UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF NEW YORK

In Re:

Red Bird Development, Inc.,

Debtor.

CASE #95-22791

DECISION & ORDER

BACKGROUND

On November 22, 1995, Red Bird Development, Inc. (the "Debtor"), a construction, trucking and hauling firm, filed a petition initiating a Chapter 11 case. On November 27, 1995, before it had even filed the lists, schedules and statements required by Rule 1007, the Debtor filed a motion (the "Sale Motion") for an order approving the auction sale of substantially all of its tractors, dump trucks, trailers and other miscellaneous equipment which the Debtor claimed was surplus equipment. The Sale Motion indicated that: (1) on November 9, 1995, the Debtor had entered into a contract with Roy Teitsworth, Inc. (the "Auctioneer") for it to conduct a December 14, 1995 auction of the assets covered by the Motion; and (2) it was important for the auction to go forward as scheduled because it had been heavily advertised.

On December 5, 1995, an objection to the Sale Motion was filed on behalf of Thomas A. Hanna, the Debtor's landlord (the "Landlord"), which alleged that: (1) the Debtor had willfully, deliberately, maliciously and illegally dumped hazardous waste and other materials on the leased premises; (2) the Landlord had not commenced eviction and other legal proceedings when it originally discovered this problem because representatives of the Debtor repeatedly assured him that the Debtor would use its trucks and employees to haul away the hazardous waste and materials; and (3) if the Court approved the auction sale, the Debtor would no longer have the means to rectify the

environmental hazard it had caused.

On the December 6, 1995 expedited return date of the Sale Motion, a number of concerns advanced by the Office of the United States Trustee (the "U.S. Trustee") were resolved, each secured creditor indicated its consent to the proposed auction sale, the Debtor's Attorney in response to the Landlord's concerns indicated that the Debtor would still have equipment after the sale and hoped to continue in business and the Court approved the auction sale and the retention of the Auctioneer.

The minute report of the Section 341 meeting of creditors conducted on January 2, 1996 indicated that: (1) the auction sale had been held as scheduled on December 14, 1995; (2) the $233,000.00 net proceeds of the sale had been deposited into an interest-bearing bank account, as required by the Court's December 13, 1995 Order approving the sale; and (3) the Debtor anticipated that a scaled down business operation could be profitable and a reorganization plan could be filed within 6 months.

On January 25, 1996, after the sixty-day period provided for under Sections 365(d)(3) and (4) had expired and the Debtor's lease with the Landlord had been deemed rejected, the Landlord filed a motion (the "Administrative Rent Motion") for an order directing the Debtor to immediately pay unpaid post-petition rent.

The Administrative Rent Motion alleged that: (1) the Debtor had filed Chapter 11 one day before a scheduled state court hearing in eviction proceedings commenced by the Landlord; (2) On December 10, 1995, the Landlord had filed a proof of claim for unpaid rent and environmental clean-up costs; (3) the Debtor's lease had been deemed rejected pursuant to Section 365(d)(4); and (4) an order should be entered requiring the Debtor to pay post-petition rent for sixty days ($6,333.33) and

to remove all vehicles, equipment, furniture, debris and other belongings from the leased premises.

On February 8, 1996, the Debtor filed the Affidavit of its President, Susan M. Sulli ("Sulli"), in opposition to the Administrative Rent Motion (the "Opposition"). The Opposition alleged that: (1) the Debtor had filed Chapter 11 to prevent the Landlord from obtaining an order of eviction and a judgment sought by the Landlord in the amount of $160,000.00; (2) the Debtor, pursuant to an oral agreement with the Landlord, had vacated the leased premises on December 21, 1995, seven days after the auction sale; and (3) administrative rent should only be calculated from November 22, 1995, the date of the filing of the petition, through December 21, 1995, when the premises were surrendered in good condition. The Opposition included a number of photographs alleged to be of leased premises and taken on December 6, 1995. Sulli asserted that the photographs showed that there was no construction debris or other materials dumped on the premises.

On February 12, 1996, a Reply Affidavit was filed on behalf of the Landlord which alleged that: (1) there had been no agreement, oral or otherwise, regarding the surrender of the leased premises to the Landlord; (2) numerous items of personal property, including a table, couch, lamps, chairs and other items of personal property, remained on the premises; (3) the Debtor had not turned over the keys to the premises, even though it had changed the locks without the knowledge or consent of the Landlord; and (4) the Debtor had made no effort to remove the construction debris and other hazardous waste from the premises. The Reply Affidavit included a number of photographs alleged to be of the leased premises and taken on February 9, 1996 which showed various trailers, automobiles, tires and construction debris.

