

IN THE UNITED STATES BANKRUPTCY COURT
DISTRICT OF NEW MEXICO

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IN RE: §
FURR'S SUPERMARKETS, INC., § NO. 11-01-10779-SA
DEBTOR. § Chapter 11
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§

MEMORANDUM OF LAW IN SUPPORT
OF
TGAAR'S RESPONSE TO TRUSTEE'S MOTION FOR PARTIAL SUMMARY
JUDGMENT ON TGAAR'S MOTION FOR PAYMENT
OF ADMINISTRATIVE EXPENSES
AND
TGAAR'S CROSS-MOTION FOR PARTIAL SUMMARY JUDGMENT

COMES NOW, TGAAR PROPERTIES, INC., d/b/a WESTWOOD VILLAGE SHOPPING CENTER and TGAAR WEST TEXAS, INC. (collectively referred to as "TGAAR") and, pursuant to Local Bankruptcy Rule 7056, files this Memorandum of Law in Support of TGAAR's Response To Trustee's Cross-Motion for Partial Summary Judgment on TGAAR's Motion for Payment of Administrative Expenses and TGAAR's Cross-Motion for Partial Summary Judgment, in support thereof, would show unto the Court as follows:

I.

GENERAL

The Chapter 7 Trustee's Motion for Summary Judgment (referred to as the "Trustee's Motion") and TGAAR's Response and Cross-Motion for Partial Summary Judgment (referred to as the "Response/Cross-Motion") present three separate types of administrative expense claims, each of which will be discussed separately below. The facts as set forth in TGAAR's Response/Cross-Motion are incorporated by reference herein.

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II.

BURDENS OF PROOF

Under federal practice, a motion for summary judgment must be supported by undisputed, competent summary judgment proof in accordance with well-established guidelines. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 106 S. Ct. 2505 (1986); *Celotex Corp. v. Catrett*, 477 U.S. 317, 106 S.Ct. 2548 (1986); and *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 106 S.Ct. 1348 (1986). As established by these cases, the guidelines are:

- A. The movant has the burden of proving by undisputed, disinterested summary judgment proof that there is no genuine issue of any material fact, and that the movant is entitled to judgment as a matter of law;
- B. When a defendant is the movant, it must conclusively establish as a matter of law that there is no genuine issue of material fact as to at least one essential element of each of respondent's claims;
- C. When a defendant seeks summary judgment based on an affirmative defense, its burden is to conclusively establish, as a matter of law, all elements of its affirmative defense;
- D. In analyzing whether there is any disputed material fact precluding summary judgment for the movant, all evidence favorable to the respondent must be accepted a true; and
- E. Every reasonable inference from the summary judgment proof must be made in favor of respondent, and any doubts must be resolved in respondent's favor.

III.

ANALYSIS OF ADMINISTRATIVE EXPENSE CLAIMS

A. Administrative Expense Claims – In General

Administrative expenses include “the actual, necessary costs and expenses of preserving the estate.” 11 U.S.C. §503(b)(1)(A). “The actual and necessary expenditures of the Trustee [or debtor-in-possession] in operating the business of the estate, **for storage of property, for rent,** and for other goods and services incidental to protecting, conserving, maintaining and rehabilitating the estate or certainly contemplated within the phrase ‘actual, necessary costs and expenses of preserving the estate.’” *4 Collier on Bankruptcy*, ¶503.06[2] (rev. 15th Ed. 2001). For a claim to qualify as an administrative expense for being an actual and necessary cost of preserving the estate, the expense must satisfy two requirements: (1) it must have arisen out of a post-petition transaction between the creditor and the debtor-in-possession (or trustee), and (2) it must have benefited the estate in some demonstrable way. *4 Collier on Bankruptcy*, ¶503.06[3] (rev. 15th Ed. 2001); *In re: Commercial Financial Services, Inc.*, 246 F.3d 1291 (10th Cir. 2001); *In re: Mid Region Petroleum, Inc.*, 1 F.3d 1130 (10th Cir. 1993); *In re: Amarex, Inc.*, 853 F.3d 1526, 1530 (10th Cir. 1988); *Texas Comptroller of Public Accts. vs. Megafoods Stores, Inc.*, 163 F.3d 1063 (9th Cir. 1998); *In re: Merry-Go-Round Enterprises, Inc.*, 180 F.3d 149, 156-57 (4th Cir. 1999) (referred to hereinafter as “MGRE”). The “benefit” analysis is a way of testing whether a particular expense was “necessary” to preserve the estate. *4 Collier on Bankruptcy*, ¶503.06[3] [b] (rev. 15th Ed. 2001).

