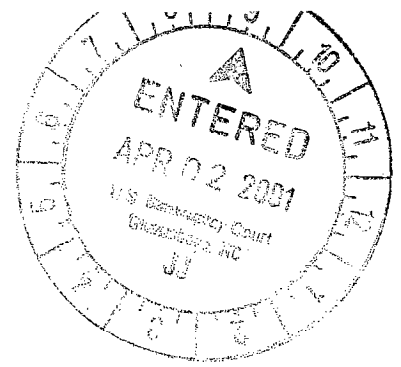


UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF NORTH CAROLINA
WINSTON-SALEM DIVISION



IN RE:

FAMCO, Inc.,

Debtor.

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Case No. 99-51952C-11W

ORDER

This case came before the court on March 1, 2001, for hearing upon Debtor's objection to claim number 133 filed by Welders Supply in the amount of \$82,737.63. C. Edwin Allman, III appeared on behalf of the Debtor. Jennifer A. Youngs and Richard B. Fennell appeared on behalf of Welders Supply.

FACTS

Welders Supply filed its proof of claim as including a \$71,972.04 general unsecured claim and a \$10,765.59 administrative expense claim. The unsecured claim consists of pre-petition indebtedness for industrial gases that were supplied to Debtor prior to the filing of this case. The administrative expense claim involves forty-seven cylinders that Welders Supply alleges were lost by the Debtor. The Debtor does not object to the general unsecured claim. However, Debtor objects to the allowance of an administrative expense claim on the grounds that it returned all cylinders which were in its possession on the petition date or received after the petition was filed and that Welders Supply therefore at most is entitled to include the value of any missing cylinders in its general unsecured claim.

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According to the Welders Supply proof of claim, Welders Supply sold various industrial gases to the Debtor for approximately five years prior to the Debtor filing its Chapter 11 petition. These gases were delivered in metal cylinders that were leased to Debtor by Welders Supply. Welders Supply typically delivered and picked up a large number of cylinders each month. The delivery and pick up of cylinders were made at various times throughout the month. Each time Welders Supply delivered and picked up cylinders, a representative of Welders Supply prepared a delivery ticket and a packing slip on which was noted the number of cylinders delivered and the number picked up. Copies of the delivery tickets and packing slips were left with the Debtor. Welders Supply invoiced the Debtor for the gases as the deliveries were made throughout the month. The Debtor was invoiced on a monthly basis for the rental of the cylinders in the possession of the Debtor. The Prepaid Cylinder Rental Agreement, which the parties signed at the outset of their business relationship, provides that Debtor shall reimburse Welders Supply for any cylinders not returned upon termination of the rental agreement.¹

¹"In case any of the Rented Cylinders are lost or destroyed by [Debtor] for any cause whatever, [Debtor] shall pay [Welders Supply], on demand, a sum in an amount not exceeding . . . [Welders Supply's] established list prices for comparable cylinders Rented Cylinders not returned to [Welders Supply] within six months after the expiration or other termination of this Agreement shall be conclusively presumed to be lost." Exhibit 5, Prepaid Cylinder Rental Agreement, Paragraph 6.

The Debtor filed for relief under Chapter 11 on October 28, 1999. Welders Supply was notified of the filing, along with Debtor's other creditors. The Debtor and Welders Supply continued to conduct business in the same manner as they had prior to the filing of the petition. This occurred without the Debtor assuming the lease agreement and without Welders Supply requesting that the Debtor do so.

In February of 2000, the Debtor ceased buying gases from Welders Supply, but did not return all of the cylinders at that time because some of the cylinders still contained gas. According to the testimony of Joan Williams, Debtor's purchasing agent, she requested in April of 2000 that Welders Supply perform a physical inventory of the cylinders in the possession of the Debtor. At some later date,² a representative of Welders Supply, Mr. Bobby Kale, and two employees of the Debtor inventoried the cylinders. According to Joan Williams, Mr. Kale identified the cylinders which belonged to Welders Supply and he was given all that he claimed, even though some of the cylinders that he claimed had another vendor's name on them. Welders Supply maintains that the Debtor

²Mr. Bobby Kale of Welders Supply testified that he performed the inventory some 2 to 3 weeks after the April request, while Ms. Joan Williams testified upon behalf of the Debtor that the physical inventory occurred on June 2, 2000. While the actual date of the inventory is not decisive in resolving the matter at hand, it seems likely that the inventory was conducted in June of 2000, since the invoice from Welders Supply to the Debtor for the missing cylinders is dated June 29, 2000.

failed to return forty-seven of its cylinders. The \$10,765.59 administrative expense claim of Welders Supply arises from the loss of these cylinders.

