IN THE UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF TEXAS
SHERMAN DIVISION

In re:	§	
	§	
WRN 1301, INC., formerly known as White Rock Networks, Inc.,	§	CASE NO. 06-41381
	§	
	§	Chapter 11
Debtor.	§	

MEMORANDUM OPINION AND ORDER SUSTAINING IN PART AND OVERRULING IN PART DEBTOR'S OBJECTION TO PROOF OF CLAIM OF GRANITE 190 CENTER, LTD.

This matter is before the Court following a hearing on the Objection ("Objection") filed by WRN 1301, Inc., formerly known as White Rock Networks, Inc. ("WRN" or "Debtor"), to the Proof Claim, as amended (the "Claim") filed by Granite 190 Center, Ltd. ("Granite"). The Court, having considered the evidence introduced at the hearing, the arguments of counsel and the record before it, concludes that the Objection should be sustained in part and overruled in part for the reasons discussed in this Memorandum Opinion. This Memorandum Opinion constitutes the Court's findings of fact and conclusions of law pursuant to Federal Rule of Civil Procedure 52, as incorporated into contested matters in bankruptcy cases by Federal Rules of Bankruptcy Procedure 7052 and 9014.

JURISDICTON

This Court has jurisdiction to consider the Objection pursuant to 28 U.S.C. §1334 and 28 U.S.C. §157(a). The Court has authority to enter a final order in this contested matter since it constitutes a core proceeding as contemplated by 28 U.S.C. §157(b)(2)(A), (B), and (O).

BACKGROUND

The Debtor became indebted to Granite pursuant to a Lease Agreement dated as of November 2, 2000 (as subsequently amended, the "Lease").[1] The Debtor thereby leased certain nonresidential real property known as "Granite 190 Center – Phase 1," which is located at 1301 W. President George Bush Freeway in Richardson, Texas. The Lease was anticipated to actually commence on October 1, 2001 and to end on September 1, 2008.

The Lease was subsequently amended on three occasions, as follows: (i) First Amendment to Lease Agreement, dated August 31, 2001 ("First Amendment"); (ii) Second Amendment to Lease Agreement, dated July 25, 2002 ("Second Amendment"); and (iii) Third Amendment to Lease Agreement, dated May 1, 2006 ("Third Amendment"). In the Third Amendment, Granite extended the expiration date for the Lease to December 31, 2008. Granite also made a material rent concession, conditionally reducing the Debtor's monthly rental obligation from $103,000 to $60,000. The Third Amendment provided, *inter alia*, that the deferred rental obligation would be repaid or waived under certain circumstances.

On August 31, 2006 (the "Petition Date"), the Debtor filed its voluntary petition for relief under chapter 11 of title 11 of the United States Code (the "Bankruptcy Code"). Subsequent to the Petition Date, the Lease was deemed rejected by the Debtor as of October 31, 2006, by the consent of the parties.

Granite thereafter filed its Claim on or about January 16, 2007, which, as amended on April 17, 2007 (assigned Claim No. 132-2 in the Court's Claims Register for

[1] Granite Properties, Inc. was the Debtor's original lessor. Granite Properties, Inc. subsequently conveyed its interest in the Lease to Granite 190 Center, Ltd.

the Debtor's bankruptcy case), asserts that the Debtor owes Granite the total amount of $3,303,914.28. The Claim, as amended, is comprised of the following components: (i) $2,024,096.80 corresponding to the Debtor's breach of its obligations for prospective rent under the Lease; (ii) $1,136,300.00 corresponding to the Debtor's obligation for a "Deferred Payment" as provided for and defined in the Third Amendment; and (iii) the remainder consisting of various charges and other obligations of the Debtor under the Lease, including but not limited to fees, construction and repair obligations, and attorneys' fees (the "Miscellaneous Charges"). Included within Granite's Claim for prospective rent are obligations of the Debtor for certain Operating Expenses (as defined in the Lease, "Operating Expenses") estimated by Granite to be in the amount of $27,559.15 per month ("Operating Expense Estimate").

On or about February 22, 2007, the Debtor filed its Objection, asserting, *inter alia*, that: (i) the Claim is subject to the provisions of §502(b)(6) of the Bankruptcy Code providing for limitations on pre-petition claims of lessors of nonresidential real property arising from the termination of their leases; (ii) the Deferred Payment is not enforceable under state law as a default penalty or unenforceable clause for liquidated damages; (ii) the Operating Expense Estimate is improperly inflated; (iii) none of the Deferred Payment, Operating Expenses, nor any of the Miscellaneous Charges constitutes "rent reserved" within the meaning of §502(b)(6), and, therefore, cannot factor into the proper calculation of the "cap" allegedly imposed by §502(b)(6) on the Claim (the "Landlord Cap"); (iv) also pursuant to §502(b)(6), none of the Deferred Payment, Operating Expenses, nor any of the Miscellaneous Charges, is allowable in excess of the amount of the Landlord Cap. Notice of the Objection was adequate and sufficient under the

particular circumstances of this case. Granite responded to the Objection, and the Court conducted a hearing on April 23 -24, 2007.

