

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

IN RE: CASE NO. 04-78434

Rhodes, Inc.,
CHAPTER 11

JUDGE MASSEY

Orland Holdings, LLC,

Movant,

v.

CONTESTED MATTER

Rhodes, Inc.,

Respondent.

ORDER

Rhodes, Inc. leased nonresidential real property located in Orland Park, Illinois (the “Property”) from Orland Holdings, LLC (“Orland”) pursuant to a lease agreement dated January 9, 1998 (the “Lease”). Under the Lease, Rhodes agreed to pay annual base rent in equal monthly installments of \$64,770.42 on the first day of each month. On November 4, 2004, Rhodes filed this Chapter 11 without having paid the rent for November 2004, and it has not made any payment to Orland with respect to that month. Rhodes subsequently rejected the Lease on January 31, 2005.

Orland moves for an order compelling Rhodes to pay prorated rent, based on the full monthly rent payment required by the Lease, in the amount of \$56,134.00 for the period from

November 4, 2004 through November 30, 2004 (the "Stub Period").¹ Rhodes contends that no obligation to pay the November rent arose under the lease after November 1 and therefore that it owes Orland only the reasonable value of its use of the Property during the Stub Period, which it says amounts to \$30,375.00.

Section 365(d)(3) provides that the "trustee shall timely perform all the obligations of the debtor . . . arising from and after the order for relief under any unexpired lease of nonresidential real property, until such lease is assumed or rejected" 11 U.S.C. § 365(d)(3). An obligation arises under a lease at the point in time that the tenant must perform it notwithstanding that the lease is later terminated. *In re Rhodes*, 321 B.R. 80, 89 (Bankr. N.D.Ga. 2005). The determination of when an obligation arises under a lease must be made in the context of the actual circumstances. For example, virtually all leases, including the one here, contain clauses that relieve the tenant from the obligation to pay rent if the premises are condemned or destroyed. But the mere existence of such a provision does not shed light on the question of when the obligation to pay rent arises during those months in which the premises had not been condemned or destroyed.

¹ The parties had also disputed the amount of real estate taxes owed Orland. Orland claimed that it was owed \$766,336.70 as real estate taxes for the period from the second half of 2003 through January 31, 2005. Debtor responded, stating that Orland's tax claim should be limited to the amount attributable to the period from November 4, 2004 through January 31, 2005. At the hearing held on June 30, 2005, Orland's counsel stated that just prior to the hearing the parties had stipulated to the taxes owed Orland being \$115,511.47, representing the amount attributable to the period from November 4, 2004 through January 31, 2005. As Debtor's counsel did not state to the contrary at the hearing, the tax claim is deemed to be resolved, and the Court will enter a separate order accordingly.

The burden of proof on a claim for damages for breach of a contract existing on the petition date and arising under state law is the same in bankruptcy as it would be under state law.

Creditors' entitlements in bankruptcy arise in the first instance from the underlying substantive law creating the debtor's obligation, subject to any qualifying or contrary provisions of the Bankruptcy Code. *See Butner v. United States*, 440 U.S. 48, 55, 99 S.Ct. 914, 59 L.Ed.2d 136 (1979); *Vanston Bondholders Protective Comm. v. Green*, 329 U.S. 156, 161-162, 67 S.Ct. 237, 91 L.Ed. 162 (1946). The "basic federal rule" in bankruptcy is that state law governs the substance of claims, *Butner, supra*, at 57, 99 S.Ct. 914, Congress having "generally left the determination of property rights in the assets of a bankrupt's estate to state law," 440 U.S., at 54, 99 S.Ct. 914 (footnote omitted). "Unless some federal interest requires a different result, there is no reason why [the state] interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding." *Id.*, at 55, 99 S.Ct. 914.

Raleigh v. Illinois Dept. of Revenue, 530 U.S. 15, 20, 120 S.Ct. 1951, 1955 (2000). The Lease provides that Illinois law governs, and the Property is located in Illinois. Under Illinois law, the landlord who asserts a claim for damages for breach of a lease has the burden of proof.