ANALYSIS

Section 503(a) of the Bankruptcy Code³ permits the filing of a request for the payment of an administrative expense,⁴ while § 503(b) specifies the various types of administrative expenses that may be allowed. Welders Supply bases its claim for an administrative expense upon § 503(b)(1)(A) which authorizes the allowance of an administrative expense for "the actual, necessary costs and expenses of preserving the estate" Guidance for interpreting and applying this provision is provided in a recent opinion by the Court of Appeals for the Fourth Circuit, In re Merry-Go-Round Enterprises, Inc., 180 F.3d 149 (4th Cir. 1999).

³All section number references made herein are to the United States Bankruptcy Code.

⁴An application for payment of an administrative expense is not properly asserted in a proof of claim. NL Indus. v. GHR Energy Corp., 940 F.2d 957 (5th Cir. 1991). Nevertheless, at least one court has recharacterized a proof of claim as an application for payment of administrative expenses under section 503(a). In re Parker, 15 B.R. 980 (Bankr. E.D. Tenn. 1981), aff'd, 21 B.R. 692 (E.D. Tenn. 1982). "The prudent practice, however, for a creditor unsure of the status of its claim is to timely file both a proof of claim and a separate request for payment of an administrative expense or to caption a single document in the alternative as a proof of claim or request for payment." 4 COLLIER ON BANKRUPTCY ¶ 503.02[1][a] (15th rev. ed. 2000). In the present case, the court will treat the proof of claim filed by Welders Supply as a request for payment of an administrative expense pursuant to § 503(a).

"Since there is a general presumption in bankruptcy cases that all of a debtor's limited resources will be equally distributed among creditors, § 503 must be narrowly construed." Id. at 157. "For a claim to qualify as an actual and necessary administrative expense, '(1) the claim must arise out of a post-petition transaction between the creditor and the debtor-in-possession (or trustee) and (2) the consideration supporting the claimant's right to payment must be supplied to and beneficial to the debtor-in-possession in the operation of the business.'" Id. at 157 (quoting from In re Stewart Foods, Inc., 64 F.3d 141, 145 n. 2 (4th Cir. 1995)).

The burden of proof is on the applicant to establish its entitlement to an award under 11 U.S.C. § 503(b) by a preponderance of the evidence. In re Merry-Go-Round Enterprises, Inc., 180 F.3d at 157; In re Dak Industries, Inc., 66 F.3d 1091, 1094 (9th Cir. 1995); In re Buttes Gas & Oil Co., 112 B.R. 191, 193 (Bankr. S.D. Tex. 1989); In re U.S. Lines, Inc., 103 B.R. 427, 429 (Bankr. S.D.N.Y. 1989). The burden of production shifts to the objector, after the applicant has presented a prima facie case. Buttes Gas & Oil, 112 B.R. at 193. However, the ultimate burden of persuasion remains with the applicant. Id. Moreover, the presumptive validity accorded properly filed proofs of claim under Bankruptcy Rule 3001(f) is not applicable to a request for payment of an administrative expense under § 503. In re Fulwood Enterprises, Inc., 149 B.R. 712, 715 (Bankr. M.D. Fla. 1993).

It is not disputed that the gases and cylinders supplied during the Chapter 11 case were essential to Debtor's business and hence constitute expenses that were necessary for the preservation of the estate for purposes of § 503(b)(1)(A). The dispute centers around whether the missing cylinders were possessed and used by the Debtor during the pendency of the Chapter 11 case. Stated another way, the decisive fact is whether the missing cylinders were lost before or after the petition date. In order to prevail on this issue, Welders Supply must show by a preponderance of the evidence that the cylinders in question were lost after the petition date, i.e., possessed by the Debtor during the Chapter 11 case and not returned to Welders Supply. This is clear from the statement in the Merry-Go-Round case that an administrative expense claim "must arise out of a post-petition transaction between the creditor and the debtor-in-possession. . . ." 180 F.3d at 157. See also United Trucking Service, Inc. v. Trailer Rental Co., 851 F.2d 159, 163 (6th Cir. 1987) (administrative expense claim not allowed because leased property that was stolen from debtor pre-petition was never in the debtor's possession post-petition and hence could not have benefitted the estate); In re Hanna, 168 B.R. 386 (B.A.P. 9th Cir. 1994) (post-petition cleanup costs resulting from contamination which occurred pre-petition do not qualify as an administrative expense under § 503); In re ICS Cybernetics, Inc., 111 B.R. 32, 37 (Bankr. N.D.N.Y. 1989) (administrative expense claim not allowed for leased

equipment that was sold, traded or stripped for parts before the petition was filed).

