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UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO

In re:)	Case No. 03-15009
)	
WESTCO GROUP INC.,)	Chapter 11
)	
Debtor.)	Judge Arthur I. Harris

MEMORANDUM OF DECISION

This matter is before the Court on the motion of the debtor in possession ("Westco") to reject unexpired leases of real property (Docket # 61), the objection thereto of CI-Ross Limited Partnership ("CI-Ross") and Cafaro Bradford Tuller Square ("Cafaro") (Docket #78), the supplemental objection of CI-Ross and Cafaro (Docket # 93), the supplemental brief of Westco (Docket # 94), and the parties' stipulations of fact (Docket # 98). The principal question raised in these filings is on what date shall Westco's rejection of the commercial leases with CI-Ross ("Chantry Lease") and Cafaro ("Tuller Lease") become effective. For the reasons explained below, the Chantry Lease and the Tuller Lease shall be deemed rejected as of June 11, 2003, the date on which Westco filed its motion to reject the leases.

FACTS

The facts relevant to Westco's motion are not in dispute. Westco operates over 30 retail stores in the Midwest and specializes in the sale of mattresses and

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bedroom furniture. In the months leading up to its petition filing, Westco defaulted on a number of its rental obligations for its retail stores. As a result of defaults on the Chantry Lease and the Tuller Lease, CI-Ross and Tuller informed Westco on October 8, 2002, that they were exercising the rights in their respective leases to terminate Westco's right of possession, but were not permitting or accepting a surrender of the leased premises. Two months later, Westco vacated the two leased premises. On December 7, 2002, Westco returned to CI-Ross and Tuller the keys to the facilities. On April 18, 2003, Westco filed a voluntary petition for relief under Chapter 11 of the United States Bankruptcy Code.

In its efforts to reorganize and restructure its business operations, Westco has moved to shed some of its unprofitable retail locations and to retain others that appear to be more profitable. To that end, on June 11, 2003, Westco filed motions to assume certain real estate leases and to reject others (Docket ## 61, 63). With respect to the leases proposed for rejection, Westco requested that the date of rejection be deemed the date that Westco vacated the property.¹

¹Although Westco's motion to reject these leases (Docket # 61) requests retroactive rejection only with respect to property vacated *post-petition*, this Court construes Westco's request to apply to property vacated *pre-petition* as well. This is consistent with the way that both parties have construed Westco's motion in their supplemental briefing.

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While conceding that Westco, as a debtor in possession, has authority to propose which unexpired leases to reject and which to assume or assign, CI-Ross and Tuller objected to Westco's position regarding the effective date of rejection. CI-Ross and Tuller argue that any rejection of the subject leases should be effective only upon the entry of a court order granting the motion to reject rather than on the date Westco vacated the leased premises.

After oral argument on July 8, 2003, the parties filed stipulations of fact and supplemental briefs. On August 1, 2003, the Court entered an Order granting Westco's motion to reject the Chantry and Tuller Leases, "with the reservation that the effective date(s) of rejection of each of the Leases remains undetermined." Order (Docket #103) at 2. This Memorandum of Decision addresses the issue left undetermined in that Order.

DISCUSSION

The Court has jurisdiction in this contested matter pursuant to 28 U.S.C. § 1334(b) and Local General Order No.84, entered on July 16, 1984, by the United States District Court for the Northern District of Ohio. This is a "core" proceeding pursuant to 28 U.S.C. § 157(b)(2)(A), (M), and (O).

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A trustee or debtor in possession² may assume or reject executory contracts and unexpired leases of the debtor. Section 365(a) of the Bankruptcy Code provides that a "trustee, subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor." In addition, the Bankruptcy Code provides a number of special protections for unexpired leases of nonresidential real property, including 11 U.S.C. § 365(d)(3). Section 365(d)(3) provides, in relevant part:

The trustee [or, as here, a debtor in possession with the powers and duties of a trustee, pursuant to § 1107(a)] 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, notwithstanding section 503(b)(1) of this title.

