

# In the United States Bankruptcy Court

## for the Northern District of Iowa

CREGAR'S AUTOWERKS, INC.

Debtor(s).

Bankruptcy No. L-92-00872-C

Chapter 7

### ORDER

The above-captioned matter came on for hearing on October 28, 1993 on an Amended and Substituted Motion for Approval of Administrative Expenses filed by Schwitters Enterprises, Inc. Attorney Ray Terpstra appeared for Schwitters Enterprises, Inc. Thomas McCuskey appeared as the case Trustee. John Titler appeared on behalf of Creditor City National Bank. Evidence was presented and the Court took the matter under advisement.

### STATEMENT OF THE CASE

Schwitters seeks payment of rent on commercial property as an administrative expense under 11 U.S.C. §§ 365(d)(3) and 503(b)(1)(A). Debtor occupied two commercial buildings at 1857 (smaller building) and 1901 (larger building) 16th Ave. SE, Cedar Rapids, Iowa. Schwitters entered into a lease with Cregar & Brooker Real Estate Partnership for the smaller building dated August 1, 1990. It entered into a real estate contract dated July 6, 1988 with Cregar and Swanson Real Estate Partnership for the purchase of the larger building. Debtor, although not a party to either the lease or the contract, occupied the premises with the knowledge of all parties. Debtor made the lease and contract payments to Schwitters.

No payments were made on the real estate contract or the lease after approximately March 1991. Debtor remained in possession of the property during the entire period of default. A petition for Chapter 11 relief was filed May 1, 1992. The case was converted to Chapter 7 on May 29, 1992. Schwitters is requesting payment of postpetition rent as an administrative expense from the date of filing the petition until October 10, 1992 when City National Bank assumed responsibility for payment. City National is the holder of a security interest in almost all of Debtor's property.

Schwitters asserts that it is entitled to an administrative expense claim for Debtor's use of the smaller building at \$1,900 per month. This amount is computed on the basis of \$1,550 in rent plus taxes and insurance payments all called for under the lease. Schwitters also makes a claim regarding the larger building of \$3,500 per month. This equals the monthly payment provided for in the real estate contract.

City National objects on several grounds. First, it asserts that no administrative expense claim can arise from the lease and contract because Debtor was not a party to them. Second, it argues that forfeiture of the real estate contract cuts off any right of the vendor, Schwitters, to claim rent from the property which accrued prior to the forfeiture.

Third, the parties dispute the extent of Debtor's use of the small building. City National claims that Debtor vacated the building in late June 1992, although it used a fenced area behind the building beyond that time for storage. Schwitters claims that Debtor or the Trustee used the smaller building into November 1992. The parties do not appear to dispute that Debtor remained in possession of the larger building for the entire period from filing its Chapter 11 petition until October 10.

Also in dispute is the correct measure of Schwitters' claim. Schwitters asserts that it is entitled to the payments called for in the lease and contract. The Trustee and City National argue that the claim should be measured according to the worth of Debtor's use of the buildings to the estate determined by a commercially reasonable standard. No evidence was presented regarding rental value of the buildings.

## CONCLUSIONS

Landlords of nonresidential property can be entitled to an administrative expense under § 365(d)(3) which requires the trustee to timely perform debtor's lease obligations. In re ASAP Printing, Inc., No. 93-60443LW, slip op. at 4 (Bankr. N.D. Iowa July 26, 1993) (ASAP Printing I). In order to apply § 365(d)(3), however, the Court must make a threshold inquiry regarding the existence of a lease. In re Farley, Inc., 152 B.R. 516, 523 (Bankr. N.D. Ill. 1993). If the debtor has no right to possession of the premises under a lease, there would be no obligation to pay § 365(d)(3) administrative rent. Farley, 152 B.R. at 524.

The lessor/lessee relationship is a question of state law. In re CFM-Etc. Inc., 139 B.R. 756, 758 (Bankr. M.D. Fla. 1992) (considering § 365(h)(1)); Farley, 152 B.R. at 524 (applying Alabama law). In Iowa, to create a relationship of landlord and tenant, it is only necessary to identify the parties, describe the property and state the term and amount of rent. Sunset Mobile Home Park v. Parsons, 324 N.W.2d 452, 457 (Iowa 1982). Valid lease agreements may be oral. Id. A prima facie right to recovery of rent may be established by merely showing that the alleged tenant was in actual possession. 49 Am. Jur. 2d Landlord and Tenant § 473, at 463 (1970). The presumption is, in those instances, that the alleged tenant occupies as assignee of the original lessee.

