousdale Property would not have been as useful to the Debtor for storing goods. For example, the hanging items would have been laid flat and stacked up, and the finish on those items would have been ruined. The storage capacity for the Debtor's finished goods at the Trousdale Property was approximately 350,000 dozen goods. As of the bankruptcy filing, the Trousdale Property was substantially full and is estimated to have contained approximately 325,000 dozen of finished goods.

Between March 1 and March 18, 1988, the date on which a Bankruptcy Trustee was appointed, no inventory was sold from the Trousdale Property. Beginning March 19, 1988, the Bankruptcy Trustee began to sell and ship inventory located in the Trousdale Property. This activity continued until all of the inventory was removed from the Trousdale Property, the last of which was shipped out around June 1, 1989.

During the week of April 18 through April 22, 1988, the Bankruptcy Trustee conducted an inventory of the amount and category of goods located in the Trousdale Property. Monthly thereafter, until at least January 29, 1989, the Bankruptcy Trustee updated this inventory report based on the shipments made during the previous month. Stip. Coll. Ex. 7. All of the inventory listed on the inventory reports was stored in the Trousdale Property except for the following categories: California Manual, California, Houston and New Jersey.

Handwritten shipment records maintained by Ms. Patricia Burke, who worked for the Bankruptcy Trustee and who had worked for the Debtor for more than 25 years, documenting the dollar amounts of goods shipped each day during the period from March 18, 1988, through March 31, 1989, indicate that prior to

conducting the April 1988 inventory, the Bankruptcy Trustee had shipped from the Trousdale Property goods with a total value of \$2,998,076.55. Stip. Coll. Ex. 8. The Sales and Tax Summaries, also maintained by the Bankruptcy Trustee, summarize the dollar amounts of goods shipped each day during the period from February 1, 1989, through March 31, 1989. Stip. Coll. Ex. 9.

Using the information contained in the monthly inventory reports, Ms. Burke's handwritten shipment records, the daily Sales and Tax Summaries, and the deposition testimony of Mr. Lamar Bullard, who was vice-president in charge of manufacturing for the Debtor and who was in charge of the liquidation of the inventory of the Trousdale Property for the Bankruptcy Trustee, the parties have determined the following regarding the goods stored in the Trousdale Property as of the stated dates:

<u>INVENTORY DATE</u>	<u>DOLLAR VALUE⁴ IN 000'S</u>	<u>DOZENS OF PRODUCT</u>	
March 1 - 18, 1988	\$25.068	325,000	(estimate)
March 31, 1988	\$23.662	306,500	(estimate)
April 22, 1988	\$22.070	283,970	
May 28, 1988	\$18.093	232,874	
June 25, 1988	\$14.297	186,450	
July 29, 1988	\$13.757	182,571	
August 26, 1988	\$12.393	163,654	
September 24, 1988	\$11.146	149,519	
October 29, 1988	\$9.332	128,264	
November 26, 1988	\$8.130	113,828	
December 24, 1988	\$7.214	102,558	
January 27, 1989	\$5.316	75,415	
February 25, 1989	\$4.689	66,986	(estimate)
March 31, 1989	\$3.079 ⁵	45,000 - 50,000	(estimate)
April 29, 1989 through June 1, 1989	\$.000	5,000 - 10,000	(estimate)

⁴ These values are estimated values prior to sale. Actual sales of inventory from the Trousdale Property was approximately \$21 million.

⁵ Book value of remaining inventory during this period is estimated to be \$3.1 million.

According to Lamar Bullard, the last substantial block of inventory to be removed from the Trousdale Property was the block of industrial goods, and he believes this block was shipped around May 1, 1989. These goods totaled approximately 40,000 dozen.

The weekly payroll records for the Bankruptcy Trustee's employees for the period from March 4, 1989, through May 27, 1989, reflect that all warehouse employees of the Bankruptcy Trustee had been terminated by the end of April 1989. Charles Covington remained as an employee of the Bankruptcy Trustee after that date; his responsibilities still included some work at the Trousdale Property, as well as other work for the Bankruptcy Trustee.

Between the bankruptcy filing and January 27, 1989, the office space portion of the Trousdale Property was physically occupied only by the warehouse manager. Mr. Bullard estimates that he utilized 5% of the office space. Mr. Bullard further estimates that, between January 27, 1989, and April 30, 1989, approximately 80% of the office space in the Trousdale Property (designated Y on Stipulation Exhibit 6) was utilized by employees of the Bankruptcy Trustee who moved to these offices from the Debtor's offices located at 1010 South Seventh Street in Nashville. The Bankruptcy Trustee's employees moved on April 30, 1989, to offices located on County Hospital Road in Nashville.