DISCUSSION

A proof of claim, if it is executed and filed in accordance with the Federal Rules of Bankruptcy Procedure, constitutes *prima facie* evidence of the validity and amount of that claim and is deemed allowed unless a party in interest objects. *See* 11 U.S.C. §502(a); FED. R. BANKR. P. 3001(f). A proof of claim, however, does not qualify for that *prima facie* evidentiary effect if it is not executed and filed in accordance with the Bankruptcy Rules. *See First Nat'l Bank of Fayetteville v. Circle J. Dairy (In re Circle J Dairy, Inc.)*, 112 B.R. 297, 300 (W.D. Ark. 1989). Federal Rule of Bankruptcy Procedure 3001 generally sets forth the requirements for filing a proof of claim, and one of those requirements states that:

> when a claim . . . is based on a writing, the original or a duplicate shall be filed with the proof of claim. If the writing has been lost or destroyed, a statement of the circumstances of the loss or destruction shall be filed with the claim.

FED. R. BANKR. P. 3001(c). Likewise, if a creditor claims a security interest in property of the debtor, Bankruptcy Rule 3001(d) requires the creditor to accompany his proof of claim with evidence that the creditor perfected a security interest.

Hence, the burden of persuasion under the bankruptcy claims procedure always lies with the claimant, who must comply with Bankruptcy Rule 3001 by alleging facts in the proof of claim that are sufficient to support the claim. If the claimant satisfies these requirements, the burden of going forward with the evidence then shifts to the objecting party to produce evidence at least equal in probative force to that offered by the proof of claim and which, if believed, would refute at least one of the allegations that is essential

to the claim's legal sufficiency. *See Lundell v. Anchor Const. Specialists, Inc. (In re Lundell)*, 223 F.3d 1035, 1041 (9th Cir. 2000); *Sherman v. Novak (In re Reilly)*, 245 B.R. 768, 773 (B.A.P. 2d Cir. 2000). This can be done by the objecting party producing specific and detailed allegations that place the claim into dispute, *see In re Lenz*, 110 B.R. 523, 525 (D. Colo. 1990), or by the presentation of legal arguments based upon the contents of the claim and its supporting documents, *see In re Circle J Dairy*, 112 B.R. at 300. If the objecting party meets these evidentiary requirements, then the burden of going forward with the evidence shifts back to the claimant to sustain its ultimate burden of persuasion to establish the validity and amount of the claim by a preponderance of the evidence. *See In re Consumers Realty & Dev. Co.*, 238 B.R. 418 (B.A.P. 8th Cir. 1999); *In re Alleghany Int'l, Inc.*, 954 F.2d 167, 173-74 (3d Cir. 1992).

In this case, since Granite filed its Claim in compliance with the Federal Rules of Bankruptcy Procedure, including the attachment of a copy of the agreement upon which its Claim is based, the Claim is entitled to *prima facie* validity. To rebut that effect, the Debtor alleged, *inter alia*, that the amounts claimed by Granite were excessive and should be at least partially disallowed pursuant to §502(b)(6) of the Bankruptcy Code. The evidence submitted by the Debtor at the hearing was sufficient to bring the legitimacy of the Claim into question and to overcome the *prima facie* validity of the Claim. Thus, it was incumbent upon Granite to establish the validity and amount of its claim by a preponderance of the evidence.

Section 502(b)(6) places a mandatory cap on the amount that may be allowed for damages resulting from the termination of a lease of real property. *See In re Mr. Gatti's*,

162 B.R. 1004, 1010 (Bankr. W.D. Tex. 1994).[2] Section 502(b)(6) specifically provides:

> (b) Except as provided in subsections (e)(2), (f), (g), (h) and (i) of this section, if such objection to a claim is made, the court, after notice and a hearing, shall determine the amount of such claim in lawful currency of the United States as of the date of the filing of the petition, and shall allow such claim in such amount, except to the extent that-
>
> (6) if such claim is the claim of a lessor for damages resulting from the termination of a lease of real property, such claim exceeds-
>
> (A) the rent reserved by such lease, without acceleration, for the greater of one year, or 15 percent, not to exceed three years, of the remaining term of such lease, following the earlier of-
>
> (i) the date of the filing of the petition; and
>
> (ii) the date on which such lessor repossessed, or the lessee surrendered, the leased property; plus
>
> (B) any unpaid rent due under such lease, without acceleration, on the earlier of such dates.

11 U.S.C. 502(b)(6). This limitation on damages prevents a lessor who files a claim against a bankruptcy estate from reaping an unfair share of the estate over the remaining pool of unsecured creditors. *See In re Stonebridge Technologies, Inc.*, 430 F.3d 260, 268-69 (5th Cir. 2005) (citing S. Rep. No. 95-989, *reprinted in* 1978 U.S.C.C.A.N. 5787, 5849; H.R.Rep. No. 95-595, *reprinted in* 1978 U.S.C.C.A.N. 5963, 6309).