Northwest Commerce Bank v. Continental Data Forms, Inc., 233 Ill.App.3d 124,129, 598 N.E.2d 446, 450 (Ill.App. 2 Dist. 1992). The expense that a trustee incurs under section 365(d)(3) is an expense of administration, though not one that necessarily must benefit the estate as required by section 503(b)(1)(A). Thus, placing the burden of proving the expense on a claimant under section 365(d)(3) is consistent with the placement of that burden on a claimant under section 503(b)(1)(A). *See, e.g., In re La Electronica, Inc.*, 995 F.2d 320, 322 (1st Cir. 1993); *Matter of TransAmerican Natural Gas Corp.*, 978 F.2d 1409, 1417 (5th Cir. 1992).

Similarly, so long as a party objecting to a claim presents enough evidence to rebut the presumption of validity set forth in Fed. R. Bank. P. 3001(f), the claimant has the ultimate burden of persuasion that a prepetition claim is allowable. *In re Biscayne Investment Group, Ltd.*, 264 B.R. 765, 770 (Bankr. S.D.Fla. 2001). There is no sound policy reason to treat landlords' claims

under section 365(d)(3) differently for purposes of establishing the liability and amount of the postpetition obligation. In short, Orland had the burden of proving its entitlement to payment from the estate pursuant to section 365(d)(3) and the amount of the estate's obligation, i.e., that the parties intended that Rhodes' liability to pay rent accrued day to day. Orland failed to carry its burden of proof.

The Court conducted an evidentiary hearing on Orland's motion on June 30, 2005. At that hearing, neither party presented any evidence concerning the issue of when the obligation to pay rent under the Lease arose during the month of November 2004, other than the introduction of the Lease itself. The Orland Lease provides that the "Annual Base Rent" is to be paid in "equal monthly installments, *in advance*, on the first (1st) day of every calendar month (each, a 'Due Date')." (Lease, ¶ 5A) (emphasis added). It also provides that "[a]ll monthly installments of the Annual Base Rent shall be paid on or before the Due Date . . . *without prior demand or offset* accept as specifically permitted under this lease." (Lease, ¶ 5B) (emphasis added). Even though rent is due to be paid no later than the first day of the month, the Lease provides two fifteen day grace periods during each calendar year before there is an interest penalty. (Lease ¶ 5B). The Lease also provides for prorated rent in three circumstances – where the commencement of the lease occurred on a day other than the first day of the month (Lease, ¶ 5A), where the premises are taken under the power of eminent domain and the tenant terminates the Lease (Lease, ¶ 10A), and where damage or destruction of the premises deprives the tenant of full enjoyment (Lease, ¶ 13A).

Rhodes contends that the obligation to pay rent for a given month arises no later than the first day of that month because the Lease so states and that the fact that the parties articulated a

few specific circumstances in which rent would be prorated does not imply that they intended proration in all other circumstances. Orland argues that the three provisions expressly authorizing proration “point to proration” generally. The Court agrees with Rhodes that the most straightforward reading of the Lease is that the obligation to pay rent for a particular month arises on the first day of that month. Even if the Court were to accept the argument that specific proration provisions suggest or point to an agreement to prorate under any other circumstance that might occur, the most that could be said is that the Lease is ambiguous on this point. Because Orland had the burden of proof, its failure to present other evidence of the intention of the parties is fatal to its case.

Although Orland has not shown that Rhodes became obligated under the Lease after the petition date to pay rent for the Stub Period, Rhodes’ use of the premises during the Stub Period gave rise to an administrative expense owed to Orland. 11 U.S. C. § 503(b)(1)(A) (“[T]here shall be allowed administrative expenses . . . the *actual, necessary costs and expenses* of preserving the estate”) (emphasis added); *In re Rhodes, supra* at 92-3 (stating that in the context of use and occupation of property by the trustee, the actual, necessary costs and expenses of preserving the estate is the reasonable value of such use and enjoyment). The presumption is that the rent specified in the lease defines the value of the leased space to the trustee. *See id.* That presumption may be rebutted, however, by showing that the rent specified on the lease is clearly unreasonable. *See id.*

At the hearing conducted on June 30, 2005, the Court heard the testimony of Edward Zimmer and Richard Kahan, expert witnesses called by Debtor and Orland respectively, concerning the reasonable value of the use of the leased premises during the Stub Period.