Along with the employees, on January 27, 1989, the Bankruptcy Trustee also moved various office furniture, fixtures and equipment into the Trousdale Property from the Debtor's 1010 South Seventh Street offices. From June 1, 1989, and continuing until December 10, 1990, the Bankruptcy Trustee used 6,000 square feet of the Trousdale Property to store the office equipment and furniture that the Bankruptcy Trustee anticipated selling by auction.

Between the bankruptcy filing and June 1, 1989, sales from inventory in the Trousdale Property exceeded \$21 million.

According to Lamar Bullard's testimony, at no time between the bankruptcy filing and June 1, 1989, did the amount of inventory drop to a point that it would have been cost efficient for the Bankruptcy Trustee to move the remaining inventory to a smaller facility. To have moved the inventory to another facility at any

time would have been expensive and wasteful. For example, Mr. Bullard estimated that, had the Bankruptcy Trustee moved the inventory at a time when the building was full, it would have cost the Debtor's estate in excess of \$100,000 in moving expenses alone.

At the Bond Trustee's decision, between September 1, 1989, and December 10, 1990, the Bond Trustee incurred out-of-pocket expenses in connection with the Trousdale Property in the total amount of \$48,281.71.

The Bond Trustee's out-of-pocket expenses break down as follows:

(a)	Electricity	\$18,676.55
(b)	Gas	13,147.57
(c)	ADT (fire alarm)	2,854.40
(d)	National Guardian (security system)	2,555.28
(e)	Labor	7,464.41
(f)	Metro water bill - sprinkler hook ups	3,583.40*
	Total:	<hr/> 48,281.71

*Billed but not yet paid.

Stip. Coll. Ex. 10 (copies of receipts evidencing the Bond Trustee's labor expenses).

The Bond Trustee incurred the categories of expenses referenced above after December 10, 1990, and continues to incur such expenses.

The Bankruptcy Trustee first noticed the proposed auction sale of the office equipment and furniture stored in the Trousdale Property on June 15, 1989, indicating in the notice that unless an objection was filed, the auction would be conducted on August 1, 1989. Stip. Ex. 11 (copy of notice). The Bond Trustee filed an objection to the sale on July 3, 1989, asserting a security interest in some of the property scheduled to be auctioned and indicating that it did not want that property sold at auction. Stip. Ex. 12 (copy of objection). The Bond Trustee's objection was not resolved until the entry of an agreed order by this Court on August 2, 1990. Stip. Ex. 13 (copy of order). This order did not become final until the twenty-day objection period expired in late August 1990.

After entry of the agreed order, the Bankruptcy Trustee requested permission from the Bond Trustee to conduct the auction at the Trousdale Property, which request was refused in November 1990, because the Bond Trustee was concerned about liability and lack of adequate insurance coverage for the auction to be conducted at the Trousdale Property. The Bankruptcy Trustee removed the stored office furniture and equipment from the 6,000 square feet of the Trousdale Property on December 10, 1990.

On October 25, 1988, the Bankruptcy Trustee filed a motion to Amend Schedules to Reflect Debtor's Ownership of the Trousdale Property. Stip. Ex. 14 (copy of Motion). In this motion, the Bankruptcy Trustee asserted that the Debtor, as opposed to the Board, was the owner of the Trousdale Property and that the agreements between the Debtor, the Board and the Bond Trustee reflected a financing arrangement and not a true lease. By agreed orders, the Bond Trustee obtained extensions of the hearing on the Bankruptcy Trustee's motion until March 7, 1989. Prior to March 7, 1989, the Bond Trustee and the Bankruptcy Trustee reached an agreement regarding the motion. The agreed order reflecting the agreement between the Bond Trustee and the Bankruptcy Trustee was entered on April 13, 1989. Stip. Ex. 15 (copy of agreed order). This order sets forth the parties' agreement that the property would be shown for sale or lease purposes; that the Bankruptcy Trustee would vacate the premises within thirty days of receipt of written notice from the Bond Trustee that the property had been sold or re-leased; and further, that the Bankruptcy Trustee could vacate the property upon thirty days written notice to the Bond Trustee.

The Bond Trustee filed its Motion for Allowance of Claim For Administrative Expense Pursuant to 11 U.S.C. §503 on April 19, 1991. On October 19, 1992, this Court entered an order finding that the Lease was a true lease for purposes of 11 U.S.C. §365 and §503.

Shortly after the filing of the Bankruptcy Trustee's Motion To Amend Schedules To Reflect Debtor's Ownership Of The Trousdale Property, the Bond Trustee solicited and obtained proposals from commercial real estate companies regarding listing the Trousdale Property for sale. By letter dated December 12, 1988, the Bond Trustee notified the Bankruptcy Trustee that it had chosen Coldwell Banker and requested that the

Bankruptcy Trustee consent to its choice. The Bankruptcy Trustee consented, and Coldwell Banker listed the Trousdale Property for sale beginning in early 1989.

