

**UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF NORTH CAROLINA
DURHAM DIVISION**

In Re:)	
)	
E-Z Serve Convenience Stores, Inc., <u>et al.</u>)	Case No. 02-83138 - 11D
)	(Jointly Administered)
Debtors.)	
<hr/>)	

ORDER

This matter came on before this court to consider the Application by Frances Bowles for allowance and payment of administrative expense and attorney compensation as to Store 4224. Appearing before the court was Josiah E. Hutton, attorney for Frances Bowles, John A. Northen, attorney for the Trustee, Lisa P. Sumner, attorney for the Unsecured Creditors Committee and Michael D. West, Bankruptcy Administrator. After considering the matters set forth therein and the record in the case, the Court makes the following findings of fact and conclusions of law:

FACTS

E-Z Serve Convenience Stores, Inc., E-Z Serve Corporation, SSCH Holding Corp., Swifty Serve, LLC, and Swifty Serve Holding Corp. (collectively the "Debtors") commenced their respective reorganization cases by filing voluntary petitions for relief under Chapter 11 of the Bankruptcy Code on October 4, 2002. This Court ordered that the cases be administered jointly on October 7, 2002. On October 18, 2002, upon motion by the Debtors, Richard M. Hutson, II (the "Trustee") was appointed to serve as the Chapter 11 trustee for all of the Debtors.

Prior to the petition date, the Debtors had operated a convenience store business through direct ownership, indirect ownership and the lease of stores located in states throughout the

Southeast. At the time of the bankruptcy filing, the Debtors owned approximately 197 store locations and leased approximately 454 other locations. GE Capital Franchise Finance Corporation ("GE Capital") held a claim against the Debtors in an aggregate principal amount of approximately \$113 million secured by liens on a significant number of the Debtors' owned properties and equipment. In addition, the Debtors were indebted to CIT Group/Business Credit Inc., the secured inventory lender, in the amount of approximately \$17 million, with an additional exposure of approximately \$4.1 million arising from outstanding stand-by letters of credit.

On the date of the filing, the Debtors had insufficient funds to pay accrued payroll or withholding taxes. None of the landlords had been paid rent for the month of October and certain landlords had not received their prepetition September rent or other amounts due under their leases, including property taxes and late fees. In view of the lack of operating funds, the Trustee retained National Real Estate Clearinghouse, Inc. ("NRC") to coordinate and supervise a public sale of all fee properties and saleable leasehold interests. The Trustee also negotiated a post-petition credit facility with GE Capital to provide funds sufficient to protect and preserve the estate properties during the liquidation process.

On November 26, 2002 the court entered an Order granting the Trustee's motion to reject numerous unexpired real property leases, including the lease for Store 4224 (the "Lease") located at 132 W. Main Street in Autauga County, Prattville, Alabama. Frances P. Bowles ("Bowles") is the successor in interest to the lessor under the Lease. The Lease provides that the Lessee reimburse the Lessor for any increase in ad valorem taxes subsequent to the initial assessment in 1974. The Lease does not address the payment of taxes upon termination. On February 26, 2003 Bowles filed an application for payment of administrative expenses pursuant to 11 U.S.C. §

365(d)(3) in the amount of \$1,914.24, including post-petition rent of \$1,450 and ad valorem taxes of \$464.24 for the year 2002. Bowles had paid the ad valorem taxes in full on October 11, 2002. The parties agree as to the amount of rent due and, on April 15, 2003, an order was entered directing the Trustee to pay the rent accordingly. As to the taxes, the Trustee and the Unsecured Creditors' Committee ("Committee") contend that only those taxes attributable to the time period between the petition date and the lease rejection date should be paid as a cost of administration. In contrast, Bowles contends that the entire amount of the 2002 taxes should be paid as an administrative claim because the taxes were due and paid post-petition and prior to the lease rejection. While the dollar amount at issue for this particular store is small, the Debtor has rejected in excess of 75 leases.

DISCUSSION

There is a clear split of authority on the issue of whether the language of § 365(d)(3) requires a debtor to pay the full amount of any ad valorem taxes due or a prorated amount when a debtor is obligated under a lease to pay real estate taxes and the yearly taxes become due post-petition and pre-rejection of the lease. Prior to the 1984 enactment of § 365(d)(3), the payment of post-petition lease obligations was governed by 11 U.S.C. § 503(b)(1) which allows payment of the "actual, necessary costs and expenses of preserving the estate" as administrative expenses. Section 365(d)(3) provides, in relevant part, as follows:

The trustee shall timely perform all the obligations of the debtor, except those specified in section 365(b)(2), arising from and after the order for relief under any unexpired lease of nonresidential real property, until such lease is assumed or rejected, notwithstanding section 503(b)(1) of this title.

