UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA
THIRD DIVISION

In re:
Nelson's Office Supply Stores, Inc.
BKY No. 3-94-5237

Debtor. Chapter 11 Case

This matter came on for hearing on Debtor's Objection to Claim of Northtown Mall Partners (Northtown)(F1) and for evidentiary hearing on the Motion for Administrative Expense Claim by Northtown. Appearances are as noted in the record. Based on the Federal and Local Rules of Bankruptcy Procedure, the Court issues this ORDER.

I.
FACTS

On February 2, 1988, the Debtor and Northtown entered into a lease of non-residential real property. The lease was set to expire on January 31, 1995. The lease contained specific provisions regarding holdover, which made the tenant liable for rent at a rate of 1 1/2 times the normal rent.

Sometime prior to the expiration of the lease, Gary Nelson, president of the Debtor, approached Gail Siegler, property manager of Northtown, requesting that the Debtor be allowed to stay in possession of the premises beyond January 31, 1995 in order to properly clean the property. She agreed and never discussed the holdover provision or whether rent would be charged. On or about February 10, 1995, the Debtor vacated the property turning the keys over to Ms. Siegler after she inspected the premises. Again, she at no time made mention that she would charge the Debtor at the holdover rate or that she considered the Debtor to be on holdover status.

On November 17, 1994, an involuntary Chapter 7 case was filed against the Debtor. On September 18, 1995, the Debtor filed a voluntary conversion of the case to Chapter 11.

Neither party disputes that the Debtor owes postpetition rent for the months of December 1994 and January 1995 in the amount of $ 20,417.68. The Debtor presented $25,916.02 at the hearing to Northtown, but the cashiers check was written out to Northtown Mall Partners instead of Northtown LLP and, therefore a new cashiers check was to be issued. The Debtor represented that a new check would be issued immediately after the hearing. The $25,916.02 also included an amount deemed reasonable by the Debtor for rent during the period in February in which the Debtor occupied the premises.

Northtown asserts a claim in the total amount of $86,460.04. $35,415.84 is for rent accrued before December of 1994. Northtown claims this portion is an unsecured non-priority claim which is not disputed by the Debtor. The portion of the claim in dispute is $51,044.20, including $20,417.68 for rent owing in December 1994 and January of 1995. The additional $30,626.52 is based on a claimed liability for rent for the months of February and March of 1995 pursuant to Minn. Stat. Section 504.06 at the holdover rate in the lease which entitles it to receive rent at 1 1/2 times the normal rate. Northtown claims the entire $51,044.20 is an administrative expense.

The Debtor argues that Northtown waived the holdover provision by allowing it to stay and clean up the premises; and, that if it is to be liable for rent, the Debtor is only liable for the reasonable value of the use and occupancy of the premises beyond the January 31, 1995 lease termination. Additionally, the Debtor asserts that Northtown's claim is a "gap" claim under 11 U.S.C. Section 502(f) only, in the amount of $25,916.02.

II.
DISCUSSION

A. NORTHTOWN'S PRIORITY CLAIM

The remaining claim of Northtown at issue is $51,044.02. The entire amount of the claim arose prior to the entering of the order for relief. Northtown argues that it is entitled to full postpetition performance under the lease, pursuant to 11 U.S.C. Section 365(d)(4), and that all postpetition unpaid rent is due as an administrative expense. However, sec. 365(d)(4) applies to rent accruing after the order for relief. Here, the rent at issue accrued postpetition, but before the order for relief, and the section does not apply.

11 U.S.C. Section 503 sets out when claims for administrative expenses are allowed. 11 U.S.C. Section 503(b) provides:

> After notice and a hearing, there shall be allowed, administrative expenses, other than claims allowed under section 502(f) of this title. . . (emphasis added).

11 U.S.C. Section 502(f) provides:

> In an involuntary case, a claim arising in the ordinary course of the debtor's business or financial affairs after the commencement of the case but before the earlier of the appointment of a trustee and the order for relief shall

> be determined as of the date such claim arises, and shall be allowed under subsection (a), (b), or (c) of this section or disallowed under subsection (d) or (e) of this section, the same as if such claim had arisen before the date of the filing of the petition. (emphasis added).