By letter dated August 21, 1989, and pursuant to the terms of the April 13, 1989, order, the Bankruptcy Trustee notified the Bond Trustee of his intent to surrender the Trousdale Property effective October 1, 1989. However, the Bankruptcy Trustee continued to use 6,000 square feet of the Trousdale Property to store the furniture, fixtures and equipment until December 10, 1990, which items had previously been scheduled for auction.

From the bankruptcy filing to October 1, 1989, the Bankruptcy Trustee paid all utilities, provided lawn mowing and general cleaning, security and fire alarm monitoring fees, liability insurance and casualty insurance for the Trousdale Property. Stip. Ex. 17.

At no time prior to October 1, 1989, did the Bond Trustee ever file a motion to require assumption or rejection of the purported lease of the Trousdale Property and the Bond Trustee never requested the Bankruptcy Trustee to surrender possession of the Trousdale Property in accordance with the order entered April 13, 1989.

In the summer of 1990, the Bond Trustee requested that the Bankruptcy Trustee agree to the entry of an order abandoning from the Debtor's estate the Bankruptcy Trustee's interest in the Trousdale Property. The Bankruptcy Trustee consented, and an agreed order was entered on August 2, 1990, providing for the abandonment of the Bankruptcy Trustee's interest in the Trousdale Property. Stip. Ex. 18 (copy of agreed order). One of the bondholders objected to the order, but never pursued it to hearing; therefore, an order denying the objection to the order of abandonment was entered on March 22, 1991.

The Trousdale Property is vacant today and has been continually vacant since the Bankruptcy Trustee ceased his use of the premises. Since early 1989, the Bond Trustee has retained commercial real estate brokers to sell or lease the Trousdale Property, but no purchaser or tenant has entered any agreement to buy or lease the Trousdale Property.

The Bankruptcy Trustee's calculations of the approximate square footage of the Trousdale Property occupied by the remaining inventory is set forth at Stipulated Exhibit 19. The Bond Trustee stipulates to the authenticity and admissibility of Exhibit 19 to prove the truth of the matters asserted therein.

The stipulations referred to establish that the Debtor and/or Bankruptcy Trustee occupied the premises to some degree from the onset of this Chapter 11 case on March 1, 1988, until December, 1990. Moreover, this Court's prior ruling has determined that the prepetition agreement pursuant to which the Debtor occupied the premises is a true lease. Both factors ordinarily give rise to an administrative expense claim in the bankruptcy context. However, as the following discussion demonstrates, under existing law, the amount of any allowable administrative expense claim is dependent upon the circumstances, extent and term of the Bankruptcy Trustee's occupancy.

DISCUSSION

PREREJECTION ADMINISTRATIVE EXPENSE CLAIM

Section 503(b)(1)(A) of the Bankruptcy Code allows "the actual, necessary costs and expenses of preserving the estate" to be classified and paid as administrative expense claims. The significance of administrative expense status is that such claims are allowable and payable ahead of other unsecured claims pursuant to 11 U.S.C. §507(a)(1). In re Moore, 109 B.R. 777, 783 (Bankr. E.D. Tenn. 1989). Under §503(b), bankruptcy courts have broad discretion to determine whether a claim for an administrative expense is in fact comprised of the actual and necessary costs and expenses of preserving the bankruptcy estate. Id. Thus, where the administrative expense claim is asserted pursuant to this section and arises out of the estate's use or occupancy of property, the Court of Appeals for the Sixth Circuit, among other courts, has held that the allowed amount of any such claim should be based upon the reasonable value to the estate for such actual use and/or occupancy. In re United Trucking Service, Inc., 851 F. 2d 159, 162 (6th Cir. 1988). This Court is obliged to adhere to this standard in determining the extent of any administrative expense claim allowable under §503(b).

However, the Code additionally provides for administrative expense treatment of claims comprised of

obligations of the debtor, . . . 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

in that it directs that the "trustee shall timely perform" such obligations. 11 U.S.C. §365(d)(3). (Emphasis added).

The majority of the Courts interpreting §365(d)(3) since its 1984 amendment have concluded that the section's "timely performance" requirement is "an unambiguous statement of Congressional intent that lessors of nonresidential realty receive the rent provided for in the lease until the lease is rejected." In re Worths Stores Corp., 135 B.R. 112, 114 (Bankr. E.D. Mo. 1991). See also, e.g., In re Duckwall-Alco Stores, Inc., 150 B.R. 965 (D. Kan. 1993). This interpretation is supported by the legislative history wherein Senator Orin Hatch remarked that the amendment was intended to lessen the problems of the nonresidential landlord who is "forced to provide current services . . . without current payment." Id. at 115; see also 130 Cong. Rec. S. 8894-95 (daily ed. June 29, 1984)) reprinted at Appx. Vol. 4 Collier on Bankruptcy XX-70 (15th ed. 1992). Additional support for the majority view is drawn from the language of the statute itself which unmistakably requires timely performance of the debtor's nonresidential lease obligations until the lease is either assumed or rejected. Thus, where a debtor in possession or bankruptcy trustee has failed to timely perform postpetition but prerejection lease obligations, these same courts hold that under §365(d)(3) a nonresidential

lessor is entitled to an administrative expense for rent due under the lease notwithstanding the requirement that expenses be actual and necessary costs of preserving the estate under §503(b)(1)(A) before they can be accorded administrative expense priority.

