11 U.S.C. § 365(d)(3)

In re Troutman Investment Co. Case # 602-69650-aer11

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Before it filed Chapter 11, Debtor was the tenant under a commercial lease of non-residential real property. Under the lease, it was liable for property insurance, common area maintenance charges, and property taxes (collectively, the charges), which all essentially were due upon billing by the landlord. That billing occurred post-petition, but many of the charges covered pre-petition periods. Landlord claimed the entire amount due as an administrative expense. Debtor claimed only the pro-rata portion of the charges which had accrued post-petition, and pre-rejection, were entitled to administrative priority.

The court was called upon to interpret 11 U.S.C. § 365(d)(3) which compels a trustee (or debtor-in-possession), to timely perform all obligations which arise post-petition and pre-rejection under unexpired nonresidential leases, and grants administrative priority to same. Recognizing a split in the case-law, the court adopted Debtor's "pro-ration" (or "accrual") approach, as opposed to Landlord's "billing date" (or "performance") approach. The court took particular heed of recent 9th Circuit case-law where the court appeared to adopt the "accrual" approach.

UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF OREGON

In Re:	Bankruptcy Case No. 602-69650-aer11
TROUTMAN INVESTMENT COMPANY,	MEMORANDUM OPINION
Debtor.	

This matter comes before the court on Timberhill Shopping Center LLC's (Timberhill) Request for Administrative Payment in the amount of $44,839.76. Both Debtor and the Official Committee of the Unsecured Creditors (Creditors' Committee) have opposed the request. For the reasons that follow, this court agrees with the position taken by Debtor and Creditors' Committee. Timberhill's request will be denied.

FACTS

Before filing Chapter 11, Debtor operated a number of retail department stores. One such store was located in the Timberhill Shopping Center in Corvallis, Oregon. Timberhill, as assignee, was the landlord under a lease originally entered into in 1987 between Gary and Gail Hawkins, as landlord, and Debtor, as tenant for the

space in the mall. Pursuant to the lease, Debtor was responsible for its proportionate share of common area maintenance (CAM) costs, property damage insurance, and property taxes (the charges). Specifically, the lease required that proportionate CAM costs be paid to lessor "as additional rent...within ten (10) days of receiving a bill therefore from lessor, which shall be no more frequently than monthly."[1] Lease, page 14. The lease further required that proportionate property damage insurance and assessed real property taxes be paid to lessor "as additional rent" "upon demand." Under the lease, Debtor's obligation to pay taxes was to be prorated for the lease's first and last partial fiscal years, if any.

On December 13, 2002, Debtor filed its Chapter 11 petition. Early in the case, Debtor decided to cease operations and liquidate. Many of its leases had remaining terms with value in the marketplace. Pursuant to a "Designation Rights Order" Debtor sold, to a third party, the right to designate assignees of many of these remaining tenancies, including the Timberhill lease and concurrently obtained an order extending the time until October 31, 2003, for it to assume (and then assign) or reject these leases.

During 2002, Timberhill paid the Center's CAM costs and insurance, as well as tax year 2002-2003 property taxes.[2] On

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[1] The CAM costs were "capped" according to a formula, not relevant to the court's decision.

[2] Oregon's property tax (or fiscal) year begins July 1st and ends June 30th. ORS 308.007(1)(c). Property tax bills are prepared in October of the tax year in

(continued...)

January 13, 2003, it invoiced Debtor $47,132.72 for Debtor's proportionate share of the charges.[3] Debtor did not pay the full invoice, but instead paid the amounts representing the post-petition pro rata share.[4]

Pursuant to a stipulation and order entered in May, 2003, the lease was deemed rejected and terminated when Debtor vacated the premises, which was apparently sometime in May, 2003, although the parties cannot agree on the exact date.

ISSUE

Timberhill claims administrative expense priority for all of the charges. Debtor concedes such priority only for the pro-rated post-petition, pre-rejection period thereof. At issue is the interpretation and application of 11 U.S.C. § 365(d)(3),[5] which provides in pertinent part:

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[2](...continued)
question; taxpayers are billed by November 15th. ORS 311.250(1). One third of the tax is due by November 15th, one third by February 15th, and the final third by May 15th. ORS 311.505(1). Taxpayers are offered a discount for prepayment, ORS 311.505(3), which Timberhill apparently took advantage of.

[3] The invoiced amounts were as follows:
CAM costs -$10, 446.95;
Insurance- $8,760.87,
Property taxes- $27,924.89;
for a total of $47,132.71.

[4] Debtor also voluntarily paid on a going-forward basis, year 2003 monthly pro rata shares of its lease obligations. Timberhill accepted these payments without waiver of its rights.

[5] Unless otherwise noted, all subsequent statutory references are to Title 11 of the United States Code.