B. TGAAR Is Entitled To Administrative Expense Claim for the Debtor/Chapter 7 Trustee’s Actual Use and Possession of Store #966

Although the pre-petition Lease was rejected and the August 31, 2001 letter (Affidavit ¶10, Exhibit “D”) stated that the Debtor-in-possession “hereby surrenders possession of the premises to you effective August 31, 2001,” the Debtor-in-possession did not actually remove its equipment or relinquish possession until July 3, 2002. The bankruptcy estate benefited from the possession and use of Store #966 to store and protect the grocery store equipment left therein. Therefore, the bankruptcy estate is liable for the reasonable value of the use and occupancy of

the premises since this represents a benefit to the estate. 3 *Collier on Bankruptcy*, ¶1365.04[7][a] (rev. 15th Ed. 2001).

This case does not involve a situation where the debtor-in-possession possessed, but did not actually use, the property in question. See *In re: Mid Region Petroleum, Inc.*, *supra*, (*GATX railcars not used at all*). Instead this case involves a situation where Store #966 was actually used to store and protect the grocery store equipment left therein and such usage actually benefited the estate. *In re: Climax Chemical Co.*, 167 B.R. 665 (Bankr. N. Mex. 1994) (freight services); *In re: Amarex, Inc.*, *supra*, (portion of bonus attributable to services performed post-petition allowed as an administrative expense); *In re: Cochise College Park, Inc.*, 703 F.2d 1339, 1354 (9th Cir. 1983) (where the “trustee actually uses the property, the law is clear” -- an administrative expense is allowed); *In re: Dant & Russell, Inc.*, 853 F.3d 700, 701 and 706 (9th Cir. 1988) (debtor-in-possession continued to use leased sites for more than a year after bankruptcy filing); *Matter of Heurth & Hinge, Inc.*, 28 B.R. 595 (S.D. Ohio 1983) (storage of property protected and preserved the estate’s assets); *In re: Thompson*, 788 F.2d 560, 562 (9th Cir. 1986).

The amount of rent allowed as an administrative expense when the debtor-in-possession actually uses the leased premises is presumed to be equal to the amount of rent set forth in the Lease. *Cochise*, *supra*, 703 F.2d at 1354 n. 17; *Dant & Russell*, *supra*, 853 F.2d at 707; *In re: Litho Specialties, Inc.*, 154 B. R. 733, 738 (D. Minn. 1993); *In re: Pacific-Atlantic Trading Co.*, 27 F.3d 401 (9th Cir. 1994).

Based on the foregoing, TGAAR should be allowed an administrative expense claim for the amount of rent under the Lease for the period that the Debtor-in-possession and the Chapter 7 Trustee actually used and possessed Store #966 to store and protect the equipment.

C. TGAAR Is Entitled To Administrative Expense Claim for the Amount of Rent During the Term of the Post-Petition Extension

The Debtor-in-possession’s exercise of the option to extend the term of the Lease for Store #966 for a 5-year period, created a new, post-petition obligation. It is undisputed that the extension of the Lease arose from a post-petition transaction between the Debtor-in-possession

and TGAAR that was executed in the ordinary course of the Debtor-in-possession's business and was entered into for a good cause. 11 U.S.C. §363(c); *MGRE, supra*; *In re: Lampartar Org., Inc.*, 207 B.R. 48 (E.D.N.Y. 1997). Therefore the extension of the Lease was an actual cost of preserving the estate.

The extension of the Lease was clearly beneficial to the Debtor-in-possession before Fleming backed-out of the purchase of Store #966. Without the extension of the Lease, the Debtor-in-possession would not have been able to continue to operate Store #966 after December 31, 2001, and could not have entered into a contract to sell Store #966 to Fleming pursuant to the Asset Purchase Agreement. The extension of the Lease during the Chapter 11 bankruptcy case was not an "extraordinary business activity of the debtor-in-possession [so the Debtor-in-possession's] creditors reasonably would have expected it to continue its leasing activities." *Dant & Russell, supra*, 853 F.2d at 705; *Johns-Manville Corp.*, 60 B.R. 612, 616(S.D.N.Y. 1986), rev'd on other grounds, 801 F.2d 60 (2nd Cir. 1986).