By its terms, section 365(d)(3) creates a special period in the course of a bankruptcy case—the period from the date that an order for relief is entered to the date that an unexpired lease of nonresidential real property is assumed or rejected. This period can be referred to as the "option phase" of the bankruptcy case—the period during which the debtor in possession or trustee, under the protection of the Bankruptcy Code, is allowed to decide whether or not a lease should be assumed.

² Pursuant to 11 U.S.C. § 1107(a), a Chapter 11 debtor in possession exercises the same rights that a trustee would exercise, including the right to assume or reject unexpired leases under 11 U.S.C. § 365(a).

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See In re UAL Corp., 291 B.R. 121, 124 (Bankr. N.D. Ill. 2003). Thus, section 365(d)(3) essentially operates to create an administrative claim upon the estate for costs associated with leases of nonresidential real property prior to formal rejection or assumption. *See, e.g., In re Thinking Machines Corp.*, 67 F.3d 1021, 1024 (1st Cir. 1995) (noting that section 365(d)(3) "requires the trustee . . . to pay rent under the lease at the contract rate unless and until he rejects it, and gives the landlord what amounts to a preference—in the form of an administrative claim—for such avails").

In applying section 365(d)(3) to the present case, the Court is faced with several questions:

1. Were there unexpired leases in existence as of the petition date?
2. Must there be a benefit to the estate for the landlord to recover under section 365(d)(3)?
3. When principles of equity dictate, may a bankruptcy court approve rejection of an unexpired lease retroactive to the motion filing date or some other date?
4. If court approval can be made retroactive, do principles of equity dictate that this Court approve rejection of these two leases retroactive to the motion filing date or some other date?

The Court will address each of these questions in order.

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1. Were there Unexpired Leases in Existence as of the Petition Date?

Westco contends that, because it vacated the two leased premises in December, 2002, and gave up any possessory interests in the premises, the leases were expired at the time the petition was filed on April 18, 2003. The Court rejects this argument for the same reasons that the Bankruptcy Court for the District of New Jersey rejected an analogous argument by the debtor in possession in *In re Slim Life Weight Loss Centers, Corp.*, 182 B.R. 701, 703-05 (Bankr. D. N.J. 1995).

"Generally, courts have looked to non-bankruptcy law to determine whether a lease was expired at the time the petition was filed." *Id.* at 703, *citing In re Windmill Farms, Inc.*, 841 F.2d 1467, 1469 (9th Cir. 1988). Because the Chantry Lease and the Tuller Lease provide that they shall be construed in accordance with Ohio law,³ the Court must look to Ohio law to determine if they expired prior to the petition date.

Under Ohio law, the tenant's vacation of the premises does not effect a

³See Exhibit A to Supplemental Objection of CI-Ross and Cafaro at 36; Exhibit C to Supplemental Objection of CI-Ross and Cafaro at 40 (Docket #93).

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surrender⁴ or termination of the unexpired lease. "An acceptance by the landlord of the key to the premises, his advertising for a new tenant, and renting the premises to another upon its vacation by the old tenant . . . are not sufficient to constitute a surrender." *Bumiller v. Walker*, 95 Ohio St. 344, 346 (1917). *See In re Fifth Avenue Jewelers, Inc.*, 203 B.R. 372, 378 (Bankr. W.D. Pa. 1996) (interpreting Ohio law regarding surrender of leased premises); *see also* 65 OHIO JUR. 3D *Landlord and Tenant* § 510 n.84 (1986) ("An acceptance by a lessor of the keys to leased premises tendered by the lessee before the expiration of the lease does not constitute an acceptance of the lessee's proffer of surrender, where, at the time of receiving back the keys, the lessor notifies the lessee that he is not accepting the surrender of the premises, or waiving any right he might have under the lease, but is taking possession for the purpose of preventing waste and deterioration, and of securing a tenant with the view to minimizing damages arising from the breach of the contract of lease."). *Accord In re Slim Life Weight Loss Centers*, 182 B.R. at 704 (construing Pennsylvania law similarly).

