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### The Commercial Real Estate Landlord's Rights to Receive Post-Petition Rental Payments under Section 365(d)(3) of the Bankruptcy Code

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# THE COMMERCIAL REAL ESTATE LANDLORD'S RIGHTS TO RECEIVE POST-PETITION RENTAL PAYMENTS UNDER SECTION 365(d)(3) OF THE BANKRUPTCY CODE

C. Alan Gauldin\*

## I. INTRODUCTION

A bankruptcy trustee<sup>1</sup> has sixty days after bankruptcy is filed to determine whether to assume or reject an unexpired lease of nonresidential real property.<sup>2</sup> The court has authority to grant the trustee an extension of time to make this election, but unless the trustee takes steps to assume or reject the lease prior to the deadline, the lease is automatically rejected upon expiration of this period.<sup>3</sup>

Prior to assumption or rejection, the trustee can continue to hold the real property and the landlord must wait to see what the trustee does with the lease.<sup>4</sup> Before 1984, the trustee could hold the property during this waiting period without paying rent or other charges due under the contract.<sup>5</sup> If the landlord wanted to receive rent, he had to request payment as an administrative claim, which was usually measured by the fair market value of the estate's actual benefit from or use

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1. For purposes of this article, the term "trustee" also applies to a debtor in possession under 11 U.S.C. §§ 1107, 1203 (1988).

2. See the text of 11 U.S.C. § 365(d)(4) (1988), *infra* note 18.

3. *Id.* Courts are divided on whether the trustee must actually obtain an order or simply make application during the grace period. See *In re Tandem Group, Inc.*, 60 B.R. 125, 126-27 (Bankr. C.D. Cal. 1986) and cases cited.

4. 11 U.S.C. § 365(a), (d)(4) (1988).

5. 11 U.S.C. § 365(d) (1983) (amended 1984) stated:

(1) In a case under chapter 7 of this title, if the trustee does not assume or reject an executory contract or unexpired lease of the debtor within 60 days after the order for relief, or within such additional time as the court, for cause, within such 60-day period, fixes, then such contract or lease is deemed rejected.

(2) In a case under chapter 9, 11, or 13 of this title, the trustee may assume or reject an executory contract or unexpired lease of the debtor at any time before the confirmation of a plan, but the court, on request of any party to such contract or lease, may order the trustee to determine within a specified period of time whether to assume or reject such contract or lease.

of the property, and would be paid, if at all, with other such claims.<sup>6</sup>

To rectify this situation, Congress passed the so-called "Shopping Center Amendments" to the Bankruptcy Code as part of the Bankruptcy Amendments and Federal Judgeship Act of 1984.<sup>7</sup> These amendments added to the Code provisions that required the trustee to honor the debtor's lease obligations during the time between filing and assumption or rejection.<sup>8</sup>

Even prior to these amendments, the trustee had to cure defaults if he wished to assume the lease, so the landlord would ultimately receive payment in case of assumption.<sup>9</sup> This did not change under the amendments.<sup>10</sup> Under current practice, however, when the trustee ultimately rejects the lease, either by court order or expiration of the waiting period, and also fails to pay the rent due during this period, the landlord has to seek payment of an administrative claim under the applicable provisions of the code.<sup>11</sup>

6. 11 U.S.C. § 503(b)(1)(A) (1988); *Memphis-Shelby County Airport Auth. v. Braniff Airways, Inc.* (*In re Braniff Airways, Inc.*), 783 F.2d (1283, 1285 (5th Cir. 1986)); *In re Attorneys Office Management, Inc.*, 29 B.R. 96, 98-99 (Bankr. C.D. Cal. 1983). Some courts held the extent of the debtor's use of the property should *not* be considered in determining the amount of the claim. *In re Fred Sanders Co.*, 22 B.R. 902 (Bankr. E.D. Mich. 1982). The lease amount was presumed to be the reasonable rate. *Braniff*, 783 F.2d at 1285; *Fred Sanders Co.*, 22 B.R. at 907. Administrative claims are entitled to priority payment under 11 U.S.C. § 507(a)(1) (1988). Prior to 1984, nothing entitled such a claim to any priority over other administrative claims.

7. *Great Western Savings Bank v. Orvco, Inc.* (*In re Orvco, Inc.*), 95 B.R. 724, 726-27 (Bankr. 9th Cir. 1989); *In re Tammy Jewels, Inc.*, 116 B.R. 292, 294 (Bankr. M.D. Fla. 1990); *In re O.P. Held, Inc.*, 77 B.R. 388, 389-90 (Bankr. N.D.N.Y. 1987); *In re M.H.I., Inc.*, 61 B.R. 69, 70 (Bankr. D. Md. 1986).

8. 11 U.S.C. § 365(d)(3) (1988). Although these provisions were intended to specifically benefit the shopping center industry, they are not limited to that industry and apply generally to all commercial leases. *Orvco*, 95 B.R. at 720.

9. 11 U.S.C. § 365(b) (1983) (amended 1984) stated:

(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;

(B) compensates, or provides adequate assurance that the trustee will promptly compensate, a party other than the debtor to such a contract or lease, from any actual pecuniary loss to such party resulting from such default; and

(C) provides adequate assurance of future performance under such contract or lease.

10. 11 U.S.C. § 365(b) (1988 & Supp. II 1990); *In re Westview 74th St. Drug Corp.*, 59 B.R. 747, 754 (Bankr. S.D.N.Y. 1986); *In re Tandem Group, Inc.*, 60 B.R. 125, 127 (Bankr. C.D. Cal. 1986).