As previously stated, there is no dispute that the entire amount of the claim at issue arose prior to the order for relief. Therefore, the claim cannot be an administrative expense claim as it is specifically excluded under 11 U.S.C. Section 503(b). The first issue then is whether the claim is allowable under Section 502(f).

The Debtor does not dispute the fact that the rent expense for the months of December 1994 and January 1995 was incurred in the ordinary course of its business, and benefited the estate. Therefore, the $20,417.68 rent due for those months is allowed as a claim under 11 U.S.C. Section 502(f). A claim allowable under 11 U.S.C. Section 502(f) is given second priority under 11 U.S.C. Section 507 which provides:

> (a) The following expenses and claims have priority in the following order:
>
> (1) First, administrative expenses allowed under section 503(b) of this title, and any fees and charges assessed against the estate under chapter 123 of title 28.
>
> (2) Second, unsecured claims allowed under section 502(f) of this title. (emphasis added).

Therefore, $20,417.68 is allowed as a Section 507(a)(2) priority, payable in full on the effective date of the Debtor's Chapter 11 plan. 11 U.S.C. Section 1129(a)(9)(A). The entire $20,417.68 is due, since the Debtor's plan was confirmed on June 5, 1997.

The second issue involves Northtown's claim for rent relating to the holdover. The Debtor takes the position that $5,498.34 was the reasonable value for rent for the time period in which the Debtor occupied the premises during the month of February.(F2) Northtown argues that it is entitled to rent at the holdover rate of 1 1/2 times the regular rent for this period. However, Section 507(a)(2) priority claims are measured by value to the estate, not contract rates. The $5,498.34 appears to be a reasonable amount of rent for the time the Debtor occupied the premises based on the amount of rent due for an entire month.(F3) There is no dispute that rent for the time the Debtor was occupying the property in February was also in the ordinary course of the Debtor's business and therefore, also must be paid on the effective date of the plan.

B. NORTHTOWN'S GENERAL UNSECURED CLAIM

1. HOLDOVER

The remaining issue is how to treat the balance of $25,128.18(F4) which was incurred when the debtor was not in possession of the property. In order for the claim to be a "gap claim" entitled to a priority under 11 U.S.C. Section 507, it must fall under the provisions of 11 U.S.C. Section 502(f) which provides for claims arising in the ordinary course of the debtor's business. If the claim does not qualify as an ordinary course of business claim, then it is merely a general unsecured claim. See, In re Manufacturer's Supply Co., 132 B.R. 127 (Bankr. N.D. Ohio 1991). The Debtor was engaged in the sale of office supplies from the Northtown location. When the Debtor vacated the premises, it was no longer engaged in its business as an ordinary course at that location. Therefore, the $25,128.18 is not entitled to a 507(a)(2) priority for that portion of the claim that arose for the period that the debtor was out of possession.

Northtown takes the position that it is entitled to rent for both the months of February and March at the holdover rate. As a portion of February's rent is a priority claim, the amount in dispute is $25,128.18. Northtown bases its entitlement to rent on Minn. Stat. Section 504.06 which requires a notice period of one month before vacating.(F5) As the Debtor vacated February 10 and no notice was given prior to the date of vacating, the month notice period would take the Debtor into March, and as the normal termination date of the lease is the end of March, the Debtor is liable for rent until the end of March.

Northtown also claims that it is entitled to rent at 1 1/2 times the normal rental rate based on the holdover provision in the lease which provides:

> ARTICLE 34. HOLDING OVER. In the event Tenant remains in possession of the Premises after the expiration of this Lease and without the execution of a new lease, it shall be deemed to be occupying the Premises as a tenant from month to month as (sic) a Gross Rent equal to one and one-half times the then existing Gross Rent paid by Tenant to Landlord in the previous twelve (12) months, and subject to all of the other conditions, provisions and obligations of this Lease insofar as the same can be applicable to month-to-month tenancy cancelable by either party upon thirty (30) days written notice to the other.