⁴ A "surrender of a tenancy for years or a lesser tenancy is a yielding up of the tenancy to the owner of the reversion or remainder, wherein the tenancy is submerged and extinguished by agreement or by operation of law." 65 OHIO JUR. 3D *Landlord and Tenant* § 505 (1986), citing 49 AM. JUR. 2D *Landlord and Tenant* § 1094 (1964).

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Nor did Westco's vacation of the premises effect a surrender or termination of the two unexpired leases under the provisions of the underlying leases.

Section 23 of the lease agreements with CI-Ross and Cafaro provide that, upon Westco's default,

[the] Landlord, besides other rights or remedies it may have, shall have the immediate right to terminate this Lease in which event Tenant shall have no further right, title or interest in or to either the Demised premises or this Lease, or to reenter with court order and attempt to relet without terminating the Lease No such reentry or taking possession of the Demised Premises by Landlord shall be construed as an election to forfeit its right to receive rental and other sums pursuant to this Lease unless notice of such intention be given to Tenant.

Exhibits A and C to Supplemental Objection of CI-Ross and Cafaro (Docket #93).

In written correspondence dated October 8, 2002, CI-Ross and Cafaro informed Westco that they were terminating Westco's right of possession to the leased premises, but "not terminating the Leases themselves, nor . . . permitting or accepting a surrender of the Lease for either location." Exhibit B to Supplemental Objection of CI-Ross and Cafaro (Docket #93).

Thus, in spite of turning over the keys, Westco did not terminate the leases when it vacated the premises. Rather, upon the filing of Westco's Chapter 11

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petition, section 365(d)(3) created a special period, during which the debtor in possession or trustee was allowed to decide whether or not a lease should be assumed. *See In re UAL Corp.*, 291 B.R. at 124. Even if Westco had expressly disavowed any interest in regaining possession of the leased premises before bankruptcy, as a debtor in possession it gained the right under the Bankruptcy Code to assume or assign its interest in the unexpired leases because the landlords had not agreed to a surrender or termination of the leases prepetition.

Concomitant with these rights, however, were Westco's postpetition obligations under section 365(d)(3) "to pay rent under the lease[s] at the contract rate unless and until [the trustee or debtor in possession] rejects [the leases]" and the court approves such rejection. *In re Thinking Machines*, 67 F.3d at 1024.

Congress intended § 365(d)(3) to shift the burden of indecision to the debtor: the debtor must now continue to perform all the obligations of its lease or make up its mind to reject it before some onerous payment comes due during the prerejection period.

In re Koenig Sporting Goods, Inc., 203 F.3d 986, 989-90 (6th Cir. 2000), quoting

In re Krystal Co., 194 B.R. 161, 164 (Bankr. E.D. Tenn. 1996). Accordingly, the

Court finds that both leases remained in existence as of the petition date.

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2. Must There Be a Benefit to the Estate for the Landlord to Recover under Section 365(d)(3)?

Westco contends that under Sixth Circuit case law there must be a benefit to the estate for the landlord to recover under section 365(d)(3). The Court rejects this argument. The express language of section 365(d)(3) indicates that the unexpired lease obligations are to be paid "notwithstanding section 503(b)(1) of this title." Thus, to the extent that Sixth Circuit case law requires a benefit to the estate in order for an administrative claim to be allowed under section 503(b)(1), such case law simply has no application to claims under section 365(d)(3), which are to be paid "notwithstanding section 503(b)(1) of this title." *See In re Koenig Sporting Goods*, 203 F.3d at 989 n.2. ("A debtor's obligations under § 365(d)(3) should not be analyzed by reference to the principles governing administrative claims under § 503(b)(1)."). The majority of courts which have considered this issue have reached the same conclusion. *See, e.g., In re Slim Life Weight Loss Centers*, 182 B.R. at 705 (affirming majority view that "obligations imposed by § 365(d)(3) prior to rejection are not contingent upon any occupancy of the property; rather, they depend only on the existence of an unexpired non-residential

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property lease")(internal quotes and citations omitted); *In re Brewer*, 233 B.R. 825, 829 (Bankr. E.D. Ark. 1999) (collecting cases). Therefore, CI-Ross and Cafaro need not show a benefit to the estate in order to recover under section 365(d)(3).