11. See generally the cases cited *infra* notes 23 to 63, which all involve situations where the trustee has not paid the rent and which were all decided on "administrative claim" grounds. The statute actually says nothing about according the unpaid rent claims administrative expense sta-

When the landlord does so, trustees have defended on many grounds, raising primarily these two issues:

- (1) What is the proper amount of the landlord's claim; the contract amount or the fair market value of the estate's actual benefit from the use of the premises?
- (2) Should the rent be paid immediately, ahead of other administrative claims, or must the landlord wait to be paid along with other administrative claimants?<sup>12</sup>

This article will not discuss the wisdom or policy concerns behind the relevant Congressional Acts,<sup>13</sup> but will specifically address the purported congressional intent, the statutory language, the courts' implementation of these policies, and what action may be necessary to clear up confusion and promote uniformity among the jurisdictions.

## II. HISTORICAL ANALYSIS

After adoption of the Bankruptcy Code in 1978, and prior to the 1984 amendments, a bankruptcy trustee could wait at least sixty days to determine to accept or reject a lease of real property, regardless of whether it was residential or commercial.<sup>14</sup> During that time, even if the debtor was not actually using the property, the landlord had no real recourse to require the trustee to pay rent other than to seek payment of an administrative claim.<sup>15</sup>

This situation apparently caused particular problems for the shop-

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tus. On this issue, see the discussion *infra* note 68.

12. See generally the cases cited *infra* notes 24 to 63.

13. For purposes of this discussion, the author takes the position invoked by Judge Louise DeCarl Malugen of the Bankruptcy Court for the Southern District of California:

Apparently, a legislative decision has been made to sacrifice the potential for realizing on certain assets of the estate for the benefit of all creditors so as to minimize the potential for harm which might be caused by delay in payment to only one class of creditors—landlords. This is a judgment within the province of the legislature to make and not within the province of the court to change no matter how deleterious the effect may be on maximizing recovery in liquidation proceedings. After all, it may be argued that the time limitations imposed by section 365(d)(3) only spread to all creditors that burden which was previously borne only by the landlord.

*In re Galvan*, 57 B.R. 732, 734 (Bankr. S.D. Cal. 1986). For a discussion of the policy considerations behind the adoption of the "Shopping Center Amendments," see Diane Banks, Note, *Section 365 of the Bankruptcy Code: Out of Balance After 1984?*, 1986 UTAH L. REV. 781 (1986).

14. 11 U.S.C. § 365(d)(1) (1983) gave the trustee 60 days in a chapter 7 liquidation. Under subparagraph (2), the trustee in a chapter 9, 11, or 13 proceeding could wait until "any time before the confirmation of a plan." See *supra* note 5 for the text of these provisions prior to the 1984 amendments.

15. See generally Banks, Note *supra* note 13 and cases cited *supra* note 6.

ping center industry, which successfully lobbied Congress for adoption of the so-called "Shopping Center Amendments," or additional provisions requiring trustees to continue to honor the debtor's nonresidential lease obligations during this period.<sup>16</sup> To justify these amendments, the congressional record reflects the following reasoning:

This subtitle contains three major substantive provisions which are intended to remedy serious problems caused shopping centers and their solvent tenants by the administration of the bankruptcy code.

[The second] problem is that during the time the debtor has vacated space but has not yet decided whether to assume or reject the lease, the trustee has stopped making payments due under the lease. These payments include rent due the landlord and common area charges which are paid by all the tenants according to the amount of space they lease. In this situation, the landlord is forced to provide current services—the use of its property, utilities, security, and other services—without current payment. No other creditor is put in this position. In addition, the other tenants often must increase their common area charge payments to compensate for the trustee's failure to make the required payments for the debtor. The bill would lessen these problems by requiring the trustee to perform all the obligations of the debtor under a lease of nonresidential real property at the time required in the lease. This timely performance requirement will insure that debtor-tenants pay their rent, common area, and other charges on time pending the trustee's assumption or rejection of the lease.<sup>17</sup>

To promote these policies, Congress revised 11 U.S.C. § 365(d)(1) and (2) to apply to residential real property, and added subparagraphs (3) and (4).<sup>18</sup> Subparagraph (3) states:

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16. See generally Banks, Note *supra* note 13 and cases cited *supra* note 7.

17. 130 CONG. REC. S8894-95 (daily ed. June 29, 1984) (statement of Sen. Hatch), quoted in *In re Longua*, 58 B.R. 503, 505 n.1 (Bankr. W.D. Wis. 1986).

18. Compare the text of section 365(d) prior to the amendments, as set forth *supra* note 5, with the current language of the provision, which is as follows:

(d)(1) In a case under chapter 7 of this title, if the trustee does not assume or reject an executory contract or unexpired lease of residential real property or of personal property of the debtor within 60 days after the order for relief, or within such additional time as the court, for cause, within such 60-day period, fixes, then such contract or lease is deemed rejected.

(2) In a case under chapter 9, 11, 12, or 13 of this title, the trustee may assume or reject an executory contract or unexpired lease of residential real property or of personal property of the debtor at any time before the confirmation of a plan but the court, on the request of any party to such contract or lease, may order the trustee to determine within a specified period of time whether to assume or reject such contract or

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) of this title.

Congress apparently intended the trustee to pay this rent, but the statute has not always had this effect, at least not in a substantial number of reported cases. Instead of paying rent during the initial period, the trustee often retains the property, makes no effort to pay rent or other charges, waits as long as possible to avoid having to make the election, and then allows the lease to be rejected by operation of law, having used the property for at least two and up to any number of months without paying any rent.<sup>19</sup>

### III. ANALYSIS

#### A. Judicial Interpretations of the Statute Itself and of the Intent of Congress

##### 1. *The Amount of Rent to be Paid—Contract Rate vs. Fair Market Value of the Debtor's Actual Use*

Prior to the adoption of Section 365(d)(3), the lessor of nonresidential real property was relegated to seeking rent payments as administrative expenses under 11 U.S.C. § 503(b)(1)(A), which accords administrative expense status to "the actual, necessary costs and expenses of preserving the estate." Before 1984, most courts interpreted this pro-

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lease.

