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Sec. 554: Who Pays for Abandonment?

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Under a standard commercial lease, a tenant is required to leave the premises in broom-clean condition. However, what happens to this provision and who bears the cost of cleanup when a tenant files for bankruptcy and abandons leased property in unrentable condition? The right of a bankruptcy debtor to abandon property of the estate is quite clear, but the question of who is responsible for the clean-up costs with respect to adondoned property is far from settled.

Bankruptcy Code § 554 allows a debtor to abandon certain property of the estate and delineates three possible methods for the abandonment of such property. First, property may be abandoned by motion of the trustee of the estate. Second, it may be abandoned upon request of a party in interest. Third, property is deemed abandoned as a matter of law if it is property scheduled under Code § 521 and is not otherwise administered at the closing of the case. See 11 U.S.C. § 554 (2002).

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While § 554 provides methods of abandoning property of the estate, it offers no guidance regarding which party should be responsible for any costs associated with the removal or clean-up of such property. The issue most commonly arises in the case of a debtor-tenant terminating a commercial lease and abandoning its personal property on the landlord's premises. In such a situation, three questions arise. First, assuming the property is valueless, as is most likely the case, what is the responsibility of the debtor-tenant regarding the removal of the abandoned property? Second, does the debtor-tenant remain in possession of the premises, notwithstanding rejection, if the sheer volume of abandoned property renders the premises impossible to rent to another tenant without considerable clean-up costs being incurred by the landlord? Third, if the cost of the clean-up and removal of the abandoned property is deemed to be the responsibility of the debtor-tenant, is a landlord entitled to an administrative claim under § 503(b) if he or she undertakes the clean-up and removal himself or herself?

Onus on the Landlord

The case law examining this issue provides limited guidance to the parties concerned with these questions. The U.S. Bankruptcy Court for the District of Delaware examined this issue in *In re Uni-digital Inc.*, 262 B.R. 283 (Bankr. D. Del. 2001). In *Unidigital*, the debt-or, a media service company that also provided printing services, rejected a lease for commercial space with its landlord, SNY Inc. While the debtor sold most of the assets located on the premises, it was unable to sell and therefore sought to abandon a "Champion Printer" located on the premises. The printer was more than 25 feet long and weighed more than 30,000 pounds. Removal of the printer required dismantling the machine and removing it through the windows of the premises by crane. Removal also required hiring a licensed plumber and a licensed electrician and disposal of the chemicals used in the printing process.

SNY objected to the debtor's motion to abandon the printer on two grounds. First, it asserted that the abandonment of the printer fell within the *Midlantic* exception to abandonment. (Under the *Midlantic* exception, abandonment of property by a debtor is disallowed where there is an imminent and identifiable harm to the public health or safety.)

The court disagreed with SNY and found there was no imminent harm to the public health and therefore the proposed abandonment was not subject to the *Midlantic* exception. See *id*. at 286 (citing *Midlantic Nat'l Bank v. New Jersey Dep't of Env'l. Protection*, 474 U.S. 494, 106 S.Ct. 755, 88 L.Ed.2d 859 (1986)).

Second, SNY argued that the cost it would have to incur if the debtor was allowed to abandon the printer should be considered an administrative claim under the Bankruptcy Code. See *Unidigital*, 262 B.R. at 288.

The court concluded that "[w]hile it may seem inequitable to 'saddle' SNY with the cost of cleaning up the [d]ebtor's mess, absent a benefit to the estate, no priority claim is allowable." See *id*. at 289. In its analysis, the court cited the two-prong test for determining whether a creditor's claim is entitled to an administrative priority: (1) the expense must have arisen from a post-petition transaction between the creditor and the debtor; and (2) the transaction must have been "actual and necessary" to preserve the estate. See *id*. (citing *Microsoft Corp. v. DAK Indus. Inc. (In re DAK Indus. Inc.)*, 66 F.3d 1091, 1094 (9th Cir. 1995)).

The court explained that the only transaction between the parties was the lease the debtor sought to reject. Because Bankruptcy Code § 502(g) renders the rejection of a lease a prepetition breach, SNY's claim failed the first prong of the test.

The court also concluded that the removal of the printer by SNY did not confer any substantial benefit on the debtor or the debtor's estate and, therefore, SNY's claims also failed the second prong of the test. The court stated that "the cost of cleaning...the premises does not benefit the estate here. Rather, it only benefits SNY." *Unidigital*, 262 B.R. at 289.

SNY also alleged that the cost of clean-up of the printer should not be borne by a single creditor of the estate but, in keeping with bankruptcy principles, be equitably distributed among the creditors. The court explained that SNY misinterpreted the meaning of § 507, which sets the order by which unsecured creditors are paid from the estate. The court stated that "SNY's at-tempt to receive payment of its removal costs as an administrative expense is not an attempt to be paid on an equal basis with other creditors but ahead of them." *Id*.

Global Crossing: A Landlord's Perspective

In the Global Crossing bankruptcy matter, the authors represented a landlord that leased a large commercial space to the debtor. The debtor, a subsidiary of Global Crossing, informed the landlord that it would vacate the premises no later than the end of April 2002. Until to the end of April, the debtor continued to exchange personal property on the premises, such as office furniture and equipment, with damaged property from other locations. Moreover, Global Crossing employees continued to enter the premises and remove certain items for at least four days following the stated vacancy date. During that time, the debtor also had a fully operational security system and key-card activated access system still being used by employees.