Id. at 115 (citing, inter alia, In re Lunn, 129 B.R. 476, 477 (Bankr. N.D. Ohio 1991); In re ABC Books & School Supplies, 121 B.R. 329, 331 (Bankr. S.D. Ohio 1990)). The performance obligation under §365(d)(3) is "expressly independent of the normal standards for administrative expense claims under §503(b)(1) and constitutes an administrative expense payable without notice and a hearing." In re Coastal Dry Dock & Repair Corp., 62 B.R. 879, 883 (Bankr. E.D. N.Y. 1986).

On the other hand, a minority number of courts faced with the §365(d)(3) issue have opined that although the language of the section requires payment of a nonresidential lessor's postpetition claim pending assumption or rejection of the lease, the section does not, at least when the lease has been rejected, completely abrogate the necessity for showing the reasonableness of the rent or meeting the other requirements of §503(b)(1)(A). See, e.g., In re Orvco, 95 B.R. 724, 728 (9th Cir. BAP 1989); In re Bedroom of Central Florida, Inc., 150 B.R. 982 (Bankr. M.D. Fla. 1992); In re Tammey Jewels, Inc., 116 B.R. 292, 294 (Bankr. M.D. Fla. 1990). Such an interpretation vitiates the plain language of §365(d)(3) by imposing a non-existent reasonableness requirement onto the statute. In re Telesphere Communications, Inc., 148 B.R. 525 (Bankr. N.D. Ill. 1992); In re Cardinal Industries, Inc., 109 B.R. 738 (Bankr. S.D. Ohio 1989).

As quoted above, the statute itself dictates timely satisfaction of the obligations arising under a nonresidential lease pending assumption or rejection "notwithstanding section 503(b)(1) of [the Bankruptcy Code]." The plain ordinary meaning ascribed to the term "notwithstanding" is "in spite of" and "in spite of the fact that." Websters II New Riverside University Dictionary, p. 805 (1988). Therefore, it is reasonable to conclude that in the context of §365(d)(3), the term "notwithstanding" can only mean that timely satisfaction of the postpetition lease obligations arising prior to rejection or assumption of the lease is required "in spite" of any opposing conditions of §503(b)(1).

Accordingly, under §365(d)(3) the Bond Trustee is entitled to the allowance of an administrative expense claim for the obligations under the lease "arising from and after the order for relief" until the lease was deemed rejected, i.e., from March 1, 1988 until October 31, 1988. The question thus becomes the amount of said claim under the terms of the lease agreement. As set out in the stipulations recited above, the Bankruptcy Trustee in this case was given an extension of the statutory 60 day time limit within which to assume or reject the lease. According to the Bond Trustee the total "rent" due under the lease agreement from the March 1 petition date through the October 31 rejection date is \$585,081.29. Stip. Ex. 3 This amount is comprised of "Basic Rent" of \$474,830.42 and "Additional Rent" of \$110,250.87. Id. The lease defines "Basic Rent" as "an amount equal to the principal and interest on the Bonds due on [each February 24, May

24, August 24, and November 24 until the bonds have been paid in full]." Stip. Ex. 1, Lease §4.01. There were two series of bonds, Series A and Series B. Stip. Ex. 2. The principal and interest payments on the Series A Bonds were payable on these four dates while the Series B installments were payable twice annually on May 24 and November 24. Stip. Ex. 2.

According to stipulated Exhibit 3, the cumulative Basic Rent obligation arising under the Series A bonds from commencement of the case until deemed rejection of the lease is \$181,748.64 while that arising under the Series B bonds equals \$293,081.78. This calculation of Basic Rent includes prorated interest and principal in the amount of \$100,926.87 that accrued from the last payment due dates falling during the prerejection time period until the date of rejection, i.e., from May 24th, for the Series B bonds, and from August 24th, for the Series A bonds, until October 31, 1988. Although this amount was not payable under the lease during the prerejection time period, it is clearly an "integral component" of the debtor's rent obligation that arose under the lease postpetition and prerejection. In re Child World, Inc., 150 B.R. 328 (Bankr. S.D.N.Y. 1993). Consequently, in keeping with the language and intent of §365(d)(3), the Court must conclude that the cumulative Basic Rent claim of \$474,830.42 is an allowable administrative expense. See, e.g., In re Child World, Inc., 150 B.R. at 332; In re Ames Dept. Stores, 136 B.R. 353, 356 (Bankr. S.D.N.Y. 1992); In re ABC Books and School Supplies, 121 B.R. 329, 332 (Bankr. S.D. Ohio 1990); In re Cardinal Industries, Inc., 109 B.R. 738, 741 (Bankr. S.D. Ohio 1989).