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

(4) Notwithstanding paragraphs (1) and (2), in a case under any chapter of this title, if the trustee does not assume or reject an unexpired lease of nonresidential real property under which the debtor is the lessee within 60 days after the date of the order for relief, or within such additional time as the court, for cause, within such 60-day period, fixes, then such lease is deemed rejected, and the trustee shall immediately surrender such nonresidential real property to the lessor.

19. See generally *infra* notes 24 to 63, the cases cited, and accompanying text.

vision to entitle the landlord to receive the fair market value of the actual benefit of the real property to the estate. This required the court to analyze the value of payments and the actual extent of the debtor's use.<sup>20</sup>

For example, if the contract provided for monthly rent of \$1,000 a month, but the fair market rental of the property was \$500 a month, then \$500 was the most the landlord could recover, regardless of the contract rate. If the debtor only used ten percent of the premises, then the lessor was entitled to receive ten percent of the fair market value, or \$50 per month. If the debtor only used the property for a portion of the time, the amount could be reduced by the number of days of actual use, and if the debtor did not use the property at all, the landlord's claim could be nothing.

With the adoption of section 365(d)(3), this procedure changed, though not as effectively as Congress apparently intended.<sup>21</sup> Theoretically, the trustee is now to pay the rent pending assumption or rejection, but the landlord often still has to seek the assistance of the court to compel the trustee to pay the rent. At this point, the trustee invariably claims the landlord is entitled to fair market value rather than the contract rate, to be reduced by the percentage of the debtor's actual, beneficial use of the property.<sup>22</sup>

As a result of these defenses to claims, the courts have faced the question of whether the adoption of section 365(d)(3) has wrought any change in this standard once the lease has been rejected, or whether they may still reduce the contract rate as appropriate under the circumstances.

Initially, courts took a simplistic and straight-forward view of the statute, which says the trustee must perform all the debtor's obligations under the lease. Because one of the debtor's obligations was to pay rent at a specified rate, the language of the statute required the contract rate.

The Bankruptcy Court for the Southern District of Ohio was apparently the first to address this issue in a reported case,<sup>23</sup> the case of

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20. See *supra* note 6 and accompanying text; see generally Banks, Note, *supra* note 13.

21. See Statements of Senator Hatch *supra* text accompanying note 17. The cases discussed in this article, particularly at notes 24 to 63, indicate that in a substantial number of reported cases the trustee has not made payments in accordance with Section 365(d)(3).

22. See cases cited *infra* notes 23 to 36 and accompanying text.

23. The case of *In re Barrister of Delaware, Ltd.*, *infra* note 26, was reported prior to *Fisher*, but the opinion was actually rendered a few weeks after *Fisher*.

*In re Fisher and Fisher, Inc.*<sup>24</sup> The landlord sought payment of an administrative claim for several months of rent due after bankruptcy was filed. The court found the lease was automatically rejected under section 365(d)(4), and, concerning the rent accruing during the first two months after bankruptcy, held, "We are precluded from questioning the reasonableness of the monthly rental under the Rental Agreement for those two months because of an amendment to the bankruptcy statute effected by the Bankruptcy Amendments and Federal Judgeship Act of 1984 at 11 U.S.C. Section 365(d)(3)."<sup>25</sup>

In the case of *In re Barrister of Delaware, Ltd.*,<sup>26</sup> decided less than a month after *Fisher*, the Delaware Bankruptcy Court reached the same conclusion. In deciding a landlord's claim for administrative rent accruing between the filing date and the rejection date, the court held, "The debtor had the obligation under the lease to pay rent. After entry of the order for relief the trustee must perform that obligation since no subsection under Section 365 excepts it . . . . Under the recited facts, [the landlord] is immediately entitled to the amount claimed."<sup>27</sup>

Specifically quoting the statutory language and legislative history, the Bankruptcy Court for the Western District of Wisconsin agreed, and in *In re Longua*,<sup>28</sup> held:

The trustee's obligation to pay full rent due during the sixty-day period for assumption or rejection constitutes an administrative expense which is payable without notice or hearing. Any necessity for showing the reasonableness of the rent or of any of the other factors considered under Section 503(b) has been completely abrogated by Section 365(d)(3).<sup>29</sup>

Other courts uniformly adopted and followed this reasoning<sup>30</sup> until

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24. 51 B.R. 680 (Bankr. S.D. Ohio 1985).

25. *Id.* at 682-83.

26. 49 B.R. 446 (Bankr. D. Del. 1985).

27. *Id.* at 447.

28. 58 B.R. 503 (Bankr. W.D. Wis. 1986).

29. *Id.* at 505.

30. *In re Industrial Distribution Servs., Inc.*, 86 B.R. 718 (Bankr. M.D. Fla. 1988); *In re Granada, Inc.*, 88 B.R. 369 (Bankr. D. Utah 1988); *In re Homeowner's Outlet Mall Exch., Inc.*, 89 B.R. 965 (Bankr. S.D. Fla. 1988); *In re Gillis*, 92 B.R. 461 (Bankr. D. Haw. 1988); *In re Damianopoulos*, 93 B.R. 3 (Bankr. N.D.N.Y. 1988); *In re TDC Dev. Corp.*, 73 B.R. 135 (Bankr. N.D. Tex. 1987); *In re Dieckhaus Stationers of King of Prussia, Inc.*, 73 B.R. 969 (Bankr. E.D. Pa. 1987); *In re O.P. Held, Inc.*, 77 B.R. 388 (Bankr. N.D.N.Y. 1987); *In re National Oil Co.*, 80 B.R. 525 (Bankr. D. Colo. 1987); *Daugherty v. Kenerco Leasing, Inc. (Matter of Swanton Corp.)*, 58 B.R. 474 (Bankr. S.D.N.Y. 1986); *In re M.H.T., Inc.*, 69 B.R. 69 (Bankr. D. Md. 1986); *In re Coastal Dry Dock & Repair Corp.*, 62 B.R. 879 (Bankr. E.D.N.Y. 1986); *Feld v. S & F Conces-*



the question came before the Ninth Circuit Bankruptcy Appellate Panel in *Great Western Savings Bank v. Orvco, Inc. (In re Orvco, Inc.)*.<sup>31</sup> The Appellate Panel, noting section 365(d)(3) does not specifically provide any remedy for violation of its terms, rejected prior decisions and held:

