

**UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF NEW YORK**

In re:

INDUSTRIAL CERAMICS, INC.,

Debtors.

CASE NO. 96-22069

DECISION & ORDER

BACKGROUND

On April 8, 1996, Industrial Ceramics, Inc. (the “Debtor”) filed a petition initiating a Chapter 11 case. On the schedules and statements required to be filed by the Bankruptcy Code and Rules, the Debtor indicated that: (1) it was indebted to Niagara Mohawk Power Corporation (“Niagara Mohawk”) in the amount of \$215,941.76 for pre-petition utility services; and (2) it was a party to an executory contract with Niagara Mohawk which it described on Schedule G as an SC-11 Service Agreement through the year 2002 (the “SC-11 Agreement”).

In the Debtor’s August 6, 1997 Second Amended Disclosure Statement, filed while the Debtor was still attempting to confirm a plan, the Executory Contracts section provided that:

The Plan provides that any pre-petition executory contract or unexpired lease of the Debtor not heretofore terminated by operation of law or rejected by order of the Court or expressly rejected under the Plan, or which is not the subject of a pending application by the Debtor to reject such contract or lease, shall be deemed assumed by the Debtor. Any said assumption, which requires the cure of pre-petition defaults, will either be paid on the Effective Date or as per agreement reached between the parties. The Debtor is not aware of any executory contract which will require the cure of any pre-petition arrearages.

The Debtor was never able to negotiate and file a plan that could be confirmed by the Bankruptcy Court. Ultimately the Debtor's assets were liquidated at an auction sale, and on November 3, 1998, the Debtor's Chapter 11 case was converted to a Chapter 7 case.

On July 31, 1998, Niagara Mohawk filed a priority administrative proof of claim (the "Administrative Request.")¹ The Administrative Request asserted that Niagara Mohawk was entitled to payment of an administrative expense in the amount of \$328,496.88. Of this amount, \$252,794.40 represented the difference between what Niagara Mohawk billed the Debtor post-petition for utility services (the "Differential Component"), which was at the SC-11 Agreement rate even though the Debtor never formally assumed the Agreement under Section 365, and what the Debtor would have been billed for the same utility services at the otherwise approved non-SC-11 Agreement rate. The

¹ Section 503 provides in part that:

(a) An entity may timely file a request for payment of an administrative expense, or may tardily file such request if permitted by the court for cause.

(b) After notice and a hearing, there shall be allowed administrative expenses, other than claims allowed under section 502(f) of this title, including:

(1) (A) the actual, necessary costs and expenses of preserving the estate, including wages, salaries, or commissions for services rendered after the commencement of the case. . .

11 U. S. C. §§503(a) and 503(b)(1)(A) (1999).

Section 503(a), as set forth above, requires an entity to make a written request and notice it for a hearing in order to obtain the allowance and payment of an administrative expense. Therefore, the filing of a priority administrative proof of claim does not comply with either The Bankruptcy Code, The Rules of Bankruptcy Procedure or the specific provision of the Official Form to be used to file a proof of claim, which states that the proof of claim form should not be used to request the allowance of an administrative expense.

additional \$75,702.48 requested represented a termination charge alleged to be due as the result of the Debtors terminating its operations (the "Termination Charge.")

On April 6, 1999, the Chapter 7 Trustee (the "Trustee") filed an objection (the "Objection") to the Administrative Request which asserted that there was no documentary basis for the claim and no proof submitted that would entitle Niagara Mohawk to an administrative expense.

On May 5, 1999, Niagara Mohawk filed a Response to the Objection which alleged that: (1) SC-11 is a special tariff filed with the New York State Public Service Commission (the "PSC") which allows qualifying non-residential customers to receive below-market rates for a specified term; (2) at the time of the filing of the Debtor's petition, it owed Niagara Mohawk \$232,740.37, most of which was incurred under the SC-11 Agreement; (3) "[a]lthough debtor had defaulted on the SC-11 contract, the bankruptcy filing forced Niagara Mohawk to continue to provide below-market rates pursuant to said contract;" (4) "[i]n other bankruptcy cases, Niagara Mohawk has attempted to force the debtor to either assume or reject similar below market-rate contracts without success;" (5) Niagara Mohawk made several requests to the Debtors' attorneys to have the Debtor assume or reject the SC-11 Agreement, but the Debtor refused to do so; (6) the Debtor continued to be unjustly enriched by receiving utility services at below-market rates even though it was in default under the SC-11 Agreement which allowed it to receive those rates; (7) "[i]t is a 'Catch-22' for the utility, which can neither unilaterally reject the contract and bill the debtor at market rates nor force the debtor to assume the favorable contract along with payment of the pre-petition debt;" (8) the Debtor should not be unjustly enriched by the artificially deflated below-market utility services rates which it received post-petition pursuant to the SC-11 Agreement that it never formally assumed; (9) the Termination Charge was a component of the continuing post-

petition utility services which should be paid as an administrative expense; and (10) since a utility cannot force a debtor to assume or reject a below-market rate pre-petition contract upon which it has defaulted, a debtor-in-possession is unjustly enriched.

On the return date of the Objection, the Court heard oral argument and, at the request of Niagara Mohawk, agreed to issue a written decision.

DISCUSSION

_____ Section 365 contains provisions for the assumption and rejection of executory contracts. The relevant provision of Section 365 are as follows:

- (a) Except as provided in sections 765 and 766 of this title and in subsections (b), (c), and (d) of this section, the trustee, subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor.
- (b) (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 contract or lease, for any actual pecuniary loss to such party resulting from such default; and
 - (C) provides adequate assurance of future performance under such contract or lease.
- (2) Paragraph (1) of this subsection does not apply to a default that is a breach of a provision relating to—
 - (A) the insolvency or financial condition of the debtor at any time before the closing of the case;

(B) the commencement of a case under this title;

(C) the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement; or

(D) the satisfaction of any penalty rate or provision relating to a default arising from any failure by the debtor to perform nonmonetary obligations under the executory contract or unexpired lease.