In re Great Northern Forest Prods., Inc., 135 B.R. 46 (Bankr. W.D. Mich. 1991), considered the issue in the context of determining whether a landlord's lien existed. The debtor was a subsidiary of the entity named as lessee in the lease. The court considered whether the circumstances warranted a finding of a constructive or implied lease or implied assignment of lease. Id. at 55-56. The landlord has the burden to show the existence of a lease. Id. at 55. Where there is no document, the existence of a lease depends on the conduct of the parties. Knowledge of the parties is most important.

A claim for rent may also arise under § 503(b)(1)(A) which gives administrative expense status to "the actual, necessary costs and expenses of preserving the estate." A claim under § 503(b)(1)(A) only arises for actual and necessary expenses, directly and substantially benefitting the estate, incurred postpetition by a debtor in possession or trustee. Great Northern, 135 B.R. at 59. Even absent a lease, a landlord who allows a debtor to use and possess property for storage purposes may be granted administrative expense priority. Id.; see also In re Bio-Med Labs., 131 B.R. 72, 74 (Bankr. N.D. Ohio 1991) (granting administrative expense claim where debtor was holdover tenant); In re Grimm & Rothwell, Inc., 108 B.R. 186, 190 (Bankr. S.D. Ohio 1989) (holding that even though rental agreement was not established, trustee's use for storage was necessary to preserving estate).

City National takes the position that, as to the larger building, Schwitters cannot make a claim for rent against Debtor who is merely the tenant of the contract vendee, the partnership, because the contract forfeiture cuts off any claims related to the contract. Schwitters forfeited the contract in December 1992 after being granted relief from the automatic stay. It is making a claim for rent for the postpetition period from May through October 1992, prior to the forfeiture. Iowa law provides that a vendor's act of forfeiture terminates the contract and precludes recovery from the vendee of monthly payments for use of the property prior to completion of the forfeiture. Risse v. Thompson, 471 N.W.2d 853, 858 (Iowa 1991). This holding is based on the theory that such recovery is a claim for payments on the unpaid purchase price under the contract which is extinguished by the vendor's election to forfeit the contract.

However, Schwitters is not making a claim for contract payments from the vendee, the partnership. Debtor was not the vendee under the contract, but was occupying the larger building. Debtor's use of the premises postpetition benefitted the estate to the detriment of Schwitters as Schwitters was delayed by the automatic stay from pursuing contract forfeiture against the partnership. A § 503(b)(1)(A) claim can arise if allowing the debtor to remain on the premises helps preserve the estate and has the effect of precluding the premises owner from further disposition of the property. Bio-Med Labs., 131 B.R. at 75.

Some factors exist in this case which could justify a finding of an implied lease of both buildings. Debtor made the lease and contract payments directly to Schwitters. Schwitters knew Debtor was occupying the buildings and considered Debtor to be the tenant. The partnership which entered into the lease and contract with Schwitters was apparently operating entirely as Debtor. However, in these circumstances, the Court will refrain from applying § 365(d)(3) under a theory of implied lease as Schwitters' administrative expense claim for use and occupancy is sufficiently protected by §

503(b)(1)(A). The Court concludes that despite the lack of a contractual relationship between Debtor and Schwitters by lease or contract, Debtor's use of both buildings should be treated as an actual and necessary expense of preserving the estate. Therefore, it is granted administrative expense status under § 503(b)(1)(A). As the Court has concluded that these claims should be granted as administrative expense status under § 503(b), the Court does not ultimately resolve whether an implied lease exists under the factual record presented or whether these facts would justify an administrative expense claim under § 365(d)(3).

The only evidence regarding rental value of either building arises from the lease and real estate contract. Absent contrary evidence, the prior lease rate is presumed to be the proper measure for the administrative claim. ASAP Printing I, slip op. at 2. Rent under a lease is presumed fair rental value unless the evidence establishes that the lease rent is unreasonable. Bio-Med Labs., 131 B.R. at 74; Grimm & Rothwell, 108 B.R. at 190.

The record fails to establish that the lease rate is not fair or reasonable. The record is likewise silent regarding the fair rental value of the larger building other than the amount set out in the real estate contract. The Court concludes that the monthly contract payments equal the fair rental value of the larger building and the monthly lease payments equal the fair market value of the smaller building. Use of these figures is appropriate even though Debtor was not a party to the lease and contract. Debtor was extensively involved in possessing the property and making payments over time. As such, Schwitters is entitled to an administrative expense claim for the smaller building of \$1,900 per month as provided for in the lease for rent, taxes and insurance. As to the larger building, Schwitters is entitled to an administrative expense claim of \$3,500 per month as provided for in the real estate contract.