Under this section, a bankruptcy court has the discretion to order the immediate surrender of the leased premises if a debtor fails to make the required payments. However, once a lease is deemed rejected, the language of the section does not attempt the administrative claim status of the rent obligation. Nothing in the language of the section requires administrative or, worse yet, super-administrative status. In our view, the language of 365(d)(3), "notwithstanding section 503(b)(1)," means that notwithstanding the administrative or non-administrative status of a claim by a lessor, a bankruptcy court must order its payment pending assumption or rejection. It does not mean that the necessity for showing the reasonableness of the rent or any of the other factors considered under Section 503(b)(1)(A) has been completely abrogated. Accordingly, we hold that when a lease is deemed rejected, a lessor must establish its claim for administrative status under Section 503(b)(1)(A), the specific section governing such status.<sup>32</sup>

Since the *Orvco* decision, there have been several other courts which have addressed the issue, and the majority of these have continued to follow the rule laid down in *Fisher*, expressly rejecting the Appellate Panel's ruling in *Orvco*.<sup>33</sup> The most outspoken of these is the

sion, Inc. (*In re S & F Concession, Inc.*), 55 B.R. 689 (Bankr. E.D. Pa. 1985).

31. 95 B.R. 724 (Bankr. 9th Cir. 1989).

32. *Id.* at 727-28.

33. The following post-*Orvco* cases either adopt or approve the *Fisher* rule: *In re Worths Stores Corp.*, 135 B.R. 112 (Bankr. E.D. Mo. 1991); *In re Laurence R. Smith, Inc.*, 127 B.R. 715 (Bankr. D. Conn. 1991); *In re Lunn*, 129 B.R. 477 (Bankr. N.D. Ohio 1991); *Second Pennsylvania Real Estate Corp. v. Papercraft Corp. (In re Papercraft Corp.)*, 126 B.R. 926 (Bankr. W.D. Pa. 1991); *In re Safe-T-Brake, Inc.*, 127 B.R. 68 (Bankr. S.D. Fla. 1991); *In re Cardian Mortgage Corp.*, 127 B.R. 14 (Bankr. E.D. Va. 1991). *In re Dutch Inns of Am., Inc.*, 124 B.R. 1 (Bankr. D.D.C. 1991); *In re Washington Bancorporation*, 125 B.R. 328 (Bankr. D.D.C. 1991); *In re Wingspread Corp.*, 116 B.R. 915 (Bankr. S.D.N.Y. 1990); *In re ABC Books and Sch. Supplies*, 121 B.R. 329 (Bankr. S.D. Ohio 1990); *Meritbanc Sav. Ass'n v. Regency Chevrolet, Inc. (In re Regency Chevrolet, Inc.)*, 122 B.R. 60 (Bankr. S.D. Tex. 1990); *In re Virginia Packaging Supply Co.*, 122 B.R. 491 (Bankr. E.D. Va. 1990); *In re Western Monetary Consultants*, 100 B.R. 545 (Bankr. D. Colo. 1989); *In re Cardinal Indus., Inc.*, 109 B.R. 738 (Bankr. S.D. Ohio 1989); *In re U.S. Fax, Inc.*, 114 B.R. 70 (E.D. Pa. 1990).

The following cases adopt the *Orvco* reasoning: *In re Daisy/Cadnetix, Inc.*, 126 B.R. 87 (Bankr. N.D. Cal. 1990). *In re Tammy Jewels, Inc.*, 116 B.R. 292 (Bankr. M.D. Fla. 1990); *In re Myrtle Beach Golf & Yacht Club*, 118 B.R. 406 (Bankr. D.S.C. 1990); *In re Bilyk*, 101 B.R. 586 (Bankr. E.D. Mo. 1989); *In re Patella*, 102 B.R. 223 (Bankr. D.N.M. 1989).

Bankruptcy Court for the Southern District of New York, which, in the case of *In re Wingspread Corporation*,<sup>34</sup> disputed the *Orvco* ruling in detail:

[L]ate last year the Ninth Circuit Bankruptcy Appellate Panel in . . . *Orvco* . . . held that section 365(d)(3) alone does not automatically require a debtor to pay the rent reserved in the lease for the 60 days following the order for relief as an administrative claim, where the lease is ultimately rejected; *Orvco* requires that a lessor must establish its claim for administrative status under Section 503(b)(1)(A).<sup>35</sup>

The New York court quoted the Appellate Panel's analysis of the statute, and disagreed with *Orvco's* interpretation of the "notwithstanding section 503(b)(1)" language of section 365(d)(3):

I read "notwithstanding section 503(b)(1)" as meaning that irrespective of whether the payments required under the lease meet the usual requirements for administrative status, reasonableness and benefit to the estate, they are unconditionally due . . . . By requiring the trustee to pay "all obligations of the debtor," Congress could not have meant for the court to look into the reasonableness of the obligations or the extent to which the debtor utilized the premises during the 60 day period, for otherwise Congress would not have said *all* obligations.