The administrative expense status of rents accruing under leases entered into post-petition was discussed in *4 Collier on Bankruptcy*, ¶503.06[6][a] (rev. 15th Ed. 2001) as follows:

"If the trustee [or debtor-in-possession] enters into a contract or lease after the entry of the order for relief, the obligations of the trustee under the contract or lease will be eligible for administrative expense status in the same manner as other obligations incurred by the trustee . . .

If the trustee enters into a contract or lease after entry of the order for relief and subsequently breaches the contract or release, the other party will have a claim for damages. The amount of those damages will be determined under the contract or lease. As long as the other party can demonstrate that the contract obligations are entitled to administrative treatment status, the full amount of such obligations will constitute administrative expenses."

In *MGRE, supra*, 180 F.3d at 152, the Chapter 11 debtor-in-possession entered into several new leases or retail store locations during the Chapter 11 case. As in this case, such case was subsequently converted to Chapter 7 and the new leases were rejected. *Id.* The Fourth Circuit awarded the landlord an administrative expense claim in the Chapter 7 case and held that

the “rent cap” limitation under 11 U.S.C. §502(b)(6) did not apply to leases entered into post-petition. *MGRE, supra*, 180 F.3d at 161. *See also, Dant & Russell, supra*, 853 F.2d at 706 (new leases executed with old landlord post-petition).

Leases that are assumed during a Chapter 11 case are treated the same as post-petition new leases and post-petition extensions of old leases and all three give rise to administrative expense claims for future rents. *In re: Klein Sleep Prods., Inc.*, 78 F.3d 18, 21 (2nd Cir. 1996). In rejecting the trustee’s attempt to limit the administrative expense claim to the amount due prior to the trustee’s rejection, the Second Circuit in such case held that any analysis of the benefit of assuming an unexpired lease must take place at the time of assumption. *Id.* at 31. Once the lease is assumed, the rents thereunder become an administrative expense. *Id.* Such assumed lease “clearly constituted a benefit to the estate even if, later, the benefit turned to dust.” *Id.* at 23.

The post-petition extension of the Lease in this case is similar to the post-petition leases entered into in *MGRE* and *Dant & Russell* and is similar to the lease assumed post-petition in *Klein Sleep*. In all four instances, the debtor-in-possession was acting within his authority under 11 U.S.C. §363(c) “to use, sell or lease property of the estate in the ordinary course of business without the need for notice or a hearing.” 3 *Collier on Bankruptcy*, ¶363.03 (rev. 15th Ed. 2001).

Courts have developed two tests for determining whether a particular transaction is within the debtor’s ordinary course of business. These tests are described in 7 *Collier on Bankruptcy*, ¶1108.02[4][a] (rev. 15th Ed. 2001) as follows:

“The first is the so-called ‘vertical’ or ‘creditor’s expectation’ test, which requires the court to determine whether a transaction subjects creditors to economic risks different from those bargained for when credit was extended. The ‘touchstone of ordinariness’ in this context is whether the transaction is one that creditors could reasonably have expected the debtor to enter into in the normal course of its business. The second is the so-called ‘horizontal’ test, which requires the court to consider whether the transaction is of a type commonly undertaken by companies involved in business activities that are the same as or similar to the debtor’s.”

See also, Dant & Russell, supra.

Clearly, the exercise of an option to extend the Lease for Store #966 at a time when (a) the Debtor-in-possession was operating a grocery store therein, and (b) such Store #966 was subject to an Asset Purchase Agreement for which this Court's approval was being (and later was) obtained, satisfies both the "vertical" and the "horizontal" tests for an allowable administrative expense.

The trustee may argue that since the Debtor-in-possession (and the Chapter 7 Trustee) did not use Store #966 after July 3, 2002, the extension of the Lease cannot be considered necessary to the estate. Such "argument is flawed because it focuses solely on the tenant." *MGRE, supra*, 180 F.3d at 157. "Since a lease involves both a landlord and a tenant, a comprehensive inquiry must examine both sides to determine whether the [extension of the] Lease was a necessary expense of the estate." *MGRE, supra* 180 F.3d at 157; *Dant & Russell, supra*.

As far as the landlord, TGAAR, is concerned, neither the rejection of the Lease by the Debtor-in-possession (after the Lease was extended) nor the Chapter 7 conversion changed the Lease. Although such events dramatically altered the character of the bankruptcy estate, TGAAR still expected that its Lease would be honored. If the Debtor-in-possession (or the Chapter 7 Trustee) had been able to sell Store #966 to another party, the extension of the Lease would have been assigned to such buyer, the bankruptcy estate would have greatly benefited from such sale and TGAAR would have continued to receive rent payments from the assignee. Both the debtor-in-possession and TGAAR would have benefited. Unfortunately, despite its efforts, the Debtor-in-possession was unable to sell Store #966 and the "benefit" of the lease extension "turned to dust" just as did the benefit of the post-petition obligation in *Klein Sleep, supra*, 78 F.3d at 23, and *MGRE, supra*.