Mr. Zimmer has had considerable experience in evaluating commercial leases and is familiar with the rental market for commercial space in the Orland Park area in general and with the leased premises in particular. He has been a commercial real estate consultant since 2001 and is managing director of DJM Asset Management LLC, a real estate advisory firm. He is a licensed real estate broker. He was an officer of Levitz Furniture Corporation, a retail furniture chain. After serving for many years as its general counsel, he became vice president of real estate in 1992.

Mr. Zimmer evaluated commercial lease rates while employed by Levitz and participated in the valuation of such leases as a consultant. He testified that he has evaluated hundreds, if not more than a thousand, commercial real estate leases during his career.

Mr. Zimmer is familiar with the commercial lease market in the Chicago and Orland Park area because he put together a lease portfolio for Levitz when it expanded into that area in the 1990's, including a lease of the Property later leased by Orland to Rhodes. He visited the Orland Park area earlier in June 2005 to update his knowledge of that market.

Mr. Zimmer testified that the market rental rate of the Property is \$5.00 per square foot per year, a rate substantially lower than the contractual lease rate of \$9.60 per square foot per year. He formed his opinion concerning the market rental rate of the Property by considering the lease rates of comparable spaces in the same market and making adjustments based on property-specific factors such as visibility, access, age, condition, configuration, and parking. He testified that on LaGrange Road, the main commercial street near the subject premises, the rental rate for premises of comparable size is in the "mid-teens" and that the local rental market is an "A" market. But he considered the Property in question to be a "C" property based primarily on its

location, size and lack of adequate parking. The Property is hidden behind a mall on a ring road and is not visible from LaGrange Road. Mr. Zimmer also considered the Property's age, condition, type of construction (warehouse show room store), layout and configuration. He stated that the layout and warehouse configuration without windows was not popular among potential lessees. Its large size limits the number of potential tenants. The most important limitation for potential users other than furniture retailers is its lack of sufficient parking. The Court finds Mr. Zimmer's testimony to have been thorough and credible.

Mr. Kahan testified that the market rental rate of the Property remains \$9.60 per square foot per year. He stated that his valuation was based on the comparable lease rates of similar spaces, but he did not account for property-specific factors as thoroughly as did Mr. Zimmer. For example, Kahan admitted on cross examination to having no information about the Property's parking, reflecting that his evaluation of this particular property was superficial. The Court did not find Mr. Kahan's testimony to be persuasive.

Based on the testimony of Mr. Zimmer, the Court finds \$5.00 per square foot per year to be the market rental rate of the Property as of June 2005 and as of November 2004, there being no evidence to show that the market changed between November 2004 and June 2005. The Debtor therefore rebutted the presumption that the rate stated in the lease shows the market rate as of November 2004.

Debtor has represented in its reply brief filed on April 19, 2005, that \$30,375.00 is the value of the Property to Debtor for the Stub Period, using the rate of \$5 per square foot per year. Orland has not contested Debtor's calculation. Consequently, the Court holds that the rent owed Orland for the Stub Period is \$30,375.00.

For the foregoing reasons, it is

ORDERED that Orland Holdings, LLC's motion for Payment of Postpetition Rent and Tax Claims is GRANTED in part and DENIED in part. The motion is granted to the extent that Debtor shall pay to Orland \$30,375.00 as an administrative expense pursuant to 11 U.S.C. § 503(b)(1)(A), for Debtor's use of the Property from November 4, 2004 through November 30, 2004. Otherwise, the motion is denied.

Dated: November 17, 2005.



JAMES E. MASSEY
U.S. BANKRUPTCY JUDGE