. . . .  
The *Orvco* reading would flout the intent of Congress in that the landlord would still be forced to provide current services while awaiting an evidentiary hearing to determine the actual amount the debtor owed it. This interpretation would place a burden on the bankruptcy courts to hear and determine the value of the debtor's use of the premises within 60 days after the petition was filed, irrespective of when the landlord's motion was brought, because the court cannot extend the time for such a payment beyond the 60 day period. Section 365(d)(3). The only other alternative would be to construe the statute to require the trustee to pay the obligations during the 60 day period and sue later to recover any claimed overpayments, an awkward procedure which cannot have been envisioned. Accordingly, in agreement with pre-*Orvco* decisions, I believe that during the 60 days after an order for relief is entered or within such extensions as are granted by the court prior to assumption or rejection, the debtor must pay the rent reserved under the lease.<sup>36</sup>

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34. 116 B.R. 915 (Bankr. S.D.N.Y. 1990).

35. *Id.* at 925.

36. *Id.* at 926.

With these differing views in mind, the question becomes which more closely follows the language of the statute and the intent of Congress.

## 2. *The Legislative Purpose*

The stated purpose for the adoption of section 365(d)(3) is to protect lessors who are precluded from access to or use of their property and continue to incur losses postpetition while the trustee decides whether to reject or assume the lease. As stated in the Congressional Record, "This timely performance requirement will insure that debtortenants pay their rent, common area, and other charges on time pending the trustee's assumption or rejection of the lease."<sup>37</sup>

The majority rule represented in *Fisher* and subsequent cases more correctly addresses this legislative purpose and promotes its intended effect. Under the *Orvco* holding, a landlord who seeks an administrative claim after rejection of the lease is in no better shape after the adoption of this provision than before. A landlord who does not take immediate action to compel payment prior to rejection is at a disadvantage which the *Orvco* court apparently felt was justified, perhaps as a sanction for not taking quicker action.<sup>38</sup> The obvious result of such an interpretation is to encourage trustees to simply disobey the statute, make the landlord do the work and incur the expense, and then argue to reduce the rent down to, in some cases, near nothing.

Recognizing this negative incentive, the Bankruptcy Court for the District of Columbia in the case of *In re Washington Bancorporation*,<sup>39</sup> following the rule set down in *Fisher*, has stated:

To rule otherwise would give the trustee, even one with cash already on hand, an incentive during the first 60 days of the case not to comply with the prompt payment mandate of § 365(d)(3) if there is a chance the lease will be rejected and may be at an above-market rent or if the debtor has not fully occupied the premises. The statute ought not be interpreted in a fashion that will encourage frustration of the congressional intent that landlords be paid on a current basis pending

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37. See *supra* note 17 and accompanying text.

38. The Ninth Circuit Appellate Panel in *Orvco* did not openly express any intention to punish the landlord, but at least one court has indicated a belief that the landlord's failure to take appropriate action within the 60-day grace period is sufficient justification to limit the landlord's relief. See *In re Food City, Inc.*, 95 B.R. 451, 457 (Bankr. W.D. Tex. 1988). For a discussion of the relative value of such a remedy to a landlord, see *infra* subheading C. Possible Remedies.

39. 125 B.R. 328 (Bankr. D.D.C. 1991).

a determination to assume or reject.<sup>40</sup>

There is no reason to suspect Congress intended to require such payment only for those landlords fortunate enough to receive it or diligent enough to compel it before rejection. The statute and the record reflect an intention to require the trustee to pay the rent fully. Accordingly, the legislative intent is promoted more effectively by the majority rule of *Fisher* and subsequent cases. The *Orvco* reasoning would encourage frustration of the legislative purpose.

### 3. *The Statutory Language*

The statute itself in a fairly direct manner says what the trustee is supposed to do prior to assumption or rejection of the lease.<sup>41</sup> However, because it gives no specific remedy for violation of its provisions, it does not strictly address the question of the status of the claim once the lease is rejected. If the statute is read without regard to its purpose, the trustee's obligations and the lessor's administrative claim rights after rejection are less certain. When read in conjunction with the legislative record, the meaning and purpose of the statute are more discernable.

The statute says the trustee has this obligation prior to rejection of the lease,<sup>42</sup> so one might argue the obligation terminates upon rejection. There is nothing in the statute, however, which eliminates the *obligation* for full, timely performance after rejection of the lease, although the language does appear to limit the *creation or duration* of such a liability to the period before rejection. The statute, which creates an obligation that arises during the grace period and continues until released or performed, supports the majority view that the contract rate controls the amount of rent due even after rejection of the lease.

### 4. *Conclusion*

The congressional record indicates the majority rule most effectively promotes the intent of Congress and the language of the statute. The trustee must pay the contract rate on an administrative claim for rents accruing after bankruptcy is filed and before the lease is rejected.

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40. *Id.* at 329.

41. See the full text of 11 U.S.C. § 365(d)(3) *supra* note 18.

42. The specific language says "[t]he trustee shall timely perform all the obligations of the debtor . . . until such lease is assumed or rejected." See *supra* note 18.

## B. When is the Administrative Claim to be Paid?

### 1. *Judicial Interpretations—Unconditional, Immediate Payment vs. Preferential, Pro Rata Treatment*

It is virtually undisputed that a landlord who seeks payment of such a claim is entitled to immediate payment without notice or hearing unless an objection is filed.<sup>43</sup> Payment will be ordered unless someone objects, which the trustee invariably does if any substantial amount of money is involved. When he objects, the issue of when the claim is to be paid must be decided.