3. When Principles of Equity Dictate, May a Bankruptcy Court Approve Rejection of an Unexpired Lease Retroactive to the Motion Filing Date or Some Other Date?

Under the plain language of section 365(a), court approval is required for rejection of an unexpired lease. What is less clear, however, is whether the effective date of rejection for purposes of section 365(d)(3) is the date of the bankruptcy court's order approving rejection, or some other, earlier date. Courts faced with this issue have reached a variety of results. Some courts have held that the effective date of rejection is the date of the bankruptcy court's order approving rejection. *See, e.g., In re Federated Department Stores, Inc.*, 131 B.R. 808, 814-16 (S.D. Ohio 1991); *In re Revco D.S., Inc.*, 109 B.R. 264 (Bankr. N.D. Ohio 1989)(Judge White). Some courts have permitted the effective date of rejection retroactive to the motion filing date. *See, e.g., In re Thinking Machines,*

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67 F.3d at 1028 ("we rule that a bankruptcy court, when principles of equity so dictate, may approve a rejection of a nonresidential lease pursuant to section 365(a) retroactive to the motion filing date"); *In re At Home Corp.*, 292 B.R. 195, 203 (N.D. Cal. 2003)(retroactive rejection approved as of petition date where debtor filed motion to reject on petition date); *In re Amber's Stores, Inc.*, 193 B.R. 819, 827 (Bankr. N.D. Tex. 1996)(same); *In re CCI Wireless, LLC*, 279 B.R. 590, 595-96 (Bankr. D. Colo. 2002)(rejection approved retroactive to motion filing date where premises were vacated before petition date).

In deciding when the date of rejection should be effective under 11 U.S.C. § 365(d)(3), this Court believes that it has the authority to consider equitable factors. *See In re Thinking Machines*, 67 F.3d at 1028. *See also In re Koenig Sporting Goods*, 203 F.3d at 989-90 (finding that "equity as well as [§365(d)(3)]" favored full payment to landlord under the facts of that case). Therefore, absent controlling precedent from the Sixth Circuit, this Court will follow the reasoning of the First Circuit in *Thinking Machines* and hold that "when the principles of equity so dictate, [a bankruptcy court] may approve a rejection of a nonresidential

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lease pursuant to section 365(a) retroactive to the motion filing date." 67 F.3d at 1028.⁵

4. Do Principles of Equity Dictate That This Court Approve Rejection of These Two Leases Retroactive to the Motion Filing Date or Some Other Date?

Balancing the equities in this case convinces the Court that the effective date of rejection for the Chantry and Tuller Leases should be June 11, 2003, the date that Westco filed its motion to reject (Docket #61). In deciding this issue, the Court has considered a variety of equitable factors.

First, as the Sixth Circuit and other courts have noted, Congress intended section 365(d)(3) to shift the burden of indecision to the trustee or debtor in possession. The trustee or debtor in possession must now continue to perform all the obligations of its lease or make up its mind to reject the lease before some onerous payment comes due during the prerejection period. *See In re Koenig Sporting Goods*, 203 F.3d at 989-90 (*quoting In re Krystal Co.*, 194 B.R. at 164).

⁵ The Court need not decide whether it has the equitable authority to approve a rejection retroactive to a date before the motion filing date. This is because the equities in the present case do not dictate the Court approve a rejection retroactive to any date earlier than the motion filing date.