As noted above, the Bond Trustee further asserts that an additional \$110,250.87 is allowable as a §365(d)(3) administrative expense claim because that amount is comprised of "Additional Rents" under the lease. See, Stip. Ex. 1, Lease §4.03. Indeed, the terms of the lease, to which the prepetition Debtor agreed, call for the payment of Additional Rents including: 18% interest on overdue installments of Basic Rent, payable on demand; expenses associated with use and occupancy of the property, e.g., repairs; taxes and other governmental charges; payments in lieu of taxes; utility services; indemnification for the expense of defending any action arising from the management of the project or repossession of the facility; counsel and other fees and expenses incurred by the Lessor or Bond Trustee in association with the Lessor's rights and

obligations under the lease and/or indenture agreement; and amounts which might become due upon a "determination of taxability." Stip. Ex. 1, Lease §§4.03, 6.01, 6.02, 6.03, 6.05, 8.01, 8.02, 6.06, 17.01 and 17.06. It is pursuant to these provisions that the Bond Trustee requests the additional \$110,250.87 as an administrative expense. This sum includes 18% interest on Past Due Basic rent calculated through October 31, 1988, in the amount of \$26,284.49; payments in lieu of taxes in the amount of \$31,294.50; attorney's fees and expenses in the amount of \$42,278.38; and appraisal fees in the amount of \$10,393.50. Each expense was incurred during the postpetition, prerejection time period. Thus, whether they are payable as §365(d)(3) administrative expenses depends on whether they are obligations "arising . . . under [the terms of] the lease" from and after the order for relief. 11 U.S.C. §365(d)(3).

Turning first to the \$26,284.19 claim for 18% interest due on overdue Basic Rent, §4.03 of the lease specifically includes this charge among the items labeled "Additional Rent." However, the obligation to pay such interest to the Lessor or Bond Trustee arises "on demand." Section 19.08 of the lease dictates that "demand" for purposes of the lease requires written demand. There is no evidence in the record of this proceeding that written demand for the 18% interest penalty was made upon the Bankruptcy Trustee during the prerejection time period. As such, it may be concluded that this Additional Rent claim of \$26,284.19 does not qualify as an obligation "arising from and after the order for relief under [this] unexpired lease." (Emphasis added).

Next on the Bond Trustee's list of Additional Rent claims is \$31,294.50 comprised of an obligation for "accrued but not paid" payments in lieu of taxes. Stip. Ex. 3. Payments in lieu of taxes are made an express component of additional rents by §§4.03 and 6.03 of the lease. Demand for these payments is not required. Unlike a tax obligation owed by the debtor to the taxing authorities, this obligation was to be paid to the Lessor as an "integral component" of the obligations arising under the lease. In re Child World, Inc., 150 B. R. at 332. The time for payment is not controlling. Id.; In re Ames Dept. Stores, Inc., 150 B.R. 107, 109 (Bankr. S.D.N.Y. 1992). Thus, like the claim for prorated Basic Rent amounts, this claim may be allowed as a §365(d)(3) administrative expense claim.

Finally, the Bond Trustee asserts that claims of \$42,278.38 and \$10,393.50 for attorney and appraisal fees, respectively, constitute Additional Rent allowable as §365(d)(3) administrative expense claims. These fees and expenses were incurred for services performed after the Debtor's March 1, 1988, bankruptcy filing, which was after the Debtor's default on the February 24, 1988, Basic Rent payment. In fact, it appears from a review of the services described on the billing statements that performance of these services was precipitated by the Debtor's default and subsequent bankruptcy filing. Stip. Ex. 3. This fact is significant because, while the lease provides for the Debtor to unconditionally pay the Bond Trustee's reasonable counsel fees and other expenses ordinarily associated with the facility, it also provides that the Debtor will pay the Bond Trustee or Lessor's reasonable fees and expenses incurred as a result of the Debtor's default on any lease obligation "upon demand." The "ordinary" fees and expenses are classified as components of "Additional Rent" under §4.03 and §6.06 of the lease and consequently are allowable as §365(d)(3) administrative claims. Conversely, the obligation to pay fees and expenses incurred as a result of the Debtor's default arises only upon demand by the lessor. Moreover, such a nonordinary obligation is classified as a remedy for default or damages under §16.04 of the lease.