Welders Supply did not perform or request that the Debtor perform an audit or inventory of the number of cylinders in the possession of the Debtor on the petition date. In the absence of such an actual count of the cylinders, Welders Supply relied upon monthly cylinder rental invoices, delivery tickets and packing slips as establishing its administrative expense claim. The monthly cylinder rental invoices show, by item number, the number of cylinders in Debtor's possession at the start of each month, the number of cylinders shipped to the Debtor during the month, the number of cylinders returned by the Debtor during the month, and the number of unreturned cylinders at the end of the month.

The number of cylinders shipped to the Debtor and the number of cylinders returned by the Debtor during the month are derived from the delivery tickets and packing slips. The invoice number column on the monthly cylinder rental invoice shows the number of the delivery ticket or packing slip number on which a delivery of or return of cylinders was made. According to Welders Supply, a delivery ticket and packing slip were prepared each time a delivery of cylinders and/or return of cylinders occurred during the month. The delivery tickets and packing slips were presented to employees of the Debtor for Debtor's employees to sign and verify their agreement with the number of cylinders being delivered to the Debtor

and/or returned to Welders Supply.⁵ According to Debtor's President, the Debtor not did have a system in place for keeping track of the number of cylinders in its possession and simply went by the monthly cylinder rental invoices provided by Welders Supply.

The records offered by Welders Supply, prepared out of court and offered to prove the truth of their contents, constituted hearsay. Fed. R. Evid. 801(c). However, Rule 803(6) provides that certain records kept in the ordinary course of business are admissible as an exception to the hearsay rule. Rule 803(6) provides that a report, although hearsay, is admissible if it was "made at or near the time by . . . a person with knowledge, if kept in the course of a regularly conducted business activity, and if it was the regular practice of that business activity to make the [report] . . . all as shown by the testimony of the custodian or other qualified witness." Fed. R. Evid. 803(6). This rule has long recognized the "probability of trustworthiness of [such] records because they were routine reflections of the day to day operations of a business." Palmer v. Hoffman, 318 U.S. 109, 113-14, 63 S. Ct.

⁵In fact, all but 3 of the 38 delivery tickets and packing slips offered as Exhibit 2 contain the signature of a representative of the Debtor. See Exhibit 2, pp. 1-38. Additionally, 3 of these delivery tickets are duplicates. Specifically, Exhibit 2 contains duplicates of the following delivery ticket numbers: 237285, 237303, and 237314. For some unknown reason, Welders Supply did not supply all of the delivery tickets and packing slips which are reflected on the monthly cylinder rental invoices for the period October, 1999 through June, 2000.

477, 87 L. Ed. 645 (1943). The testimony of Bobby Kale, Welders Supply's sales manager, established that the records offered by Welders Supply satisfied the requirements of Rule 803(6). The records therefore were admitted into evidence.

Once admitted under the business records exception, the weight accorded to such records is left to the trier of fact. Crompton-Richmond Co., Inc., Factors v. Briggs, 560 F.2d 1195, 1202 (5th Cir. 1977) (weight accorded to business records is within the domain of the trier of fact); In re Sol Bergman Estate Jewelers, Inc., 225 B.R. 896, 901 (B.A.P. 6th Cir. 1998) (bankruptcy court was free to determine weight to be accorded to exhibits admitted under business records exception to hearsay rule); see also Paxton v. Union Nat'l Bank, 688 F.2d 552, 567 (8th Cir. 1982) (giving weight to defendant's "employment records which listed the reason why each employee with less than two years of service had been discharged"), cert. denied, 460 U.S. 1083 (1983).

The business records offered by Welders Supply were reliable evidence as far as they went. However, the records were insufficient to establish the administrative expense claim because they do not show that any loss of cylinders arose out of or occurred during the post-petition operations of the Debtor. The invoices and packing slips offered by Welders Supply show the number of cylinders received by the Debtor after the petition date and the number of cylinders that were returned after the petition date. However,

these records do not show that the Debtor received any cylinders after the petition date that were not returned to Welders Supply. In fact, the exhibits show that the Debtor actually returned many more cylinders after the petition date than were received after that date (518 cylinders were returned vs. 367 cylinders that were received after October 28, 1999).