At a February 21, 1996 adjourned hearing on the Administrative Rent Motion, the parties

advised the Court that the administrative rent dispute had been settled, and on April 5, 1996 an order (the "Administrative Rent Order") setting forth the settlement and requiring the payment of $4,000.00 as administrative rent was entered. The Order also provided that, "the payment is separate and apart from and unrelated to any and all other claims made..."

On February 12, 1996, the Debtor filed a motion (the "Proceeds Motion") which requested that it be authorized to use $24,000.00 of the auction proceeds for working capital in a scaled down business operation. On February 16, 1996, the U.S. Trustee filed a copy of her letter to the attorney for the Debtor which set forth a number of concerns and questions regarding the Debtor's requested use of auction proceeds and the nature and extent of any ongoing business operation. On the February 21, 1996 return date of the Proceeds Motion, the Court was advised that the Debtor would be converting to Chapter 7. On February 22, 1996, on the application of the Debtor, the Court entered an order converting the case to a Chapter 7 case. On February 22, 1996, the Office of the U.S. Trustee filed its designation of Kenneth W. Gordon as Trustee (the "Trustee").

On June 18, 1996, the Landlord filed a proof of claim (the "Landlord Claim") which amended and superseded its proof of claim filed on December 10, 1995. The Claim was in the total amount of $159,769.74 and included claims for: (1) unpaid pre-petition rent in the amount of $18,123.74; (2) accelerated rent as the result of the deemed rejection of the lease from January 1, 1996 through the expiration of the lease on April 30, 1998 in the amount of $91,664.00; (3) storage charges of $50.00 per day for a tank and trailer left at the premises in the amount of $7,950.00 (claimed as an administrative expense); (4) the cost, pursuant to attached written estimates, to clean up alleged environmental hazards in the nature of construction debris in the amount of $32,000.00

(claimed as an administrative expense); (5) the cost, pursuant to attached written estimates, to clean up alleged environmental hazards in the nature of oil spills on the parking lot and storage tank and container removal in the amount of $13,973.00 (claimed as an administrative expense); (6) the cost of extraordinary building clean-up in the amount of $2,700.00; (7) the Landlord's insurance deductible in connection with a claim for stolen overhead doors and broken windows in the amount of $250.00; (8) the cost to replace destroyed side building panels in the amount of $1,192.00; (9) the cost to repair or replace damaged doors in the amount of $2,637.00; (10) the cost of a stolen thermostat in the amount of $135.00; and (11) the cost of a broken two-way mirror in the amount of $95.00.[1] On January 2, 1997, the Landlord filed a motion (the "Administrative Expense Motion") and a Memorandum of Law (the "Landlord Memorandum"), requesting that, pursuant to Section 503(b)(1)(A), the Court enter an order requiring the Trustee to pay the Landlord as an administrative expense the $53,923.00 included in the Landlord Claim for environmental clean-up ($45,973.00) and storage charges ($7,950.00).

Successively, the Trustee filed an objection to the Landlord Claim (the "Claim Objection"); the Landlord filed a response (the "Landlord Response") to the Claim Objection; the Trustee filed a Memorandum of Law (the "Trustee Memorandum") in support of the Claim Objection and in opposition to the Administrative Expense Motion; and the Landlord filed a Reply Memorandum of Law (the "Landlord Reply Memorandum").

In the Administrative Expense Motion, Landlord Response and Landlord Memorandum, the

[1] The Landlord Claim also indicated that a $3,000.00 security deposit had been applied against the items listed as (6) through (11), above.

Landlord asserted that: (1) the $43,973.00 estimated cost to clean up the construction debris dumped by the Debtor at the leased premises, the oil spill on the parking lot and the removal of storage tanks and containers containing waste oil and other hazardous substances, should be allowed and paid as an administrative expense in accordance with the decision of the United States Supreme Court in *Midlantic National Bank v. New Jersey Department of Environmental Protection*, 474 U.S. 494 (1988) ("*Midlantic*") and its "progeny", including the decision of the United States Court of Appeals for the Second Circuit in *In re Chateaugay Corp.*, 944 F.2d 997 (2d Cir. 1991), ("*Chateaugay*") because these conditions, caused by the actions of the Debtor, violated federal, state or local environmental laws or regulations reasonably designed to protect the public health or safety; (2) the proposed $25.00 per day per item charge for storage of the personal property left by the Debtor at the leased premises, which the Landlord was directed by the Trustee not to remove, was a reasonable storage fee, the storage and expense were necessary to preserve property of the estate and, therefore, the storage and expense incurred benefited the estate within the meaning of Section 503(b)(1); (3) the Landlord's loss and damage from theft, property damage, and environmental clean-up costs were not damages resulting from the termination of the lease within the meaning and intent of Section 502(b)(6), and, therefore, were not subject to the cap provided for by that subsection, but were damages in addition to the lease termination damages of accelerated rents; and (4) pursuant to the terms of the lease, the Court should award the Landlord attorney's fees in connection with the enforcement of his rights.