On May 7, the landlord inspected the premises and found the space to be completely filled with the debtor's property, including 850 fully furnished cubicles, thousands of feet of communication wire and a halon fire system. The cost of clean-up was estimated at $157,000.

By motion, the debtor sought to reject the lease and set the effective date of the rejection as the earlier of (1) the date an order approving rejection is entered by the court and (2) the date the debtor relinquished possession of the premises.

In the motion, the debtor argued that the court should set the effective rejection date at April 30, 2002. Debtor also sought to abandon much of its property left at the premises.

The authors, on behalf of the landlord, argued that the debtor should not be allowed to set the rejection date to a time when it was still receiving the benefits of the occupation of the premises, and also that the debtor should have to pay the monthly rent and all other monthly charges that became due under the lease for the month of May. They also requested that, assuming April 30, 2002, was deemed the rejection date, that the debtor pay the reasonable value of its use and occupancy of the premises until it actually vacated and removed its personal property. Furthermore, the authors cited a provision of the lease that placed responsibility on the debtor to remove all items of property upon termination of its right to possession.

In the end, the parties came to an amicable settlement of these issues. The settlement was compelled by the fact that neither side had enough case law to give them complete confidence in their position. The landlord agreed to accept one-half the rent and other charges for the month of May and assert the clean-up costs as a general unsecured claim in connection with any damages resulting from the debtor's rejection of the lease. The resolution of this issue will have to await another case.

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Onus on the Debtor

In *In re Furniture-in-the-Raw Inc.*, the U.S. District Court for the Southern District of New York reached a conclusion opposite to that of the Delaware court in *Unidigital*. 1977 U.S. LEXIS 13993 (S.D.N.Y. 1977). In *Furniture-in-the-Raw*, the debtor had a lease with the landlord-claimant for a 57,000-square-foot commercial premises. See *id*. at *2. After filing its Chapter 11 petition, the debtor sought to vacate the premises. The court held that because the debtor-in-possession still had a "substantial array of machinery, lumber, work-in-progress and other items still in the building," the debtor had possession of the premises until such property was removed at the debtor's expense.

On the date the debtor informed the landlord that the premises were to be deemed vacated and any remaining items should be deemed abandoned, the landlord discovered the premises to be "virtually filled with the property of the debtor-in-possession." *Id*. at *3-*4.

The landlord asserted an administrative claim in the bankruptcy court for the clean-up costs of the premises. See *id*. at *2. The debtor-in-possession objected to the ad-ministrative claim, arguing that it received no use or benefit from the clean-up of the premises by the landlord, and therefore no payment should be made. See *Furniture-in-the-Raw* at *4.

The court explained that "it is a correct and equitable solution that the debtor-in-possession should be responsible for the clean-up of the premises" because, by compelling the debtor-in-possession to clean the premises, the estate is benefited in several respects. First, the tenant's clean-up establishes a clear end to liability for rent due for the beneficial use and occupancy of the premises. Second, forcing the debtor-in-possession to clean the premises deters the debtor-in-possession from needlessly abandoning valuable assets. Finally, it allows the debtor-in-possession to obtain the most economical cleaning service as a further check on claims against the estate.

The court further concluded that the debtor should be charged the reasonable rental value of the premises until the cleaning is accomplished as an unsecured general damage claim. See *id*. at *6.

Protecting the Landlord

The analysis adopted by the *Furniture-in-the-Raw* court results in the most equitable outcome to all of the parties involved. *Furniture-in-the-Raw* established the rule that abandoned property that renders the premises uninhabitable by any subsequent tenant is not a vacancy by the debtor. In essence, a debtor is deemed to remain on the pre-mises as a holdover tenant until the premises are cleaned to the extent that a new tenant may take over the space. The debtor is given the full enjoyment of the space as a storage facility for abandoned personal property at no cost to the estate. Thus, the debtor-tenant should be obligated to pay rent for such use. To find otherwise not only prejudices the rights of the landlord, but also imposes significant costs on the landlord for which he or she will most likely never realize repayment.

In finding that a landlord's clean-up costs should be considered an administrative expense, the *Furniture-in-the-Raw* case reaches a just result. Under a typical commercial lease, a tenant is required to leave the premises in "broom clean" condition. Thus, the imposition of clean-up costs on the landlord should be considered a postpetition transaction not contemplated in the lease.

Moreover, the continued use of the premises by the estate, prior to its clean-up, substantially benefits the estate. The benefits include providing the debtor with a place to store a substantial amount of abandoned property prior to auction or removal, as well as the additional benefits explained in the *Furniture-in-the-Raw* case.

The present economic climate, paired with the almost instantaneous obsolescence of technology used by so many of the "dot-com's" that once reigned supreme, will bring this issue to the forefront of a multitude of bankruptcy cases. As stated in *Furniture-in-the-Raw*, to allow the tenant a "'vacation' by merely turning a key on the leasehold and vacating the premises" is extremely prejudicial to the landlords that are scrambling to lease their now-vacant space. 1977 U.S. Dist. LEXIS 13993 at *4. It is hoped that the courts will reflect on the rights of the landlord when making these decisions and provide some type of relief, be it forcing the debtor to pay or allowing a landlord an administrative claim so that landlords are not further damaged in an economic fallout.