"One of the main purposes behind granting administrative priority certain expenses under 11 U.S.C. §503(b)(1)(A) is to provide an incentive for creditors and landlords to continue or commence doing business with a bankrupt party." *In re: Colortex Indus., Inc.*, 19 F.3d 1371, 1384 (11th Cir 1994); *MGRE, supra* 180 F.3d at 158. As stated in *MGRE, supra* 180 F.3d at 158:

“If landlords like [TGAAR] are not guaranteed to receive at least administrative priority on future rent, then they would have little incentive to enter into long-term leases (or allow extensions) with any tenant who has declared Chapter 11. Tenants also benefit from giving landlords incentives to lease to insolvent parties. If landlords do not receive some assurance that their leases would be paid in full, then they will refuse to enter into leases [or allow extensions] with Chapter 11 tenants. Chapter 11 debtors-in-possession like MGRE would then find themselves in the ‘Catch 22’ situation of needing a new lease [or to extend an existing lease] to get themselves out of bankruptcy but being denied a new lease [or an extension] because they are bankrupt. As a result, many more debtors-in-possession might be forced to declare Chapter 7.”

The rejection of the Lease during the Chapter 11 case had no effect on the extension of the Lease (except to breach the Lease). By its terms, 11 U.S.C. §365 applies only to leases entered into by the debtor and not to leases executed by the debtor-in-possession. Numerous cases have made this clear: *See In re: Cannonsburg Envtl. Assoc., Ltd.*, 72 F.3d 1260, 1265-66 (6th Cir. 1996) (“Section 365 does not apply to postpetition contracts or leases negotiated by the debtor-in-possession. . . It would create a financial disincentive for creditors to deal with the debtor-in-possession because holders of administrative claims are paid in full, whereas holders of unsecured claims usually receive a smaller distribution.”); *In re: Dant & Russell, Inc.*, 853 F.2d 700, 706 (9th Cir. 1988) (“Contrary to debtor-in-possession’s contention, section 365 (a) is inapplicable to leases executed postpetition as that section contemplates a prepetition lease or executory contract which is unexpired on the date of the petition.”); *MGRE, supra* 180 F.3d at 160. (“The debtor means a person ‘concerning which a case under this title has been commenced.’ 11 U.S.C.A. §101(13). A debtor-in-possession, on the other hand, is a person that only comes into existence when a Chapter 11 case is filed. This case now is under Chapter 7, and in Chapter 7 the subject lease is not a lease of the debtor, but rather is a lease of the debtor-in-possession before conversion.”); *In re: Leslie Fay Cos., Inc.*, 168 B.R. 294, 300 (Bankr. S.D.N.Y. 1994) (postpetition contracts are not subject to rejection under 11 U.S.C. §365); *In re: Airport Executive Center*, 138 B.R. 628, 629 (Bankr. M.D. Fla. 1992) (same); *In re: I.M.L. Freight, Inc.*, 37 B.R. 556, 558-59 (Bankr. Utah 1984) (same).

Based on the foregoing, TGAAR should be allowed an administrative expense claim for the entire amount of the rent owing under the post-petition extension of the Lease.

D. TGAAR Is Entitled To Administrative Expense Claim for the Clean-Up Costs and Damages

The arguments and authorities set forth in III. A. and B., above, apply equally to TGAAR's administrative claims for clean-up costs and damages to Store #966, and are incorporated by reference herein.

The clean-up of Store #966 by the auctioneer was mandated by the "Auction Order" (Dkt. #1674). The auctioneer is the agent of the Chapter 7 Trustee. If the Chapter 7 Trustee had complied with the Auction Order and expended funds to clean-up the estate, such expenditures would have been a proper administrative expense. Therefore, the amounts that TGAAR has had to expend to clean-up the mess that the auctioneer was required by the Auction Order (Dkt. #1674) should be allowed to TGAAR as an administrative expense.

While it is quite unfortunate that the buyers that purchased the equipment at the auction removed such equipment in a manner that caused very substantial damage to Store #966, such removal was done under the direction of the auctioneer who was acting as the agent of the Chapter 7 Trustee. Moreover, the Lease (Exhibit "A" to the Affidavit attached to the Response/MPSJ) specifically provided that the lessee would pay for all costs associated with the removal of fixtures. (§9 "Lessee may remove said items [i.e., fixtures] from the leased premises at any time **but shall repair any damage caused by removal**").