Beginning with the provision regarding "ordinary" fees and expenses, these sections of the lease specifically set forth the following directives:

Lessee agrees to pay as additional rent, or cause to be paid, all of the fees and expenses of the Trustee, including reasonable fees and expenses for counsel, and the reasonable expenses of Lessor relating to the Project or to Lessor's rights or obligations hereunder or under the Indenture (including, without limitation the Lessor's obligation under . . . the Indenture . . . [to pay bond transfer and exchange expenses] whether or not such fees or expenses are payable before the commencement of, during, or after the expiration of the Term.

Stip. Ex. 1. Lease §6.06

In comparison, §16.04 states:

If there should occur an event of default hereunder and the Lessor or the Trustee should employ counsel or incur other expenses for the collection of rents or the enforcement or performance or observance of any agreement on the part of the Lessee herein contained, the Lessee agrees that it will on

demand therefor pay to the Lessor or the Trustee the reasonable fee of such counsel and such other reasonable expenses so incurred by the Lessor or the Trustee.

(Emphasis added).

As noted, the descriptions of legal services for which payment is sought here reflect that these services involved efforts to preserve the Bond Trustee's interests in and rights to the subject Trousdale property including recovery of its possession following the debtor's rental payment default. These descriptions further reflect that the appraisal was conducted for the same reasons. Consequently, the Court finds as a matter of fact that the Bond Trustee's claim for payment of these counsel fees and appraisal expenses may only be classified as one resulting from the Debtor's default and thus, one comprised of default damages. To find otherwise would place form over substance. Accordingly, this claim is one for which written demand is required by the terms of the lease. There is no proof that any such demand was made upon the Bankruptcy Trustee in accordance with the lease terms. Stip. Ex. 1, Lease §16.04 and §19.08. As such, by the terms of the lease, this claim does not qualify as an allowable §365(d)(3) administrative expense claim. Given that the claim is not for costs incurred in preserving property of the estate, neither is it allowable as a §503(b)(1) administrative expense claim.

POSTREJECTION ADMINISTRATIVE EXPENSE CLAIM

Having established the allowable amount of the Bond Trustee's administrative expense claim for the prerejection time period under §365(d)(3), the issue becomes what, if any, additional amounts of the Bond Trustee's claim may be entitled to administrative expense status pursuant to §503(b)(1) for the postrejection time period. As discussed above, in order to qualify as administrative expenses under §503, the expenses must be actual and necessary costs of preserving the estate. The rentals due under the lease no longer control. In re Cardinal Industries, Inc., 109 B.R. at 741. It is undisputed that "the amount of compensation to which [the Bond Trustee] is entitled under §503(b)(1) should be based on the Bankruptcy Trustee's actual use of the property." Memorandum . . . In Support of Motion . . . , p. 14. See also, In re Cardinal Industries, Inc., 109 B.R. 738 at 741.

It is further undisputed that a reasonable approach to obtaining that value is to arrive at a reasonable rental rate, determine the amount of square footage occupied during the relevant time period and multiply the rental rate by the square footage by the length of time the property was so occupied. Memorandum. . . In Support of Motion . . . , p. 14; Trustee's Memorandum In Opposition To . . . Request for Allowance of Administrative Expenses, p. 13.

The parties' dispute arises over the specific amounts to be plugged into each component of this formula. The Bond Trustee contends that inasmuch as the premises exclusively housed the debtor's inventory from the lease rejection date until June 1, 1989, the postrejection rent claim should be calculated by assuming occupancy of the entire gross building area for that time period. It is essentially the Bond Trustee's position that it is entitled to an administrative expense claim for the reasonable rental value of the entire usable square footage of the premises from the October 31, 1988, lease rejection date until June 1, 1989, the date on which the final inventory was removed, and an additional administrative expense claim for the reasonable value of the Bankruptcy Trustee's use of 6,000 square feet of the premises from June 1, 1989, until December 10, 1990, when all estate assets were removed from the property. According to the Bond Trustee, using these figures, the total reasonable rental value of the premises for this postrejection time period is \$385,591.00. Tr. Ex. 25.

Conversely, the Bankruptcy Trustee asserts that for administrative expense purposes, the reasonable rental value of the premises for this time period must be calculated using only the square footage actually occupied by the Bankruptcy Trustee through August 1, 1989. It is his position that any occupancy after August 1, 1989, was due to the Bond Trustee's objection to the Bankruptcy Trustee's proposed auction of items remaining at the property that was originally scheduled for August 1, 1989. Thus, based on his expert's appraisal and calculations, a reasonable rental amount entitled to postrejection §503(b)(1) status is \$55,968.93. See Stip. Ex. 19.

The parties' respective expert appraisers have expressed the opinion that during the pertinent time periods, a reasonable rental rate for the "High Bay" area and office space was \$2.50 per square foot per year.