Another issue is the amount of time Debtor used the buildings to the benefit of the estate. The parties do not dispute that Debtor used the larger building for the entire period from May 1 through October 10, 1992. Schwitters is thus entitled to its claim of \$15,166.67 as Chapter 7 administrative expense for the period between the time of conversion to Chapter 7 through October 10. It is also entitled to a claim for \$3,500 for the one month which passed while Debtor was operating under Chapter 11, over which Chapter 7 administrative expenses have priority. See 11 U.S.C. § 726(b). Schwitters also makes a claim for \$750 which the Trustee apparently agreed to pay from the auction proceeds, less \$150 which Schwitters has notified the Court that it received after the hearing. This additional \$600 claim is also granted administrative expense status.

The parties dispute the date which Debtor vacated the smaller building. Schwitters asserts that although the building may have been vacated, the fenced area behind it had cars and car parts in it until after the November 1992 sale. Daniel Costello who was employed to manage Debtor's liquidation testified that Debtor's property was removed from the small building in late June 1992. He stated that continued use of the fenced area did not hinder use of the building itself.

Schwitters has failed to establish that Debtor continued to use and occupy the smaller building after late June 1992. The evidence does not establish the value to Debtor's estate of the use of the fenced area. Because of this and the lack of detriment to Schwitters, Schwitters is not entitled to payment for the use of the fenced area. As to the smaller building, Schwitters is entitled to rent for \$1,900 for June as a Chapter 7 expense and \$1,900 for May as a Chapter 11 expense. It is not entitled to rent from June 30, 1992 through October 10, 1992.

The final issue for resolution is when payment of these administrative claims should occur. This Court has previously concluded that it is inappropriate to order immediate payment of a § 365(d)(3) administrative expense claim without considering the solvency of the bankruptcy estate. In re ASAP Printing, Inc., No. 93-60443LW, slip op. at 4 (Bankr. N.D. Iowa Nov. 24, 1993) (ASAP Printing II). Payment of postpetition rent under § 365(d)(3) must be made immediately upon demand unless a showing is made by the trustee or debtor in possession that there is substantial doubt that sufficient funds will be available to pay all administrative claimants in full. Id. (citations omitted).

The Court has already concluded that § 365(d)(3) is not applicable to Schwitters' claim. Unlike § 365(d)(3), there is no requirement in § 503(b)(1) that the trustee "timely perform" any obligation of Debtor arising under a use and occupancy claim. The timing of the payment of a § 503(b)(1)(A) claim is within the discretion of the bankruptcy court. See ASAP Printing II, slip op. at 3; In re United West, Inc., 87 B.R. 138, 141 (Bankr. D. Nev. 1988). The court's discretion should be exercised with reference to other provisions and policies of the Code. In re Dieckhaus Stationers of King of Prussia, Inc., 73 B.R. 969, 972 (Bankr. E.D. Pa. 1987). "It is an important policy underlying the Bankruptcy Code that a debtor's

limited resources are to be equally distributed among all creditors with the same priority." In re Cardinal Industries, Inc., 109 B.R. 738, 742 (Bankr. S.D. Ohio 1989).

The Court concludes in its discretion that payment of Schwitters' administrative expense claim for postpetition rent should be made at the conclusion of the case along with all other administrative claims. At that time it will be clear whether the estate contains assets sufficient to pay all costs of administration.

**WHEREFORE**, this Court concludes that Schwitters Enterprises, Inc. has established that it is entitled to an administrative expense claim on the building located at 1901 16th Avenue SE, Cedar Rapids, Iowa in the amount of \$19,266.67.

**FURTHER**, the Court concludes that Schwitters Enterprises, Inc. has established that it is entitled to an administrative expense claim on the property located at 1857 16th Avenue SE, Cedar Rapids, Iowa in the amount of \$3,800.

**FURTHER**, payment of Schwitters administrative expense claims will be deferred the conclusion of the case when all other administrative expense claims are paid.

**FURTHER**, judgment shall enter accordingly.

**SO ORDERED** this 10th day of December, 1993.

Paul J. Kilburg, Judge  
U.S. Bankruptcy Court