This second question has powerful connotations because, in bankruptcy, priority in payment often is the difference in determining who will be paid. A claimant who can get earlier payment has a much better chance of recovering the full claim, because the pool of distributees is reduced.<sup>44</sup>

Some courts ordered immediate payment without specifically deciding whether it was required.<sup>45</sup> The first court to actually decide this question was the District Court of Massachusetts in the case of *In re Rare Coin Galleries of America, Inc.*,<sup>46</sup> which held, "Section 365(d)(3) thus gives a special administrative claim priority to post-petition rent due under a non-residential lease."<sup>47</sup> The court required the trustee to immediately pay rent accruing during the sixty day post-petition period.<sup>48</sup>

The Hawaii Bankruptcy Court relied upon *Rare Coin Galleries* in the case of *In re Gillis*,<sup>49</sup> holding:

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43. *Longua*, 58 B.R. at 505; *Granada*, 88 B.R. at 371; *Homeowners*, 89 B.R. at 969; *Western Monetary Consultants*, 100 B.R. at 547; *Cardinal Indus.*, 109 B.R. at 740; *ABC Books*, 121 B.R. at 329. Of course, the same can be said of any request for payment of an administrative claim, unless the court decides sua sponte to address the merits of the request, which is unlikely. If no one objects, there is no real issue for dispute and, although the court may schedule a hearing, any such uncontested request will probably be granted.

44. "In many bankruptcy cases, when a claim is paid makes the difference as to whether it will be paid at all." *In re Virginia Packaging Supply Co.*, 122 B.R. at 495. Under 11 U.S.C. § 507(a)(1) (1988), administrative expenses are accorded first priority, but there is still a question of who gets what when there is not enough money to cover administrative claims. If there are insufficient funds to pay all administrative claims, then, in a Chapter 7 liquidation, claims are paid pro rata under § 726(a)(1) and (b). Under other chapters of the Code, payment can vary depending upon the terms of the confirmed plan, but it normally will also be pro rata.

45. *Barrister of Delaware*, 49 B.R. at 447, *Longua*, 58 B.R. at 506.

46. 72 B.R. 415 (D. Mass. 1987).

47. *Id.* at 416.

48. *Id.*

49. 92 B.R. 461 (Bankr. D. Haw. 1988).

The legislative history of §§ 365(d)(3) and (4) specifically singles out the nonresidential lessor as deserving of special treatment . . . . While the Bankruptcy Code does not provide a specific remedy for the trustee's failure to comply with the provisions of Section 365(d)(3), this legislative history distinguishes the nonresidential lessor from all other creditors.<sup>50</sup>

These decisions are based on the conclusion that Congress, in adopting the provisions of section 365(d)(3), intended to grant special status to lessors of nonresidential real property. Since the statute itself requires timely performance of all such lease obligations, including the payment of rent, these courts held the commercial property lessor has a special priority status over other administrative claimants, requiring the claim to be paid fully and immediately.

Several other courts have reconsidered this issue, however, and the majority of them have not agreed with the ruling in *Rare Coin Galleries*.<sup>51</sup>

The Bankruptcy Court for the Eastern District of Pennsylvania in the case of *In re Dieckhaus Stationers of King of Prussia, Inc.*,<sup>52</sup> decided less than two months after *Rare Coin Galleries*, took a different view. The landlord in that case had suggested its claim deserved "superpriority" status under 11 U.S.C. § 364.<sup>53</sup> The court recognized a "strong expression of legislative intent" that such rental obligations be paid on time, pending assumption or rejection of the lease, and held the landlord's claim "should be paid immediately unless the trustee establishes good cause for withholding payment."<sup>54</sup> The court denied the landlord any "superpriority status," however, and held:

I conclude that the landlord's section 365(d)(3) administrative expense claim is not entitled to superpriority status; rather, it is entitled to payment pro rata with all other allowed chapter 11 administrative expense claims. Therefore, my order directing immediate payment of the landlord's claim will be subject to the trustee's right to seek recovery of all or part of the payment in the event all other administrative

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50. *Id.* at 470.

51. See cases cited *infra* notes 52 to 63 and accompanying text.

52. 73 B.R. 969 (Bankr. E.D. Pa. 1987).

53. *Id.* at 973. Section 364 gives the court authority to accord so-called "superpriority" status to certain unsecured administrative claimants in situations where the trustee cannot otherwise obtain needed unsecured credit. Such claims have priority over other administrative claimants under section 364(c)(1).

54. *Dieckhaus*, 73 B.R. at 973.

expense claimants are not paid in full.<sup>55</sup>

The court recognized a nonresidential lessor was similar to an unsecured creditor extending unsecured credit under section 503(b). Still, the court noted the Code contained no specific remedy for the trustee's failure to comply with section 365(d)(3) and held it "inappropriate to imply the existence of an automatic superpriority status."<sup>56</sup>

Subsequent decisions relying upon the *Dieckhaus* rule have followed the rationale that the court has always had the discretion to order *when* an administrative claim should be paid, and section 365(d)(3) should not be held to change this rule absent a clear expression of congressional intent.<sup>57</sup>

Accordingly, the reasoning of *Dieckhaus*, which has become the majority rule,<sup>58</sup> is that lessors of nonresidential real property are, subsequent to rejection of the lease, entitled to an administrative claim equal in priority to other administrative claims, but which should be paid immediately upon request unless the trustee establishes good cause for withholding payment. If it is subsequently determined there are insufficient funds to pay all administrative claims, the trustee will have a claim against the landlord to recover any amount over and above the landlord's pro rata share.