11 U.S.C. § 365(d)(3). Courts are divided as to whether the language of § 365(d)(3) is

ambiguous as to when an "obligation" of the debtor "arises" and therefore, disagree as to its meaning.

The Third Circuit Court of Appeals, along with numerous lower courts, has held that under § 365(d)(3), a debtor under a nonresidential property lease must pay in full all obligations which are due during the post-petition, pre-rejection period, regardless of when those charges accrued. See e.g., In re Montgomery Ward Holding Corp., 268 F.3d 205 (3rd Cir. 2001); In re Valley Media, Inc., 290 B.R. 73 (Bankr. D. Del. 2003); In re Krystal Co., 194 B.R. 161 (Bankr. E.D. Tenn. 1996); see also In re Koenig Sporting Goods, Inc., 203 F.3d 986 (6th Cir. 2000) (lease payments due during the post-petition, pre-rejection period must be paid in full). This view is based upon a finding that § 365(d)(3) is not ambiguous and means exactly what the plain language states, therefore the debtor must continue to perform all obligations when the legally enforceable duty to perform arises under the lease. See In re Montgomery Ward Holding Corp., 268 F.3d at 210. In In re Valley Media, Inc., the court reasoned:

When § 365(d)(3) was adopted numerous courts concluded that the section effectively did away with the "benefit to the estate" test of § 503(b)(1). However, § 365(d)(3) does not say that in so many words. Indeed, it makes a broader statement than that. It calls for the pre-rejection period timely performance of lease obligations "notwithstanding section 503(b)(1)". In other words, § 365(d)(3) effectively reads: "forget what § 503(b)(1) says" when the issue is pre-rejection period obligations of a nonresidential real estate lease. Consequently, § 365(d)(3) can be read to say that aside from administrative expenses provided for in § 503(b)(1), § 365(d)(3) creates a new and different kind of "obligation"--one that does not necessarily rest on the administrative expense concept.

In re Valley Media, Inc., 290 B.R. at 77-76 (citations omitted).

In contrast, many courts, including the Seventh Circuit Court of Appeals, have held that real property taxes must be prorated, regardless of the actual billing date. See e.g., In re Handy

Andy Home Improvement Centers, Inc., 144 F.3d 1125 (7th Cir. 1998); In re Phar-Mor, Inc., 290 B.R. 319 (Bankr. N.D. Ohio 2003); In re Trak Auto Corp., 277 B.R. 655 (Bankr. E.D. Va. 2002) In re McCrory Corp., 210 B.R. 934 (S.D.N.Y. 1997); In re Best Products, Inc., 204 B.R. 404 (Bankr. E.D. Va. 1997); In re Child World, Inc., 161 B.R. 571 (S.D.N.Y. 1993).¹ This line of cases finds the language of § 365(d)(3) ambiguous because an “obligation” can “arise” either when it becomes due and payable, or as it accrues. In re Phar-Mor, Inc., 290 B.R. at 324. Courts that find the language of § 365(d)(3) ambiguous look to bankruptcy policy and principles of equity and fairness to support a finding that the debtor’s obligations become post-petition obligations only as they accrue during the post-petition, pre-rejection period. In addition, many courts reason that there is nothing in the legislative history to indicate that Congress intended to change the “long-standing practice” prior to the enactment of section 365(d)(3) of prorating rent under section 503(b)(1) to cover only the post-petition, pre-rejection period, regardless of the billing date. See e.g., In re Child World, Inc., 161 B.R. at 575-76.

This court finds that prorating the ad valorem taxes is the better, more reasoned approach. If section 365(d)(3) were interpreted to give priority to payment of the entire amount of the tax obligation paid by a landlord post-petition, regardless of the fact that the majority of this tax obligation accrued prepetition, the court would be granting the landlord a windfall at the expense of other prepetition creditors. Certainly, charges that accrue post-petition must be elevated to administrative priority under § 507(a); however, taxes which accrue prepetition must be paid pro

¹ The Fourth Circuit Court of Appeals has not addressed this issue. In an unpublished opinion, the court adopted the billing date approach as to rent which became due after the petition was filed, but ad valorem taxes were not an issue. In re Roses Stores, Inc., 1998 WL 393984 (4th Cir. 1998).

rata, along with all other unsecured prepetition creditors. This approach is consistent with the priority and distribution scheme of the Bankruptcy Code which places all unsecured prepetition creditors on equal footing.

For the reasons stated herein, the court denies Bowles' Application for payment of all 2002 ad valorem taxes on Store 4224 to the extent that such taxes are not attributable to the time period between the petition date and the date the lease was rejected.

This the 13th day of May 2003.

CATHARINE R. CARRUTHERS
Catharine R. Carruthers
United States Bankruptcy Judge