Moreover, both appraisers assumed this rate would include the cost of taxes, insurance and maintenance of the roof and sidewalls. However, the Bond Trustee's expert, Mr. Marvin A. Maes, further opined that this \$2.50 rate was appropriate for the remaining 118,805 square foot "first floor" area with an eleven foot ceiling that was created by installation of the Sturdi-Built racking system. This opinion was based upon his assumption that the racking system would be removed leaving the entire building with a twenty-six foot ceiling. Otherwise, according to Mr. Maes, the building would not be suitable as a warehouse for storage unless a tenant specifically needed such a racking system. He thus considered the racking system to be equipment and ascribed a \$1.52 per square foot rental rate to the second or mezzanine level of the racking system. This \$1.52 rate equals a 9.5% annual return on the \$1.9 million cost of the racking system and resulted from just such a calculation by the expert witness. The Bond Trustee then calculated monthly rates of \$0.2083 for the \$2.50 per square foot annual rate and \$0.1266 for the \$1.52 rate.

In contrast, Mr. James Lamb, on behalf of the Bankruptcy Trustee testified that he believed \$1.50 per square foot per year was a reasonable rental rate for the racking system's "first floor" and that \$1.25 was a reasonable rental rate for the mezzanine level of the racking system area. Mr. Lamb reached these conclusions by considering the limited marketability of the warehouse in its "as is" condition, i.e., with the racking system in place, for short term warehouse tenants such as the Bankruptcy Trustee. These figures were then averaged to result in a monthly rate for the combined warehouse space of \$0.1275.

Given the consistency of both expert opinions that a \$2.50 per square foot rental rate is appropriate for the "High Bay" and office areas of the warehouse, the Court is satisfied that it is a reasonable rate for those areas during the pertinent time period. An appropriate rate for the area occupied by the racking system presents a more difficult question because although, according to the experts, it renders the property less marketable for most purposes, the parties here have stipulated that "[w]ithout the racking and shelving, the Trousdale property would not have been as useful to the Debtor for storing goods." See, "Factual Summary," p. 5 above. Consequently, the Court considers Mr. Maes' approach of viewing the racking system as equipment the most reasonable valuation approach for purposes of this dispute. Accordingly, the Court

concludes that the rate of \$1.52 per square foot for the mezzanine level, a rate which would here provide a 9.5% return on the cost of the racking system equipment during the relevant time period, is a reasonable rate for the Bankruptcy Trustee's use of the racking system.

Turning next to the question of a reasonable rental rate for the first floor area of the racking system the Court has before it the \$2.50 rate espoused by the Bond Trustee's expert, Mr. Maes, and the \$1.50 rate opined by the Bankruptcy Trustee's expert, Mr. Lamb. By his own admission, Mr. Maes' \$2.50 rate was based on his assumption that the racking system would be removed and the entire warehouse space available for rental would have twenty-six foot ceilings. Mr. Maes further stated, on cross examination, that he could not express an opinion of the rental value of the warehouse with the racking in it. As such, the Court is not convinced that the \$2.50 rate is a reasonable rental rate for the first floor of the racking system; rather, the Court is convinced that the 9.5% return on the cost of the racking system itself during the pertinent time period plus Mr. Lamb's \$1.50 rate for the first floor is more than adequate compensation for the Bankruptcy Trustee's postrejection use of the racking system and the warehouse area it occupied.

Mr. Maes' expert testimony that a "standard industrial lease" such as the one assumed to exist here for rental valuation purposes would contain rates inclusive of taxes, insurance and the cost of maintenance of the roof and side walls coupled with Mr. Lamb's concurrence with the assumption of such a lease when arriving at his opinion of the reasonable rental value, further persuades the Court that the rates determined to be applicable here are inclusive of these costs.

Having determined that reasonable rental rates for §503(b)(1) purposes are \$2.50 per square foot per year for the office and High Bay areas of the warehouse, \$1.52 per square foot for the mezzanine level of the racking system and \$1.50 per square foot for the first level of the racking system, the question next becomes the extent of the square footage to which these rates should be applied. As discussed above, §503(b)(1) calls for payment of the actual and necessary expenses of preserving property of the estate as priority, administrative expense claims. Thus, the actual benefit to the estate, or the actual square footage occupied by

the estate is the appropriate measure of space used for §503(b)(1) purposes. See, e.g., In re Cardinal Industries, Inc., 109 B.R. at 741; In re United Trucking Service, Inc., 851 F. 2d at 162.

The extent of the Bankruptcy Trustee's warehouse space occupancy decreased steadily over the time period in question because inventory was being sold and removed from the premises. Stip. Ex. 6, 8, 9 and 19. However, no proof regarding the degree to which each of the areas described above was occupied has been received. Under these circumstances, the Bankruptcy Trustee's suggested use of an average monthly rental rate, which reflects the combined warehouse space usage, is the most logical approach. Application of this average monthly rate, \$0.1532, to the decreasing square footage provided in Stipulated Exhibit 19 for the date nearest November 1, 1988, i.e., 101,016 square feet on October 29, 1988, through 5,796 square feet on June 1, 1989, results in a §503(b)(1) claim for the storage of the inventory and use of the warehouse in the amount of \$65,412.12. As noted above, the parties have stipulated that subsequent to June 1, 1989, 6,000 square feet was the maximum space used by the Bankruptcy Trustee. This space was used for the storage of equipment, furniture and fixtures. As such, the monthly rental for this storage beginning June 1, 1989, equals \$919.20.