In evaluating the evidence, the court gave particular consideration to the October 31, 1999 monthly rental invoice, which is the earliest invoice produced by Welders Supply and the invoice for the month in which the Debtor filed this case. This invoice reflects that the Debtor had received 195 cylinders prior to October 1, 1999, that had not been returned as of that date. However, this invoice does not show how many of the 195 cylinders remained in the Debtor's possession on October 1, 1999, or on any other date referred to in the invoice. Did the Debtor still have the 195 cylinders in its possession or had it lost 44 or some lesser number of them during five years of business which preceded October 1, 1999? Hence, while the October invoice was sufficient to show the number of cylinders that Debtor had received, it was not sufficient to show how many of those cylinders the Debtor still had in its possession on October 1, 1999. The October invoice shows that on October 28, 1999, the Debtor had received 195⁶ cylinders

⁶(195 unreturned cylinders as of 10/1/99) + (168 cylinders shipped to Debtor from 10/1/99- 10/28/99) - (168 cylinders returned by Debtor from 10/1/99-10/28/99) = 195 unreturned cylinders as of

that had not been returned as of that date and that there were 196⁷ unreturned cylinders as of October 31, 1999. However, as noted above, the invoice leaves the number of cylinders actually in Debtor's possession on those dates in the realm of speculation. This fatal shortcoming in Welders Supply's evidence is not remedied by the other exhibits. The November, 1999 monthly rental invoice reflects that 92 cylinders were shipped to Debtor and 92 cylinders were returned to Welders Supply during the month of November, 1999.⁸ Therefore, the number of unreturned cylinders remained at 196. The December, 1999 monthly rental invoice reflects that 125 cylinders were shipped to Debtor and 144 cylinders were returned to Welders Supply during the month of December, 1999,⁹ leaving 177 unreturned

10/28/99. An examination of the delivery tickets and packing slips admitted into evidence for the month of October shows that there were 196, not 195, unreturned cylinders on October 28, 1999. The discrepancy arises from delivery ticket number 227190, which is dated October 28, 1999, but shown on the monthly rental invoice with a transaction date of October 31, 1999. Presumably, the cylinders were actually delivered on October 28, 1999, but the Debtor was not invoiced for the delivery of those cylinders until October 31, 1999.

⁷(195 unreturned cylinders on 10/01/99) + (221 cylinders shipped to Debtor from 10/1/99- 10/31/99) - (220 cylinders returned by Debtor from 10/1/99-10/31/99) = 196 unreturned cylinders on 10/31/99.

⁸Welders Supply provided a delivery ticket or packing slip signed by the Debtor which supports all shipments and returns of cylinders reported on the November, 1999 monthly cylinder rental invoice. See Exhibit 1, p. 2 and Exhibit 2, pp. 4, 7-10.

⁹Welders Supply provided a delivery ticket or packing slip which supports all shipments and returns of cylinders reported on the December, 1999 monthly cylinder rental invoice. See Exhibit 1,

cylinders as of December 31. The January, 2000 monthly rental invoice reflects that 80 cylinders were shipped to Debtor and 79 cylinders were returned to Welders Supply during the month of January, 2000,¹⁰ reducing the number of unreturned cylinders to 178 cylinders as of January 31. The February, 2000 monthly rental invoice reflects that 17 cylinders were shipped to Debtor and 65 cylinders were returned to Welders Supply during the month of February, 2000,¹¹ resulting in the number of unreturned cylinders being reduced by 48 cylinders, leaving a total of 130 unreturned cylinders as of February 29, 2000. The March, 2000 monthly cylinder rental invoice reflects that no cylinders were shipped to Debtor and 47 cylinders were returned to Welders Supply during the month of

p. 3 and Exhibit 2, pp. 11-14, 17-18 and 20-21. In every instance, except for packing slip 80260 (Exhibit 2, p. 11), the delivery ticket or packing slip was signed by a representative of the Debtor.

¹⁰Welders Supply did not provide a delivery ticket or packing slip which supports all shipments and returns of cylinders reported on the January, 2000 monthly cylinder rental invoice. Only delivery ticket numbers 237190 and 237237 were offered and admitted as part of Exhibit 2. Delivery tickets 237206 and 23722 as well as packing slip 80143 are shown on the January, 2000 monthly cylinder rental invoice, Exhibit 1, p. 4, but were not offered as part of Exhibit 2.