There is no dispute the Debtor stayed beyond the date of the expiration of the lease, and therefore, is responsible for the rent under the holdover clause in the lease at 1 1/2 times the previous monthly rental paid, making the $25,128.18 a general unsecured claim, unless there was a waiver of the right to the increased rent by Northtown.

2. WAIVER

The Debtor takes the position that Northtown waived its claim to rent for the post vacation period of February and March, including all rent due under the holdover provision, through the conduct of Gail Siegler. Gary Nelson, president of the Debtor testified that prior to the date in which the lease expired, he spoke to Gail Siegler about staying in the premises beyond the vacate date in order to clean up. It was his testimony that she consented, as she did not have another tenant coming in, and never mentioned the increase in rent, or even paying rent for the additional time. He also testified that she never gave him a date to be out by, but he assumed it was to be in a reasonable time. No testimony or evidence was presented to counter this testimony. He also testified that on the date he vacated the premises, he went to the office to speak with Ms. Siegler regarding turning over the premises. He stated that she accompanied him to the premises and looked over the space during which time he turned over the keys. At no time did she mention that it was a problem that he stayed longer than January 31 or that he was now liable for additional rent. The testimony of Gail Siegler revealed that it was "atypical" to have a holdover tenant and in fact, in her eight years at Northtown she has never had to deal with a holdover tenant. She did not testify as to any conversations that she may have had with Gary Nelson.

The parties may contract orally to modify their agreements with respect to the manner of performance. Thoe v.Rasmussen, 322 N.W.2d 775, 777 (Minn. 1982). "Parol evidence that modifies the terms of a written agreement must be clear and convincing". Thoe, 322 N.W.2d at 777, citing Hayle Floor Covering, Inc. v. First Minnesota Const Co., 253 N.W.2d 809 (Minn. 1977). In this case, the Debtor failed to produce clear and convincing evidence that there was in fact a waiver by Northtown to charge the Debtor rent for the months of February and March; or, that there was a waiver of the right to charge rent at the holdover rate for those months. The landlord's silence on the matter did not constitute a waiver of its rights under the lease.

Based on the foregoing analysis, the

Court finds that the Debtor is liable for $25,128.18, as a general unsecured claim, for the rent at the holdover rate.

III.
DISPOSITION

IT IS HEREBY ORDERED:

1. Debtor's Objection to Claim #62 is sustained in part and overruled in part. The claim is allowed $25,916.02 as a priority claim, and $60,544.02 as a general unsecured non-priority claim.
2. Northtown's Motion for Administrative Expense Claim is denied.

Dated: By the Court:

Dennis D. O'Brien
Chief United States
Bankruptcy Judge

(1) The motion was also brought by Northtown LLP which received both the property upon which the leased premises is located and an assignment of Northtown Mall Partners claim on May 5, 1997. "Northtown" will refer to both entities.

(2) There is a dispute over the actual date in which the premises was vacated. Gary Nelson, president of the Debtor, believes the date was somewhere between February 7 and February 10, 1995. It is the position of Northtown that the property was actually vacated on February 10, 1995. The Court assumes that the date was February 10 for the purpose of the analysis.

(3) The rent owing for the month of February and March, at the holdover rate, was 30,626.52. Assuming half of the rent was for each month, making the rent for February $15,313.26. Assuming the February 10 vacate date, the portion of rent owing for those ten days would be $5,469.00. (15,313.26/ 28 days in Feb. =$546.90; $546.90 X 10= $5,460.00).

(4) Northtown is asking for $30,626.52 for the rent for the months of February and March. As this Court has already determined that $5,498.34 is a priority claim, the remaining balance at issue is $25,128.18.

(5) Minn Stat. sec. 504.06 provides:
Estates at will may be determined by either party by three months' notice in writing for that purpose given to the other party, and, when the rent reserved is payable at periods of less than