



IN THE UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF NORTH CAROLINA

CHARLOTTE DIVISION **JUDGEMENT ENTERED ON OCT 25 2001**

In re:)	Chapter 11
)	
GS Industries, Inc. <u>et al.</u> ,)	Case No. 01-30319 (GRH)
)	
Debtors.)	Jointly Administered
_____)	

**ORDER DENYING MOTION FOR ALLOWANCE OF
COSTS OF ADMINISTRATION CLAIM**

This matter is before the court on the motion of Sandvik Hard Materials Company ("Sandvik") for allowance of a cost of administration claim pursuant to 11 U.S.C. §§ 365 and 503. The debtors timely objected to the claim. A hearing was held on October 10, 2001. For the reasons stated below, the court has concluded that Sandvik's motion should be denied.

Jurisdiction

1. Jurisdiction is proper pursuant to 28 U.S.C. §§ 157 and 1334.
2. This matter came before the court after proper notice, and all parties are properly before the court.

Factual Background

3. On February 7, 2001 (the "petition date"), the debtors filed voluntary petitions with this court for reorganization pursuant to Chapter 11 of the United States Bankruptcy Code. The debtors continue to operate their businesses and to manage their

properties as debtors-in-possession pursuant to §§ 1107(a) and 1108 of the Bankruptcy Code.

4. On April 24, 2000, more than nine months before the petition date, the debtor GS Technologies Operating Co., Inc., d/b/a GST Steel Company ("GSTOC"), issued a purchase order contract to Sandvik for the purchase of specially manufactured goods (the "goods").

5. The contract price of the goods was \$85,330.00, and the contract delivery date was September 15, 2000.

6. The contract was a destination contract and provided that the terms were "F.O.B. DELIVERED" to the debtors in Kansas City, Missouri.

7. The goods were delivered to GSTOC in Kansas City on February 13, 2001, six days after the petition date.

8. The debtors did not return the goods to Sandvik.

9. Sandvik did not make a timely demand to reclaim the goods.

10. GSTOC ordered the goods before the petition date; therefore, the contract was a pre-petition transaction between the debtors and Sandvik. GSTOC did not assume the contract with Sandvik, nor did GSTOC reject the contract with Sandvik.

11. The goods were not used by GSTOC in the ordinary course of its post-petition business.

12. Sandvik has moved that its contract with the debtors be classified as a cost of administration expense alleging that it was an executory contract on the petition date.

Discussion

A. Section 503 Administrative Expenses

13. Section 503(b)(1)(A) of the Bankruptcy Code allows the court to classify claims for "the actual, necessary costs and expenses of preserving the estate" as administrative expenses. Such claims are accorded first priority for payment pursuant to § 507(a)(1). By elevating cost of administration claims above the claims of other creditors, the Code furthers the goal of rehabilitating the debtor by encouraging third parties to supply goods and services to the estate on credit. In re Patient Educ. Media, Inc., 221 B.R. 97, 101 (Bankr. S.D.N.Y. 1998) (citations omitted).

14. The Bankruptcy Code's allowance of priority treatment for administrative expenses runs counter to the general presumption in bankruptcy cases that the debtor's limited resources will be equally distributed among its creditors. In re Merry-Go-Round Enterprises, Inc., 180 F.3d 149, 157 (4th Cir. 1999). Accordingly, the overarching principle of equal treatment for creditors mandates that § 503 be narrowly construed. Id. The party asserting entitlement to an administrative expense priority claim bears the burden of proof. Ford Motor Credit Co.

v. Dobbins, 35 F.3d 860, 866 (4th Cir. 1994) (citing In re Mid Region Petroleum, Inc., 1 F.3d 1130 (10th Cir. 1993)).

15. Courts that have dealt with the construction of § 503 have developed a two-prong test for that section's application. See Merry-Go-Round, 180 F.3d at 157. The first prong requires that the claim be generated through a post-petition transaction between the debtor-in-possession and the creditor. Id. (citing In re Stewart Foods, Inc., 64 F.3d 141, 145 n.2 (4th Cir. 1995)). The second prong requires that consideration supporting the claimant's right to payment be supplied to and beneficial to the debtor-in-possession in the operation of the business. Id.

16. Applying the first prong of the test for § 503 requires consideration of whether the transaction that gave rise to the claim was induced by the debtor-in-possession. In re Russell Cave Co. Inc., 249 B.R. 145, 147 (Bankr. E.D. Ky. 2000). Such inducement by the debtor-in-possession has been characterized as "crucial to the claim for administrative priority in the context of the furnishing of goods or services to the debtor." Id.

17. The second prong of the § 503 test requires a benefit to the bankruptcy estate as a result of the extension of credit. Id. (citing In re Sunarhauserman, Inc., 126 F.3d 811 (6th Cir. 1997)). An actual use of the creditor's property by the debtor that confers a *concrete benefit* on the estate must be established before a claim will be allowed as an administrative expense.

Ford Motor Credit Co. v. Dobbins, 35 F.3d 860, 866 (4th Cir. 1994) (emphasis in original). The benefit test consists of an objective determination of whether the debtor-in-possession used the creditor's property in the ordinary course of business. In re Patient Educ. Media, Inc., 221 B.R. at 102. Accordingly, a creditor who, at the behest of the debtor-in-possession, supplies materials that enable the debtor to continue its business operations confers a benefit on the bankruptcy estate. In re Pioneer Acceptance Corp., 110 B.R. 314, 317 (Bankr. S.D. Ohio 1990).