In his Claim Objection and Trustee Memorandum, the Trustee asserted that: (1) he had no objection to the Landlord Claim to the extent of prepetition rent in the amount of $18,123.74, which

was recoverable in accordance with Section 502(b)(6)(B); (2) post-petition accelerated rent due in accordance with Section 502(b)(6)(A) should be limited to $34,517.35, the rent due under the lease for the one year period from November 23, 1995, the day after the filing of the petition, through November 22, 1996, less the $4,000.00 paid to the Landlord as administrative rent for the period from November 23, 1995 to December 31, 1995; (3) the $53,923.00 claimed by the Landlord as estimated clean-up costs for alleged environmental hazards and storage fees for a tank and trailer left at the leased premises while the Trustee investigated their value and saleability, were not proper administrative expenses or priority claims under Sections 503(b)(1)(A) or Section 507(a)(1), but were merely additional damages of the Landlord resulting from the termination of the lease within the meaning of Section 502(b)(6), and, therefore, were subject to and part of the capped Section 502(b)(6) claim in the amount of $34,517.35; (4) the $45,973.00 claimed by the Landlord as estimated clean-up costs, if not part of the damages capped by Section 502(b)(6) were, nevertheless, not properly allowable as administrative expenses pursuant to Section 503(b)(1)(A) as actual, necessary costs and expenses of preserving the estate because: (a) contrary to the facts of *Midlantic*, the property in question was leased, and not owned, by the Debtor, the Trustee was not seeking to abandon the property, the property had been rejected pursuant to the Bankruptcy Code, and the property had been surrendered to the Landlord in accordance with Section 365(d)(4), prior to the appointment of the Trustee; and (b) unlike *Midlantic,* the conditions at the leased property might not even be in violation of CERCLA (42 U.S.C. Section 9601, et seq.); (5) the $7,009.00 in property damage claims were also nothing more than claims for damages resulting from the termination of the lease, and, therefore, were subject to and part of the capped Section 502(b)(6) claim in the

amount of $34,517.35; (6) the estimates for environmental clean-up appeared excessive; (7) the requested storage fees for a tank and trailer left on the leased premises, which did not otherwise interfere with the operation of the leased premises at which there had not been a replacement tenant, were excessive; (8) the Landlord's request for attorney's fees, even if granted by the Court, were clearly damages from the termination of the lease and would be part of the capped Section 502(b)(6) claim, and were otherwise unreasonable and excessive on all of the facts and circumstances; (9) unlike *Chateaugay*, which held that claims for CERCLA response costs are pre-petition claims so long as the release or threatened release occurred pre-petition, but that post-petition clean-up costs actually incurred by the EPA or other governmental agencies were administrative expenses, no clean-up costs have been incurred by any governmental agencies in this case in connection with the conditions at the leased premises; and (10) the Landlord Claim for estimated environmental clean-up costs was a claim for reimbursement which was contingent as of the time of allowance or disallowance within the meaning of Section 502(e)(1)(B), and therefore, should be disallowed.

DISCUSSION

I. ENVIRONMENTAL CLEAN-UP COSTS AS ADMINISTRATIVE EXPENSE.

In the Rochester Division of the Bankruptcy Court for the Western District of New York, there has evolved a required practice and procedure for addressing the issue of abandonment by trustees of property owned by the estate where there are environmental concerns. In light of the *Midlantic* and *Chateaugay,* this Court has required trustees who propose to abandon property with environmental concerns to: (1) contact the responsible federal, state and local regulatory agencies;

(2) have those agencies determine whether there is any actual imminent danger to the public health or safety; (3) develop a plan with the regulatory agencies to eliminate or minimize any actual imminent danger to the public health or safety; and (4) request that the Court allow the Trustee to fund, from any available estate assets, the amounts necessary under the developed plan to eliminate or minimize any such actual imminent danger. Beyond ensuring that imminent danger to the public health or safety is minimized or eliminated to the extent possible, the Court generally allows abandonment once this procedure has been followed.