¹¹Exhibit 2 contains a delivery ticket which supports all shipments and returns of cylinders reported on the February, 2000 monthly cylinder rental invoice. See Exhibit 1, p.5 and Exhibit 2, pp. 15-16, 26-27 and 29. In every instance, except for delivery ticket 237251 (Exhibit 2, p. 26), the delivery tickets were signed by a representative of the Debtor.

March, 2000,¹² resulting in the number of unreturned cylinders dropping to 83¹³ cylinders as of March 31, 2000. The April, 2000 monthly cylinder rental invoice reflects that no cylinders were shipped to Debtor and 14 cylinders were returned to Welders Supply during the month of April 2000,¹⁴ leaving 69 cylinders unreturned as of April 30, 2000. There were no cylinders shipped to or returned by the Debtor during May, 2000.¹⁵ Likewise, the final monthly cylinder rental invoice, dated June 30, 2000, reflects that no cylinders were shipped to Debtor during the month of June, 2000.

¹²Exhibit 2 contains delivery tickets which support all returns of cylinders reported on the March, 2000 monthly cylinder rental invoice. See Exhibit 1, p. 6 and Exhibit 2, pp. 31-34. In every instance, the delivery tickets were signed by a representative of the Debtor.

¹³The ending balances by item number per the March, 2000 monthly cylinder rental invoice sum to 85. See Exhibit 1, p. 6. The 2 cylinder discrepancy between the ending balance calculated based upon the prior month's ending balance less the number of cylinders returned during March and that shown on the March, 2000 cylinder rental invoice is due to the return of 1 empty cylinder of item number NI304 per delivery ticket 237434 and the return of 1 empty cylinder of item number OXL4500 on each of delivery ticket numbers 237303 and 237381. In the case of both item numbers, 1 more cylinder of each item number was returned to Welders Supply than Debtor had in its possession. This discrepancy was resolved in favor of the Debtor, with the Debtor getting credit for the return of 47 cylinders during the month of March, 2000. All of these delivery tickets were signed by a representative of Debtor.

¹⁴Exhibit 2 contains delivery tickets which support all cylinder returns shown on the April, 2000 monthly cylinder rental invoice. See Exhibit 1, p. 7 and Exhibit 2, pp. 35-36. In every instance, the delivery tickets were signed by a representative of the Debtor.

¹⁵Exhibit 1, p. 8.

The final monthly cylinder rental invoice indicates that 10 cylinders were returned to the debtor on invoice number 237766.¹⁶ However, reference to delivery ticket 237766 reveals that 11 cylinders were actually returned to Welders Supply on this delivery ticket.¹⁷ The June cylinder rental invoice also shows that 14 cylinders were returned to the debtor on invoice number 19893.¹⁸ Therefore, a total of 25 cylinders were actually returned by the Debtor to Welders Supply during June, 2000, leaving 44¹⁹ cylinders that were lost and not returned by the Debtor during the entire course of business between the Debtor and Welders Supply. The evidence did not show that any of the missing cylinders were possessed or used by the Debtor after the petition was filed or how many, if any, of the cylinders were lost post-petition. The evidence therefore was insufficient to show that the Welders

¹⁶Exhibit 1, p. 9.

¹⁷Exhibit 2, p. 37. The return of 1 cylinder of AMCD25125, shown on delivery ticket 237766, was erroneously omitted from the cylinder returns shown on the June, 2000 monthly cylinder rental invoice.

¹⁸This amount was traced to packing slip 19893 (Exhibit 2, p. 38) for verification.

¹⁹44 = (69 cylinders in possession of Debtor at 6/1/00) - (25 cylinders returned to Welders Supply on invoice 237766 and 19893 during June, 2000). The 3 cylinder discrepancy between the number of cylinders unaccounted for per this court's analysis, 44, and the number of cylinders unaccounted for per Welders Supply, 47, resulted from the fact that Welders Supply failed to credit Debtor for a total of 3 cylinders that were actually returned by Debtor but not properly accounted for on the monthly cylinder rental invoice. See infra notes 13, 17, and accompanying text.

Supply's claim arose out of the post-petition dealings between the Debtor and Welders Supply or that there was any benefit to the estate related to the missing cylinders. Welders Supply's claim pursuant to § 503(b)(1)(A) therefore must be denied.

IT IS SO ORDERED.

This 2nd day of April, 2001.

William L. Stocks

WILLIAM L. STOCKS
United States Bankruptcy Judge