There are some other cases which have not disputed the majority view set forth in *Dieckhaus*, but have limited their holdings more narrowly. The Nevada Bankruptcy Court in the case of *In re United West, Inc.*<sup>59</sup> held the timing of payment of such an administrative claim was within the discretion of the bankruptcy court. The Bankruptcy Court for the Southern District of Ohio has twice held such payments may be subject to recovery if other claimants are not paid in full, but has not

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55. *Id.*

56. *Id.*

57. *In re* Washington Bancorporation, 126 B.R. 130 (Bankr. D.D.C. 1991). *Great Western Sav. Bank v. Orvco, Inc. (In re Orvco, Inc.)*, 95 B.R. 724 (Bankr. 9th Cir. 1989); *In re Buyer's Club Mkts., Inc.*, 115 B.R. 700 (Bankr. D. Colo. 1990); *In re Far West Corp. of Shasta County*, 120 B.R. 551 (Bankr. E.D. Cal. 1990); *In re Granada, Inc.*, 88 B.R. 369 (Bankr. D. Utah 1988); *In re Homeowner's Outlet Mall Exch., Inc.*, 89 B.R. 965 (Bankr. S.D. Fla. 1988).

The Bankruptcy Court for the District of Nevada has stated, "Section 365 does not . . . alter the longstanding rule that the court has broad discretion over the *timing* of payment of administrative claims." *In re United West, Inc.*, 87 B.R. 138, 140 (Bankr. D. Nev. 1988).

58. *Rare Coin Galleries*, *supra* note 46, and *Gillis*, *supra* note 49, appear to be the only courts which have directly addressed the question and held unconditional immediate payment is mandated.

59. 87 B.R. 138 (Bankr. D. Nev. 1988).

discussed the issue in detail. See *In re Cardinal Industries, Inc.*<sup>60</sup> and *In re ABC Books and School Supplies*.<sup>61</sup>

The Eastern District of Virginia took a different and somewhat odd position in the case of *In re Virginia Packaging Supply Company*,<sup>62</sup> appearing to hold the *landlord* has the burden of proving the administrative claims will be paid in full, as opposed to placing the burden on the *trustee* to establish good cause to withhold payment, which is the majority *Dieckhaus* rule.<sup>63</sup>

With these holdings in mind, the analysis again turns to which of these rules best reflects the intent of Congress and adherence to the language of the statute.

## 2. *The Congressional Intent*

The apparent purpose of these provisions is to provide lessors of nonresidential real property timely payment of rent.<sup>64</sup> By the time the issue at hand arises, this purpose has already been partially circumvented because payment is late. Obviously, requiring timely payment during the initial sixty days accords a nonresidential real property lessor some sort of special treatment, so there is little question Congress intended to prefer these claims over others. However, once rejection has occurred and the lessor has his property back, the question is whether Congress intended the lessor to still receive prompt payment of the claim, with priority over other administrative claimants.

Once again, the legislative record indicates that would be the goal of the statute. Most courts addressing this issue recognize Congress intended some special treatment for such claims, and require the trustee to pay the rent unless he can establish good cause not to pay.<sup>65</sup> There is no question a landlord is going to be preferred if the trustee obeys section 365(d)(3) and timely pays the rent, so if the statute is followed, there is special treatment of such a landlord.

It should be no different when a trustee elects *not* to comply with the statute, for to hold otherwise encourages the trustee to disobey the law, hold the money, and make the lessor come after it. There would be no incentive to adhere to the statute because, in case of an anticipated

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60. 109 B.R. 738 (Bankr. S.D. Ohio 1989).

61. 121 B.R. 329 (Bankr. S.D. Ohio 1990).

62. 122 B.R. 491, 495 (Bankr. E.D. Va. 1990).

63. *Id.* at 495, *Dieckhaus*, 73 B.R. at 973.

64. See *supra* note 17 and accompanying text.

65. See *Dieckhaus* and other cases following its decision, cited *supra* notes 52 to 57.



rejection, the trustee would have very good reasons to disregard it, thereby creating an excuse to disobey the obligations created by the 1984 Amendments.<sup>66</sup>

Congress intended to grant such a claimant some level of priority status over other administrative claimants. The holding in *Rare Coin Galleries* accords the claimant a clear, unconditional, and immediate priority, while the holding in *Dieckhaus* and the majority of cases accords the claimant some priority subject to the trustee's right to subsequently recover some or all of the payment. The stated intent of Congress was to have the landlord paid on time, but the majority view may discourage compliance and defeat that intention. It appears the minority view best represents the intent of Congress on this issue.

### 3. *The Statutory Language*

The provision itself gives little direction on what sort of priority such a claim should have once the landlord establishes a claim. The statute requires timely payment of these obligations, but is silent on what remedies are available in case of the trustee's failure to adhere to the requirements.<sup>67</sup>

There is no good reason to require timely payment prior to rejection and then hold a trustee who disobeys the statute absolved of any duty for timely or immediate payment after rejection, or to accord the trustee greater recovery rights against the claimant by virtue of the trustee's disobedience to the Code. Under the language of the statute, the obligation for timely payment perhaps cannot be created after rejection of the lease, but neither is the obligation which arose prior to rejection dissipated. The statute does not terminate the obligation for timely payment simply because of the rejection of the lease or the trustee's failure to comply.

The end result under *Dieckhaus* is that a trustee who obeys the statute has to pay the contract rate on time, with no chance of future recovery. If he disobeys the statute, he may be able to put off payment of the administrative claim and reduce it pro rata. Under the majority rule, the trustee is practically always better off disobeying the statute.

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66. See statements of the Bankruptcy Court for the District of Columbia in the case of *In re Washington Bancorporation*, *supra* note 40 and accompanying text.

67. See the text of the statute, *supra* note 18.

#### 4. *Conclusion*

The majority rule acknowledges a lessor of nonresidential real property is entitled to priority payment, and requires immediate payment absent a showing of good cause to withhold payment, but allows the trustee to come back and recover some or all of the payment to achieve an equal pro rata distribution among administrative claims. Since the statute was written to give specific, special protection to such claimants, the majority rule may defeat that purpose.