On the facts of this case, even if the conditions created by the Debtor pre-petition at the leased premises violate federal, state or local environmental laws or regulations, it does not appear that the conditions present any imminent danger or serious risk of harm to the public health or safety, because : (1) no allegation has been made by the Landlord that the conditions at the leased premises present any actual imminent danger or serious risk of harm to the public health or safety; (2) no allegation has been made by the Landlord that it has reported the conditions at the leased premises to the responsible federal, state or local authorities, which clearly it would do, and under some statutes and regulations has an obligation to do, if the Landlord believed that there was in fact any imminent danger or serious risk of harm to the public health or safety; (3) over one year has expired between the Debtor's surrender of the premises to the Landlord and the Administrative Expense Motion, during which time no clean-up has been done by the Landlord or required by any governmental agency, indicating that the conditions at the leased premises present no actual imminent danger or serious risk of harm to the public health or safety.

In his decision in *In re McCrory Corporation*, 180 B.R. 763 (Bankr. S.D.N.Y. 1995),

Bankruptcy Judge Cornelius Blackshear sets forth a thorough overview of the existing case law concerning whether environmental clean-up costs for leased property resulting from the pre-petition actions of a debtor-tenant, which has rejected its lease of the property and no longer operates at the property, are allowable administrative expenses. In that decision, the Court concluded that where leased property is no longer property of the estate and where the Court determines that the debtor or trustee would have been allowed to abandon the property, if it had been owned by the estate, without taking any steps to clean-up the property or to eliminate or minimize imminent and identifiable harm to the public health or safety, any environmental clean-up costs resulting from the Debtor's pre-petition actions are not entitled to administrative expense priority. *In re McCrory Corp.*, 180 B.R. at 769.

Adopting Judge Blackshear's analysis in *In re McCrory Corporation,* this Court, in its discretion, does not believe that the Landlord's request for the payment of estimated clean-up costs in the amount of $53,923.00 should be allowed as an administrative expense, because: (1) whether and to what extent the pre-petition actions of the Debtor have violated federal, state or local environmental laws or regulations has not been fully determined; (2) the alleged hazardous conditions at the leased premises resulted from the pre-petition actions of the Debtor; (3) the leased premises are no longer property of the estate because the lease was rejected by operation of the Bankruptcy Code and the premises were surrendered to the Landlord prior to the appointment of the Trustee; (4) there has been no showing that the conditions at the leased premises caused by the pre-petition actions of the Debtor present any imminent danger or serious risk of harm to the public health or safety; (5) this Court, on all of the facts and circumstances before it and as discussed above,

would have allowed the Debtor or the Trustee, if the Debtor were the owner of the leased premises, to abandon the premises without the requirement that the conditions in question be rectified, since they do not appear to present any imminent danger or risk of harm to the public health or safety; and (6) the payment of such costs would not otherwise benefit the estate or preserve its assets.

II. ACTUAL DAMAGES TO THE LEASED PREMISES

Paragraph 7 of the lease between the Debtor and the Landlord provides in part that:

> "Tenant will take good care of the demised premises, make all repairs to preserve said premises and to keep all improvements in good order and condition, pay the expense of said repairs, and suffer no waste or injury, ordinary wear and tear excepted. Tenant will not disfigure or deface any part of the building. Upon the expiration or termination of this lease, all improvements shall be surrendered to the Landlord in good condition."

Paragraph 8 of the lease provides in part that:

> "Tenant shall comply with all laws, rules, orders, ordinances and regulations at any time issued or in force applicable to the demised premises or to tenant's occupation thereof, of the federal, state and local governments and each and every department, bureau and official thereof. It is understood that this provision will be strictly enforced; the violation thereof shall result in prompt termination of the leasehold agreement, consequential damages, and all other remedies provided to the landlord herein."

The above lease provisions appear to provide for damages to the Landlord for physical damage to the premises and for the breach of maintenance and repair covenants.[2] In this Court's opinion, such claims for pre-petition physical damage to the premises and for the breach of maintenance and repair covenants are not lease termination damages or future rent and, therefore,

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[2] As such, they are not contingent claims for reimbursement under Section 502(e)(1)(B).

are not subject to the cap of Section 502(b)(6)[3]. *See In re Atlantic Container Corp.*, 133 B.R. 980

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[3] Section 502(b)(6) provides that:

(b) Except as provided in subsections (e)(2), (f), (g), (h) and (i) of this section, if such objection to a claim is made, the court, after notice and a hearing, shall determine the amount of such claim in lawful currency of the United States as of the date of the filing of the petition, and shall allow such claim in such amount except to the extent that–

(6) if such claim in the claim of a lessor for damages resulting from the termination of a lease of real property, such claim exceeds–

(A) the rent reserved by such lease, without acceleration, for the greater of one year, or 15 percent, not to exceed three years, of the remaining term of such lease, following the earlier of–

(i) the date of the filing of the petition; and

(ii) the date on which such lessor repossessed, or the lessee surrendered, the leased property; plus

(B) any unpaid rent due under such lease, without acceleration, on the earlier of such dates.