> The trustee[6] 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.[7]

DISCUSSION

Timberhill argues the statute's language is unambiguous. It requires administrative priority for all obligations of the lease, whether the obligations accrued pre-petition or post-petition, so long as the lease requires payment during the post-petition, pre-rejection period. Debtor and the Creditors' Committee argue the terms "obligations" and "arise" are ambiguous, subject to an interpretation which creates administrative priority only for those charges which accrue post-petition, pre-rejection. A plethora of case law supports each side. Timberhill's argument is often called the "performance date" or "billing date" approach. Debtor's argument is often called the "accrual" or "proration" approach and has been said to represent the "slight" majority rule. In Re National Refractories & Minerals Corp., 297 B.R. 614, 619 (Bankr. N.D. Cal. 2003).[8]

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[6] In Chapter 11 cases, the debtor in possession, with exceptions not relevant here, has the rights of a "trustee". 11 U.S.C. § 1107(a).

[7] The "notwithstanding" clause of the statute means administrative priority is given for non-residential lease claims during the post-petition, pre-rejection period, without regard to the lease's benefit to the estate. In Re Pacific-Atlantic Trading Co., 27 F.3d 401, 403-405 (9th Cir. 1994).

[8] See, In Re Phar-Mor, Inc., 290 B.R. 319 (Bankr. N.D. Oh. 2003) (collecting cases supporting both rules).

A leading "accrual" case is In re Handy Andy Home Improvement Centers, Inc., 144 F.3d 1125 (7th Cir. 1998). There, as here, real property taxes were involved, but unlike here, the taxes were billed fully in arrears, that is, tax for one calendar year was billed in the next. The court concluded the statute was ambiguous:

> The quarrel between the parties is over whether Handy Andy's "obligation" under the lease could arise before Handy Andy was contractually obligated to reimburse National for the taxes that the latter had paid. National says no, and this "billing date" approach is a possible reading of section 365(d)(3), but it is neither inevitable nor sensible. It is true that Handy Andy's obligation to National to pay (or reimburse National for paying) the real estate taxes did not crystallize until the rental due date after the taxes were paid. But since death and taxes are inevitable and Handy Andy's obligation under the lease to pay the taxes was clear, that obligation could realistically be said to have arisen piecemeal every day of 1994 and to have become fixed irrevocably when, the last day of the year having come and gone, the lease was still in force. Had the lease been terminated for one reason or another on January 1, 1995, Handy Andy would have had a definite obligation to reimburse National for the 1994 real estate taxes when those taxes were billed to National. The obligation thus arose, in a perfectly good sense, before the bankruptcy. The obligation to reimburse National for the first installment of the 1995 taxes likewise arose before the bankruptcy.

Id. at 1127.

The leading "performance date" case is In re Montgomery Ward Holding Co., 268 F.3d 205 (3rd Cir. 2001), where The court explained the statute's lack of ambiguity as follows:

> The clear and express intent of § 365(d)(3) is to require the trustee to perform the lease in accordance with its terms. To be consistent with this intent, any interpretation must look to the terms of the lease to determine both the nature of the "obligation" and when it "arises." If one accepts this premise, it is difficult to find a textual basis for a

> proration approach. On the other hand, an approach which calls for the trustee to perform obligations as they become due under the terms of the lease fits comfortably with the statutory text.

Id. at 209.

In a case decided yesterday (April 12, 2004), the Ninth Circuit appears to have adopted the "accrual" or "proration" approach. K-4 , Inc. v. Midway Engineered Wood Products, Inc., et al. *(In re Treesource Industries, Inc.)*, __ F.3d __, 2004 WL 764909 (9th Cir. 2004). In K-4, Inc., the court concluded that the debtor's obligation to remove a concrete building slab and restore the leased premises upon termination or expiration of the lease did not arise pre-rejection, hence, the landlord's claim was not entitled to priority as an administrative expense claim. The court further noted, "The Removal Obligation is different from tax or rent obligations, for which the relevant time to determine whether the obligation is pre or post-petition is when the obligations accrue and not necessarily when performance must take place ...." Id. at 2004 WL 764909, 4.

Based on the foregoing, this court concludes that only that portion of the charges accruing post-petition, pre-rejection are entitled to administrative expense priority. It is the court's understanding that all of these charges have been paid in full; as such, Timberhill is not entitled to any administrative expense payment.

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ATTORNEY'S FEES

Both sides have requested an award of attorney's fees incurred in litigating this matter. The lease, at paragraph 50, page 31, provides as follows:

> In the event any legal proceeding is commenced for the purpose of interpreting or enforcing any provision of this lease, the prevailing party in such a proceeding shall be entitled to recover a reasonable attorney's fee in such proceeding, or any appeal thereof, to be set by the court without the necessity of hearing testimony or receiving evidence, in addition to the costs and disbursements allowed by law.

Here, the amount of Timberhill's pre-petition claim is not in dispute. Again, it is the court's understanding that all of the lease charges accruing post-petition, pre-rejection, have been paid in full. The sole issue decided by this court is whether any of the lease charges accruing pre-petition are entitled to priority as an administrative expense claim. This question is decided with reference to § 365(d)(3) of the Bankruptcy Code and not by interpretation or enforcement of the provisions of the lease. Accordingly, this court concludes that none of the parties are entitled to an award of attorney's fees and costs.

Timberhill's request for administrative payment in the amount of $44,839.75 should be denied. The above constitute my findings of fact and conclusions of law under FRBP 7052. They shall not be separately stated. An order consistent herewith shall be entered.

ALBERT E. RADCLIFFE
Chief Bankruptcy Judge