#### C. Possible Remedies

There are two basic solutions to resolve these inconsistencies among the jurisdictions: (1) The courts can continue to address these questions, dispute them, and render diverse opinions until a clear majority of appellate courts adopt and follow established rules on which the parties can reasonably rely, or (2) Congress can amend the statute to clarify the status and enforcement procedure of the landlord's claim for rent after rejection of the lease. If Congress intended the contract rate to control after rejection of the lease, and also intended immediate payment upon determination of administrative claim status, this should be spelled out clearly in the statute. Until it is, courts will naturally continue to resist according a preferred claim status to this particular class of claimants, even in the face of a congressional intention to do just that.<sup>68</sup>

The second solution is obviously the better but, as with any legislative enactment, will surely create other questions for litigation. The provision as it stands leaves many unanswered questions and inspires so

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68. Firm evidence of this reluctance exists in the fact that all of the courts addressing this issue, regardless of the form of proceeding in which the claim is made, decide the claim under some sort of modified administrative claim analysis. Actually, section 365(d) says nothing about administrative claim status but requires "timely" performance of the debtor's lease obligations. 11 U.S.C. § 105(a) (1988) states, "[t]he court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." Bankruptcy Rule 9013 says, "[a] request for an order, except when an application is authorized by these rules, shall be by written motion, unless made during a hearing." It appears these statutes and this rule should be enough to set forth the authority and procedure under which a landlord may obtain the relief mandated in section 365(d)(3). The legislative history and the statutory language indicate rather clearly this type of claim is entitled to special treatment separate from the treatment accorded administrative claims under section 503. Regardless, the courts apparently feel compelled to analyze section 365(d) in relation to its effects on the previous rules under section 503 regarding administrative rent claims. This may be an example of the courts' resistance to accord some new, special status to one particular class of claimants, even when the statute and congressional record indicate this was the intention of Congress.

much disparity among the jurisdictions that it requires clarification. As it stands, the intent of Congress may in many cases be defeated.

#### D. Alternatives for the Landlord

The landlord also really has two options: (1) he can seek immediate payment for the administrative claim pursuant to the terms of the contract, or (2) he can attempt to obtain payment or eviction prior to rejection of the lease. If he pursues payment of an administrative claim, he will have to litigate the issues described in this article and, unless he is in one of the cited jurisdictions, he really will not know how he will fare in court.

If he wishes to avoid a dispute on the amount of the claim and the time of payment, he will need to take prompt action to compel payment prior to the expiration of the rejection period. This will be difficult for a number of reasons. For one thing, a landlord usually will not even know his tenant is in bankruptcy for a substantial period of time, until he receives notice from either the court, the trustee, or the debtor. If the debtor is current on rent and files bankruptcy shortly after a timely payment, then the landlord may go more than thirty days before he even suspects something is amiss, because it will be that long before there is a default in payment.

Regardless of when the landlord finds out about the problem, his first natural reaction would be to think the trustee will obey section 365(d)(3) and the landlord will get his rent. If he tries to discuss this matter with the trustee, he may learn the trustee's intentions and he may not, but he will likely be strung along for some period of time that will extend past the rejection period.

As soon as he suspects a tenant is in bankruptcy, the landlord's best remedy is to demand instant payment pursuant to the terms of the lease, and if it is not soon paid, to promptly institute a proceeding to compel immediate payment or for relief from stay to evict the debtor. If the landlord can get a hearing set, and actually procure an order for payment prior to rejection of the lease, his only problem will be getting the trustee to obey it. The trustee, upon notice of such a proceeding, may immediately request the court to reject the lease and obtain such an order at the same time or perhaps before the landlord's order for rent, so the landlord will still be relegated to litigating these other questions because his claim will be determined after rejection.

In many cases, the option of obtaining relief from stay to evict the debtor is really no option at all and renders section 365(d)(3) practi-

cally meaningless as far as according the landlord any new rights. Assuming the landlord promptly learns of the bankruptcy, and assuming he immediately seeks relief from the court to obtain payment or relief from stay, and assuming the court grants that relief, then the landlord still has to evict the debtor through a state court proceeding which may take a great deal of time, long past the rejection of the lease, and he still has to go through all the procedures described to obtain payment. Also, if the trustee does not intend to assume the lease, then he often will not care whether relief from stay is obtained or not, so there is no real pressure to resist or move. It will be a rare case where a landlord is able to obtain all this relief and actually recover the rent due under the lease and section 365(d)(3).

Accordingly, the landlord's best remedy outside of seeking instant payment of an administrative claim is to promptly obtain an order from the court requiring the trustee to immediately pay the contract rate on the lease before rejection.<sup>69</sup> If he is able to do this, he can avoid the controversies that have forestalled the landlord's effective use of section 365(d)(3) to get payment for the use of his property. Otherwise, he is left to litigate his claim entitlements under the authorities discussed.

#### IV. CONCLUSION

The Congressional Record and the language of the Bankruptcy Code indicate a lessor of nonresidential real property should, after rejection of his lease in a bankruptcy proceeding, immediately recover from the estate the full, contract amount of rent accruing between the petition date and the date of rejection. However, the courts are divided on these issues and have in many cases circumvented this intention. Though majority opinions are emerging on each question, Congress should supplement these provisions to more clearly define its intentions regarding a lessor's rights to post-petition, prerejection rental payments under a lease of nonresidential real property. Until Congress does so, the courts will continue to be divided and the congressional intent will be frustrated.

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69. At least one court has ordered such a payment, but in a situation where the lease was not yet rejected. *In re Musikahn Corp.*, 57 B.R. 942 (Bankr. E.D.N.Y. 1986).