11 U.S.C. §365(a) & (b)(1) & (2) (1999).

(d) (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 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.

11 U.S.C. §365(d)(2).

(g) Except as provided in subsections (h)(2) and (i)(2) of this section, the rejection of an executory contract or unexpired lease of the debtor constitutes a breach of such contract or lease—

(1) if such contract or lessee has not been assumed under this section or under a plan confirmed under chapter 9, 11, 12, or 13 of this title, immediately before the date of the filing of the petition; or

11 U.S.C. §365(g)(1).

Niagara Mohawk does not dispute that: (1) it billed the Debtor for post-petition utility services at the SC-11 Agreement rate; (2) the Debtor acknowledged in its schedules that the SC-11 Agreement was an executory contract; (3) at no time during the Debtor's Chapter 11 case did it exercise the right provided by Section 365(d)(2) to request that the Court order the Debtor to determine within a specified period of time whether to assume or reject the SC-11 Agreement; (4)

at no time during the Debtor's Chapter 11 case, or in connection with the Administrative Request, did it demonstrate to the Court that, notwithstanding the Debtor's failure to assume the SC-11 Agreement with Court approval, the Debtor-in-possession was not, other than because it failed to pay all pre-petition utility services in full, otherwise qualified to obtain or continue to receive an SC-11 below-market rate in accordance with the requirements of the PSC;² and (5) it never advised the Official Creditors Committee, the Office of the United States Trustee, the Debtor or the Debtor's counsel, that, notwithstanding its failure to request any relief at all from the Bankruptcy Court concerning the SC-11 Agreement and its voluntary billings to the Debtor at the SC-11 Agreement rate, it ultimately intended to file a request for an administrative expense for the difference between the SC-11 Agreement billings and what the billings would have been if the Debtor had rejected the SC-11 Agreement.

A. The Differential Component.

Because Niagara Mohawk has not provided the Court with a copy of the SC-11 Agreement or the applicable regulations of the PSC concerning such SC-11 agreements, it has not even

² Even at oral argument on the Objection, the in-house counsel for Niagara Mohawk would not provide the Court with a copy of the SC-11 Agreement, or share with the Court the exact requirements that a customer must meet to obtain an SC-11 tariff rate, other than to state that it may have something to do with the ability of a customer to obtain alternative utility services at rates that are more favorable than Niagara Mohawk's regular commercial rates. Therefore, the Court does not know whether the applicable requirements may be, for example, that: (1) the customer use a certain amount of power or pay for it even if it is not used; or (2) the customer employ a certain number of individuals within the Niagara Mohawk service area. The Court also does not know that the Debtor, during its Chapter 11 case, did not continue to meet to the requirements that initially made it eligible for the SC-11 Agreement, or whether, notwithstanding the Debtor's failure to assume the SC-11 Agreement, the PSC would have allowed Niagara Mohawk to terminate the SC-11 Agreement if, with Court approval, the Debtor was otherwise meeting the requirements that made it initially eligible for the more favorable tariff rate.

established that the Debtor's failure to pay all of the pre-petition billings for utility services constituted a default under the SC-11 Agreement and the applicable PSC regulations that would have enabled Niagara Mohawk to terminate the SC-11 Agreement and bill the Debtor at its otherwise applicable commercial rates during the post-petition period.

In addition, Niagara Mohawk has failed to demonstrate that, post-petition, the Debtor did not meet the requirements that made it initially eligible for an SC-11 agreement, whether they be alternative sources, minimum usage, minimum employment or other requirements. Therefore, Niagara Mohawk has not even demonstrated that the Debtor was unjustly enriched during the post-petition period by being billed at and paying the SC-11 Agreement rate.

Furthermore, Niagara Mohawk voluntarily billed the Debtor at the SC-11 Agreement rate and it is now estopped to claim that it is entitled to a different and higher amount for those utility services, where as here, such a result would severely prejudice the interested parties, including the Debtor and its unsecured creditors, as represented by the Official Creditors Committee, who never had the opportunity during the Chapter 11 case to present any arguments on this issue or to consider various business alternatives, which they could have done if Niagara Mohawk had made some request to the Bankruptcy Court in connection with the SC-11 Agreement, whether pursuant to Section 365(d)(2) or otherwise.

B. Termination Charge.

Since the SC-11 Agreement was never assumed by the Chapter 11 Debtor with Court approval pursuant to Section 365 or a confirmed plan, but was deemed rejected when the Chapter 7 Trustee failed to assume it, the provisions of Section 365(g)(1) apply, and the rejection constitutes a breach immediately before the date of the filing of the petition. Therefore, if there is a Termination

Charge due under the SC-11 Agreement, it would be a pre-petition claim and not an administrative expense. In this regard, before a Termination Charge claim could be allowed as an unsecured claim, it will be necessary for Niagara Mohawk to prove to the Trustee that there is such a Termination Charge provided for in the SC-11 Agreement.

CONCLUSION

The request by Niagara Mohawk for the payment of an administrative expense in the amount of \$252,794.40, representing the Differential Component, is in all respects denied. The request by Niagara Mohawk for the payment of a Termination Charge in the amount of \$75,702.48, is allowed as an unsecured claim, if Niagara Mohawk provides the Trustee with satisfactory evidence that there is such a Termination Charge provided for in the SC-11 Agreement.

IT IS SO ORDERED.

_____/s/_____
HON. JOHN C. NINFO, II
U.S. BANKRUPTCY JUDGE

Dated: June 3, 1999