The unusual nature and amount of the damage does not remove such damages from being allowed as an administrative expense. For example, in *In re: N. P. Mining Company, Inc.*, 963 F.2d 1449 (11th Cir. 1992), fines, based on violations of environmental regulations, were considered costs ordinarily incident to the operation of a regulated mining business sufficient to confer administrative expense status. While all of the damages and costs of clean-up could have been avoided if the Debtor-in-possession had accepted the offer of TGAAR to purchase the equipment (See Exhibit "E" to the Affidavit attached to Response/MPSJ), such did not occur. Since the Debtor-in-possession and later the Chapter 7 Trustee chose to leave and store, rather than move, the equipment in Store #966, auction off the equipment and allow the equipment to

be removed in the way it was removed, the damages caused to Store #966 by such removal should be allowed as an administrative expense.

IV. CONCLUSION

The Response/MPSJ, including the summary judgment evidence attached thereto, demonstrates that there are numerous genuine issues of material fact with respect to each of the matters asserted in the Trustee's Motion which preclude the granting of such Motion. TGAAR therefore respectfully requests that the Court deny the Trustee's Motion for Partial Summary Judgment in its entirety.

Likewise, the Response/MPSJ and the summary judgment evidence attached thereto demonstrate that there is no genuine issue of material fact with respect to any of the matters asserted in TGAAR's Cross-Motion for Partial Summary Judgment and that this Court should grant TGAAR's Cross-Motion for Partial Summary Judgment as follows:

1. Chapter 11 Claim for Rent/Possession – Pre-Petition Lease. From August 31, 2001 until conversion on December 18, 2001, during which the Debtor-in-possession had actual and effective use and possession of Store #966 and used it to store and protect the equipment, TGAAR should be granted summary judgment allowing it a Chapter 11 administrative expense claim of \$78,099.30.

2. Chapter 7 Claim for Rent/Possession – Pre-Petition Lease. For the period from December 19, 2001 (the day after conversion) through December 31, 2001 (the last days of the original Lease), during which the Chapter 7 Trustee had actual and effective possession and use of Store #966, TGAAR should be granted summary judgment allowing it a Chapter 7 administrative expense claim of \$9,314.58.

3. Chapter 7 Administrative Expense – Post-Petition Lease Obligation. For the five (5) years of the extended Lease term (a post-petition obligation), TGAAR should be granted

summary judgment allowing it a Chapter 7 (or Chapter 11) administrative expense claim of \$1,307,626.20.

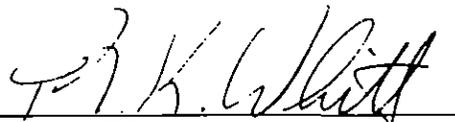
4. Chapter 7 Administrative Expense - Clean-up of Midland Store. For not complying with the Auction Order and for leaving Store #966 in a disastrous condition (as opposed to a "broom clean" condition), TGAAR should be granted summary judgment and allowed a Chapter 7 administrative expense claim in an amount to be determined at the trial of this matter.

5. Chapter 7 Administrative Expense - Damage to Midland Store. For the substantial amount of damage that resulted when the buyers, acting under the guidance of the auctioneer, removed the equipment from Store #966 following the auction, TGAAR should be granted summary judgment and allowed a Chapter 7 administrative expense claim in an amount to be determined at the trial of this matter.

Dated this 29th day of October, 2002.

Respectfully submitted,

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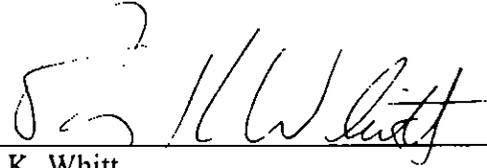
BY: 
Robert K. Whitt

**ATTORNEY FOR TGAAR PROPERTIES, INC.,
d/b/a WESTWOOD VILLAGE SHOPPING
CENTER and TGARR WEST TEXAS, INC.**

CERTIFICATE OF SERVICE

I certify that on the 29th day of October, 2002, I overnighed via UPS a copy of the foregoing pleading to the following persons:

David T. Thuma
500 Marquette N.W., Suite 650
Albuquerque, NM 87102

A handwritten signature in black ink, appearing to read "Robert K. Whitt", is written over a horizontal line.

Robert K. Whitt