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Therefore, to the extent there was uncertainty as to the existence of unexpired leases when Westco filed for relief under Chapter 11, it was incumbent upon Westco as debtor in possession to act quickly in the face of such uncertainty, because only Westco was in a position to exercise its right to assume or reject the leases under the Bankruptcy Code. Indeed, nothing prevented Westco from moving on the first day of the petition to reject those leases for which the property had been vacated months earlier. Westco has not explained why it waited until nearly two months after the petition date to request authority to reject the leases. Furthermore, Westco enjoyed the option of assuming or rejecting those leases during the interim months, while CI-Ross and Cafaro had no similar option. The Bankruptcy Code does not permit a creditor landlord to terminate the right of a debtor in possession to accept, assume, or reject leases under section 365.

Although Westco's delay in filing a motion to reject these leases militates against making the rejection date retroactive to the petition date, other factors do weigh strongly in favor of moving the rejection date retroactive to the date Westco filed its motion on June 11, 2003. Both before and after the filing of the

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bankruptcy petition, all the parties involved seemed to operate under the impression that Westco intended to reject all possessory interests in these two leases. In the schedules that accompanied its petition, Westco did not list either lease as an executory contract or unexpired lease, thus suggesting that it never had any intention of assuming or assigning the leases. Furthermore, although a showing of benefit is not necessary to recovery under section 365(d)(3), these leases did not provide any benefit to the estate after Westco had surrendered the keys.

Moreover, once Westco filed its motion to reject, CI-Ross and Cafaro could no longer treat Westco's inaction as uncertainty about whether Westco wanted to assume or assign the leases. Nor did these landlords appear to have relied to their detriment on any uncertainty that Westco would move postpetition to assume or assign the Tully Lease or the Chantry Lease. Indeed, in an effort to mitigate damages, CI-Ross successfully relet the premises of the Chantry Lease to a third party on May 11, 2003.⁶ These equitable factors, taken collectively, convince the

⁶ The Court is aware that under this ruling, CI-Ross may be entitled to an administrative expense claim even though it was also receiving rent from a new

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Court that the dates of rejection should be made retroactive to the date Westco filed its motion.

The Amounts of the Administrative Claims under Section 365(d)(3)

The Court does not decide in this opinion the specific amounts that CI-Ross and Cafaro may recover for their administrative expense claims.⁷ The fact stipulations filed with the Court do not provide information from which the Court can readily determine the proper amount of the administrative claims. *See In re Koenig Sporting Goods*, 203 F.3d at 989-90 (in month-to-month payment-in-advance lease, debtor was obligated to pay full month's rent when rejection was made one day after debtor's monthly rent obligation would normally arise).

Accord Ha-Lo Indus., Inc. v. Center Point Props. Trust, ___ F.3d ___,

2003 U.S. App. LEXIS 18165 (7th Cir. Sept. 3, 2003) (following *Koenig*). The

tenant. Such rent, however, will help mitigate any prepetition claim for breach contract that CI-Ross may assert against Westco, and will not result in a windfall to CI-Ross. Indeed, to penalize CI-Ross for its successful efforts to mitigate damages would essentially discourage the party in the best position to mitigate damages, the landlord, from taking action that would benefit both landlord and tenant.

⁷ Nor does the Court make any determination regarding either landlord's potential prepetition claim for breach of contract.

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Court herein holds only that the leases are deemed rejected as of the date of the motion filing, June 11, 2003. In the event that the parties are unable to agree as to what amount CI-Ross and Cafaro can claim as administrative expenses under section 365(d)(3), the creditors should file requests for payment of administrative claims. Westco can then file its objections, and the claims will be set for further review by the Court.

CONCLUSION

For the foregoing reasons, the Chantry Lease and the Tuller Lease shall be deemed rejected as of June 11, 2003, the date that Westco filed its motion to reject the leases.

IT IS SO ORDERED.

/s/ Arthur I. Harris 10/03/2003
Arthur I. Harris
United States Bankruptcy Judge