(Bankr. N.D.Ill. 1991).[4]

III. <u>SECTION 502(b)(6) CLAIM</u>

The parties disagree as to whether the $4,000.00 paid by the estate to the Landlord as an administrative expense and as post-petition rent should reduce the finally determined claim pursuant to the formula in Section 502(b)(6), and also disagree as to the beginning date for the computation of the one-year period under Section 502(b)(6)(A).

The statute is clear that the beginning date for the computation of the time frame in the Section 502(b)(6) formula is the <u>earlier</u> of the date of the filing of the petition or the date of the surrender of the property. In this case, the beginning date is clearly the date of the filing of the petition on November 22, 1995. As to whether the capped Section 502(b)(6) claim should be reduced by the post-petition rentals paid by the estate, this Court holds that although such rental reduces the overall damage claim that the landlord has because of the termination of the lease, the rental does not reduce the allowable capped Section 502(b)(6) claim if the total damages suffered after deduction of the post-petition rentals still exceed the appropriate capped claim. In this case, the Landlord has overall lost rental damages, measured from the date of the petition and after

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[4] I have read the decision of Chief Bankruptcy Judge Larry E. Kelly in *In re Mr. Gatti's, Inc.*, 162 B.R. 1004 (Bankr. W.D.Tex. 1994); and agree that it is "a particularly thoughtful bankruptcy court opinion," *see Matter of Austin Development Co.*, 19 F.3d 1077, 1082, footnote 9 (5th Cir. 1994). However, I believe that the decision of now United States District Judge David H. Coar in *In re Atlantic Container Corp.* is more persuasive. Particularly relevant to this case is the following quote from that decision: "this court declines to impose such a result absent a clear and unambiguous direction from Congress, especially where, as here, it is alleged that at least some of the damage to the premises was intentional." *In re Atlantic Container Corp.* 133 B.R. at 988. Furthermore, including such damages within the Section 506(b)(6) cap does not adequately deal with cases where actual physical damage may exceed the capped claim.

reduction by the post-petition rentals, from the termination of the lease which substantially exceed the capped claim which equates to the rent reserved under the lease for the year following the date of the filing of the petition. *See In re Atlantic Container Corp.*, 133 B.R. at 990.

IV. FURTHER PROCEEDINGS

Having decided that the alleged environmental clean-up costs included in the Landlord Claim are not allowable as administrative expenses, and that claims by reason of pre-petition physical damage to the leased premises and breach of maintenance and repair covenants are not lease termination damages subject to the cap of Section 502(b)(6), this Court believes that it will be necessary to conduct evidentiary hearings in connection with the Administrative Expense Motion and the Claim Objection so that the Court can finally determine the reasonable value of claimed storage charges and an allowable amount of the Landlord Claim.

As previously discussed, in his Claim Objection and Trustee Memorandum, the Trustee asserted that the estimates for environmental clean-up, the requested storage charges and the requested attorney's fees, if recoverable, were excessive. However, understandably the Trustee did not further pursue the reasonableness of these items or of the other physical damage claim items, pending the Court's decision on whether they were subject to the cap of Section 502(b)(6).

In the event that the parties are unable to otherwise settle the pending Administrative Expense Motion and the Claim Objection based upon this Decision & Order, these matters shall be placed on the Court's May 21, 1997 Evidentiary Hearing Calendar to set an evidentiary hearing date to determine a reasonable storage charge to be allowed as an administrative expense, as well the landlord's allowed unsecured claim.

CONCLUSION

The Administrative Expense Motion is denied except to the extent of reasonable storage charges for a tank and trailer left at the leased premises, which shall be determined either by the agreement of the parties or by a further evidentiary hearing. The Administrative Expense Motion and the Trustee's Claim Objection shall be called at the Court's Evidentiary Hearing Calendar at 9:00 a.m. on May 21, 1997.

IT IS SO ORDERED.

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

Dated: May 8, 1997