Turning finally to the question of office space occupancy, the degree of which also varied during the relevant time period, the uncontroverted appropriate monthly rental rate is \$0.2083 per square foot or \$2.50 per year. According to the stipulated testimony of Mr. Bullard, approximately 5% of the office space, or 457.40 square feet, was occupied from the lease rejection date of October 31, 1988, until January 27, 1989. From January 27, 1989, until April 30, 1989, additional employees placed at the property caused 80% or 7,318.40 square feet of the office space to be occupied. The parties have stipulated that on April 30, 1989, any employees at the property were terminated and from that date forward, the Bankruptcy Trustee's maximum occupancy was 6,000 square feet per month for the storage of equipment, furniture, and fixtures. Therefore, reasonable rental amounts based on the Bankruptcy Trustee's actual postrejection use of the office space only are \$285.83 for the 5% occupancy from October 31, 1988, until January 27, 1989, and \$4,573.27 from January 27, 1989, until April 30, 1989.

Resolution of the reasonable rental rates issue raises the question of the duration of the Bankruptcy Trustee's occupancy for §503(b)(1) administrative expense purposes. The Bond Trustee asserts that it has an allowable administrative expense claim for the reasonable rental value of the 6,000 square feet of the property used for storage through December 10, 1990, plus \$48,281.71 in out-of-pocket expenses incurred for maintenance, insurance, utilities and security at the property between September 1, 1989, and December 10, 1990. The Bankruptcy Trustee contends that he had planned to remove all items from the warehouse pursuant to an auction of the items he scheduled for August 1, 1989. The auction was noticed on June 15, 1989. The Bond Trustee objected to the sale, and, according to the Bankruptcy Trustee, thereby prevented the auction and caused the items to remain at the property. The objection was based upon the Bond Trustee's asserted interest in some of these items scheduled for auction; it was resolved in August, 1990. However, the auction was never conducted at the property because of the Bond Trustee's concern about liability. The Bankruptcy Trustee removed the items on December 10, 1990, although he had previously notified the Bond Trustee of his intent to vacate the premises on September 1, 1989, pursuant to the April 13, 1989, consent order. It is therefore the Bankruptcy Trustee's position that the Bond Trustee is entitled to no administrative expense claim for expenses associated with the property after August 1, 1989. Based on the record here, the Court concurs with the Bankruptcy Trustee.

There has been no showing that the storage of the auction items at the property provided any benefit to the estate as required by §503(b)(1). Neither has there been any showing that the storage of these items after August 1, 1989, interfered in any way with the Bond Trustee's attempts to sell or re-lease the property. Moreover, it is undisputed that the Bond Trustee holds the first mortgage on the property and that the objection to the auction raised by the Bond Trustee was based upon its asserted security interest in some of the items scheduled for auction. Stip. Ex. 12. From these factors it also may be concluded that the Bond Trustee's maintenance of the property was motivated by self interest and resulted primarily in preservation of its collateral rather than benefit to the estate. It is well settled that "no administrative expense claim is allowable where the movant incurs the expense substantially in its own self-interest." In re Moore, 109 B.R.

at 780. See also In re Barrett, 149 B.R. 494 (Bankr. N.D. Ohio 1993); In re Speeds Billiards & Games, Inc., 149 B.R. 434 (Bankr. E.D. Tex. 1993); Wolf Creek Collieries Co. v. GEX Kentucky, Inc., 127 B.R. 374 (N.D. Ohio. 1991).

From the above findings and conclusions, IT IS HEREBY ORDERED that:

1. The Bond Trustee is entitled to an administrative expense claim pursuant to 11 U.S.C. §365(d)(3) in the amount of \$506,124.92, consisting of the Basic Rent and payments in lieu of taxes, due for the prerejection time period;
2. The Bond Trustee is entitled to a gross administrative expense claim pursuant to 11 U.S.C. 503(b)(1) of \$72,109.62, less the amount of the Bankruptcy Trustee's costs of insurance, taxes and maintenance of the roof and sidewalls at the facility from November 1, 1988, until September 1, 1989;⁶
3. The balance of the Bond Trustee's claim, which has not been allowed as an administrative expense, may be allowed as an unsecured claim.

SO ORDERED this 11th day of May, 1993.

WILLIAM HOUSTON BROWN
UNITED STATES BANKRUPTCY JUDGE
Sitting by designation

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⁶ The amount of the Bankruptcy Trustee's costs for this time period are not established in the record.

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