18. If, however, the debtor-in-possession does not use the property supplied by the creditor, the creditor's claim is relegated to the status of an unsecured claim. In re Patient Educ. Media, 221 B.R. at 102. A claim is not elevated to administrative priority on the "mere potential of benefit to the estate." Ford Motor Credit Co., 35 F.3d at 866. Although the debtor may have possession of the creditor's property and the option to use it, no liability for an administrative expense attaches until the property is actually used. In re Patient Educ. Media, 221 B.R. at 102. However, while use of the creditor's property is required to establish a benefit, the bankruptcy estate need not realize a profit as a result of that use in order to satisfy the second prong of the § 503 test. Id. at 103.

19. Because the § 503 benefit analysis focuses on the benefit to the bankruptcy estate, any loss to the creditor by virtue of the debtor's possession of its property is irrelevant to the court's administrative expense inquiry. Ford Motor Credit Co., 35 F.3d at 866.

B. Section 365 Executory Contracts

20. The purpose of § 365 is to allow a debtor to reject executory contracts in order to relieve the estate of burdensome obligations while providing a means for the debtor to force others to continue to do business with it. Frito-Lay, Inc. v. LTV Steel Co., Inc. (In re Chateaugay Corp.), 10 F.3d 944, 954-55 (2d Cir. 1993) [hereinafter Frito-Lay]. Obligations which are executory at the time a bankruptcy is filed are payable as administrative expenses when the executory contract has been assumed by the debtor-in-possession. In re Coast Trading Co., Inc., 744 F.2d 686, 692 (9th Cir. 1984). Therefore, the estate's election to assume the contract entitles the other contracting party to assert its claim as a priority. Frito-Lay, 10 F.3d at 955. Notably, the power of election is granted to the debtor, not to the other contracting party. Id.

21. Because only post-petition transactions can be considered for administrative expense priority, the time of the seller's performance under a contract with the debtor is a pivotal issue. In re Nevins Ammunition, Inc., 79 B.R. 11, 13

(Bankr. D. Idaho 1987). A contract is considered executory if either party could withhold further performance and such withholding would constitute a material breach. Id. (citing In re Coast Trading, 744 F.2d at 692). When the contract at issue is a destination contract, the terms require the seller to complete performance by delivering the goods to the buyer. Id. Accordingly, destination contracts remain executory until the goods are received by the buyer. Id. at 16.

C. Executory Contracts and Claims for Costs of Administration

22. In In re Nevins Ammunition, the court considered the intersection between §§ 503 and 365 in the context of destination contracts. 79 B.R. at 13-14. The Nevins court noted that, in situations where delivery pursuant to a destination contract occurs post-petition, and the debtor-in-possession accepts the benefit of the executory contract, a transaction with the debtor-in-possession takes place. Id. Such a transaction would satisfy the first prong of § 503. See id. at 16 (noting that the contract at issue in that case was a shipment contract and, therefore, no longer executory on the petition date). Likewise, when an executory contract has not been assumed but the debtor-in-possession actually utilized the subject matter of the contract to enhance or preserve the estate, the creditor's claim may receive priority treatment as a cost of administration. See

In re Subscription Television of Greater Atlanta, 789 F.2d 1530, 1531 (11th Cir. 1986).

23. Accordingly, in determining whether a claim should be treated as a cost of administration, the court may consider whether the debtor-in-possession continued to receive and accept the creditor's performance without expressly assuming an executory contract. Id. When a debtor has "knowingly and willingly accepted full performance" called for in a contract, the creditor's claim may be treated as a priority administrative expense. In re Beverage Canners Int'l Corp., 255 B.R. 89, 93-93 (Bankr. S.D. Fla. 2000) (holding that the debtor's continued use of the creditor's trademark entitled the creditor to a cost of administration expense priority claim).

24. Here, although the claim at issue arose from a pre-petition contract with the debtors and was not induced by the debtors-in-possession, acceptance of the goods constituted a transaction with the debtors-in-possession. The contract between the parties was executory on the petition date because Sandvik had not rendered full performance by delivering the goods. The debtors-in-possession neither accepted nor rejected this executory contract. Nevertheless, the debtors-in-possession accepted post-petition delivery of the goods--and thus Sandvik's full performance pursuant to the contract--after the filing date.

This acceptance of Sandvik's performance satisfies the first prong of the § 503 test.

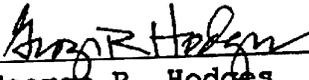
25. A creditor will be unsuccessful in asserting its right to priority treatment, however, unless the bankruptcy estate received some post-petition benefit as a result of the creditor's performance on the executory contract. See Frito-Lay, 10 F.3d at 955-56. In Frito-Lay, the court denied the creditor's claim for administrative expense priority. Id. The Frito-Lay debtors had not assumed the leases at issue, which the court found were executory contracts. Id. In denying the creditor's claim for a cost of administration expense, the court determined that no benefit accrued to the bankruptcy estate despite the creditor's ongoing performance on the executory contracts. Id.

26. In the instant case, Sandvik's claim of entitlement to priority treatment fails because no benefit accrued to the bankruptcy estate as required by the second prong of the § 503 analysis. Sandvik has shown that the goods were delivered post-petition but did not show that the debtors-in-possession used the goods in the ordinary course of its post-petition business. Moreover, mere possession of the goods, a potential benefit to the estate, is not sufficient to meet the benefit test of § 503. Therefore, Sandvik has failed to establish that its claim is entitled to priority treatment pursuant to § 503.

Conclusion

For the above-stated reasons, Sandvik's claim for priority treatment as a cost of administration expense fails to meet the two-prong test mandated by the strict construction of § 503. Accordingly, the court must deny Sandvik's motion.

It is therefore ORDERED that the Motion for Allowance of Costs of Administration Claim by Sandvik Hard Materials Company is DENIED.



George R. Hodges
United States Bankruptcy Judge