

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF INDIANA
FORT WAYNE DIVISION

IN THE MATTER OF:)
)
DFI PROCEEDS, INC.) CASE NO. 08-11955
)
)
Debtor)

DECISION

At Fort Wayne, Indiana, on February 9, 2010.

The debtor filed a petition for relief under chapter 11 on June 20, 2008. Between the date of the petition and the date its assets were sold – September 22, 2008 – it operated its business out of a facility leased from DFI Investors, an insider. See, 11 U.S.C. § 101(31). DFI Investors has filed a motion for an administrative claim for post-petition rent, to which the unsecured creditors’ committee has objected. The parties agree that DFI Investors is entitled to an administrative claim for post-petition rent. The dispute centers on how much and for what period of time. The matter has been submitted to the court on stipulations and briefs of counsel.

Howard Driggs, Jr. was president of both the debtor and its landlord, DFI Investors. For several years prior to bankruptcy, the debtor had been in a workout situation with its primary secured lender, Key Bank. During this time, DFI Investors had waived debtor’s rent for 2006 and, through a lease amendment dated April 5, 2007, waived rent for the year 2007 as well. In order to compensate DFI Investors for the rent it had waived, the amendment extended the lease term and raised the rent, beginning January 2008, from \$27,845 per month to \$39,500; beginning December, 2010, the rent increased again, to \$42,500 per month. After the petition, the lease was rejected, effective September 22, 2008 when the debtor’s assets were sold. Unfortunately, prior to rejection,

no rent was paid to DFI Investors, hence the present motion.

The motion is based upon § 365(d)(3) of the United States Bankruptcy Code which provides:

The trustee shall timely perform all the obligations of the debtor . . . arising from or 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). 11 U.S.C. § 365(d)(3).

DFI Investors seeks an administrative claim of \$139,983.33 for the rent it contends should have been paid from the date of the petition through September 30, 2008. This amount is calculated at the increased monthly rate set out in the 2007 lease amendment. While the committee acknowledges that DFI Investors is entitled to an administrative claim, it argues the amount of that claim should be calculated at the original, not the increased, lease rate and that the obligation to pay should end on September 22, 2008, the date the lease was rejected. Thus, the court has two questions before it: What was the amount of rent the debtor was required to pay and for how long? Depending on how the court answers these questions, the parties have stipulated to the amount of the resulting claim.

The second of these questions is the easiest to answer because the Seventh Circuit has already considered it. “Rent must be paid on the day it is due even if it will cover a period of time after the lease is rejected.” Ha-Lo Industries v. Centerpoint Properties Trust, 342 F.3d 794, 799 (7th Cir, 2003) (citing In re Koenig Sporting Goods, Inc., 203 F.3d 986 (6th Cir. 2000)). Debtor’s rent was due on the second day of each month. Since it did not reject the lease until September 22, it must pay the full amount that came due on September 2, prior to rejection.

The second question – How much? – is a bit trickier, but the Seventh Circuit provides the answer to it as well. In Matter of Handy Andy Home Improvement Centers, Inc., 144 F.3d 1125 (7th Cir. 1998), it was called upon to consider the debtor’s obligation to reimburse a landlord for real

estate taxes that had accrued pre-petition but which did not come due until after the petition was filed. The question it faced was whether the debt to the landlord was entirely a post-petition one, based on the date payment was due, or whether it should be pro-rated between postpetition and pre-petition periods based upon the debtor's occupancy. Id. at 1126. To the extent the debt was a post petition one, § 365(d)(3) would give it to an administrative priority, but any pre-petition component would be nothing more than a general unsecured claim. In concluding that the payment date did not control the court observed:

The purpose [of giving postpetition creditors a high priority in distribution of the estate] is to enable the debtor to keep going for as long as its current revenues cover its current costs, so that it does not collapse prematurely because of the weight of its existing debt. . . . In economic terms, the prioritizing of postpetition debt enables the debtor (or trustee) to ignore sunk costs – treat bygones as bygones – and continue operating as long as the debtor's business is yielding a net economic benefit. The purpose is relevant to any borrowing, trade or otherwise, in which the debtor engages after entering bankruptcy. . . . Handy Andy's debt to National for 1994 and earlier 1995 taxes relates entirely to an earlier period, and is thus no different from its debts to trade creditors for supplies that it bought in 1994 but never paid for.

. . . [P]ast taxes really are a sunk cost, and shouldn't affect the current operations of a bankrupt tenant; and so the obligation to pay or reimburse the taxes that accrued pre-petition is a pre- rather than post petition obligation.

. . . Congress passed section 365(d)(3) which takes [landlords] out from under the "actual, necessary" provision of 503(b)(1) and allows them during that awkward postpetition pre-rejection period to collect rent fixed in the lease. There is no indication that Congress meant to go any further than to provide a landlord exception to 503(b)(1), and thus no indication that it meant to give landlords favored treatment for any class of pre-petition debts. Id. at 1127-28.

Thus, for the Seventh Circuit, a landlord's entitlement to an administrative claim turns upon more than simply the date a payment comes due under the terms of the lease. The bill being paid must also represent something other than a "sunk cost" rooted in the debtor's pre-petition past; instead, it must somehow relate to the debtor's current operations.

Here, to the extent DFI Investor's claim to an administrative expense is based upon the increased rent set out in the 2007 lease amendment, it is in the same position as Handy Andy's landlord. The increased rent was designed to compensate it for the rent it had previously agreed to waive and, as such, represents the same kind of "sunk cost" that the Seventh Circuit concluded was not entitled to an administrative priority. Accordingly, although DFI Investors is entitled to an administrative claim, the amount of that claim should be based upon the original monthly rental of \$27,845, not the increased amount. Accord, In re Gantos, Inc., 181 B.R. 903 (Bankr W.D. Mich. 1995) (additional rent charged to recover rent that had been previously deferred was part of the landlord's pre-petition claim and not part of its capped rejection damages claim).

The court recognizes movant's reliance upon In re Cukierman, 265 F.3d 846 (9th Cir. 2001). There the Ninth Circuit concluded that "further rent" called for by a lease but which actually represented payments on promissory notes was entitled to administrative status pursuant to § 506(b)(3). Unlike the Seventh Circuit, that court focused solely upon the date payment was due and ignored the nature or origin of the debt being paid. In light of Handy Andy, the Seventh Circuit would have decided the case differently.

The parties have stipulated that if DFI Investors is not entitled to rent at the increased rate, its administrative claim is \$93,743.33 (\$86,318.5 from the petition to the sale/rejection date and \$7,425.33 from that date through Sept 30). It's motion will be granted in that amount and an appropriate order entered.

/s/ Robert E. Grant
Chief Judge, United States Bankruptcy Court