In this case, §502(b)(6) limits the allowability of Granite's Claim for damages resulting from the termination of the Lease to the rent reserved by the Lease, without acceleration, for the greater of either one year or 15%, not to exceed three years, of the remaining lease term following the Petition Date. With respect to which charges constitute "rent reserved" under the Lease, such charges generally must be fixed, regular or periodic charges related to the Lease or the value of the property. *See, e.g., Kuske v. McSheridan (In re McSheridan),* 184 B.R. 91, 99 (9th Cir. B.A.P. 1995); *In re Mr. Gatti's*

[2] In the context of damages under §502(b)(6), "'the rejection of a lease under section 365 is equivalent to a termination by breach.'" *In re SKA! Design, Inc.*, 308 B.R. 777, 781 (Bankr. N.D. Tex., 2004) (quoting COLLIER ON BANKRUPTCY ¶ 502.03[7][b] (15th Ed. Rev.2003)). *See also In re Mr. Gatti's, Inc.*, 162 B.R. at 1009.

Inc., 162 B.R. at 1010; *In re Storage Technology*, 77 B.R. 824, 825 (Bankr. D. Colo. 1986). Attorneys' fees, the cost of one-time repairs and other expenses and penalties are excluded from the scope of "rent reserved" under §502(b)(6) of the Bankruptcy Code. *See, e.g., In re Fulton*, 148 B.R. 838, 844 (Bankr. S.D. Tex. 1992); *In re Best Products Co., Inc.*, 229 B.R. 673, 677 (Bankr. E.D. Va. 1998).

The Debtor's monthly rent under the Lease clearly constitutes "rent reserved" within the meaning of §502(b)(6). The Debtor did not dispute that the monthly charge for Operating Expenses, which includes costs and expenses incurred by Granite in maintaining the leased property, also constitutes "rent reserved" within the meaning of §502(b)(6). The Debtor, however, objected to the amount of Operating Expenses claimed by Granite. At the hearing on the Objection, the Debtor presented evidence supporting its objection to the reasonableness of Granite's estimate of Operating Expenses only to the extent of approximately $2,000 per month. Accordingly, the Court finds that $25,000 per month of Operating Expenses constitute "rent reserved" within the meaning of §502(b)(6) of the Bankruptcy Code.

With respect to the Deferred Payment, this obligation relates to rental obligations owed by the Debtor under the Lease and conditionally forgiven or waived by Granite pursuant to the Third Amendment. Granite asserted, and the Debtor did not dispute, that the Debtor has not satisfied the conditions for such forgiveness or waiver. Moreover, the fact that the parties agreed to forgive the Deferred Payment under certain conditions does not alter the fundamental nature of the debt owed to Granite, which is a debt for rent. The original Lease did not provide for additional sums described as "deferred rent" to be due as a penalty upon default, and the subsequent deferral and conditional waiver of rent

in the Third Amendment to the Lease was not intended by the parties to be a penalty or liquidated damages. Accordingly, under the specific circumstances of this case, the Court finds and concludes that the Deferred Payment constitutes neither a provision for liquidated damages nor an unenforceable penalty. The Court calculates that such obligation translates to approximately $43,750 per month of rent reserved under the Lease.

The remaining amounts included in Granite's Claim – which include additional, unpaid rent and Miscellaneous Charges – do not constitute rent reserved under the Lease within the meaning of §502(b)(6). Accordingly, the total of rent reserved for one year under the Lease aggregates $1,545,000, as follows:

Operating Expenses $25,000 per month X 12 months	= $300,000
Base Rent $60,000 per month X 12 months	= $720,000
Deferred Payment $43,750 per month X 12 months	= $525,000
TOTAL	= $1,545,000

The sum of $1,545,000 constitutes the applicable limitation of §502(b)(6) upon the Claim, and no amounts asserted by Granite under the Claim are allowable in excess of the Landlord Cap.

CONCLUSION

For all of the foregoing and after due deliberation, the proper allowable amount of Granite's Claim is $1,545,000.00. All other relief requested by any party is denied. [3]

IT IS THEREFORE ORDERED that the Debtor's Objection to Granite's Claim is sustained as set forth in this Order to the extent of reducing the Claim to the amount of $1,545,000.00.

[3] To the extent that any finding of fact is construed to be a conclusion of law, it is hereby adopted as such. Likewise, to the extent any conclusion of law is construed to be a finding of fact, it is hereby adopted as such.

IT IS FURTHER ORDERED that all other objections to the Claim asserted by the Debtor are overruled.

IT IS FURTHER ORDERED that Granite's Claim, as amended, is hereby allowed as an unsecured claim in the amount of $1,545,000.00.

Signed on 9/21/2007

Brenda T. Rhoades SD

HONORABLE BRENDA T. RHOADES,
UNITED STATES BANKRUPTCY JUDGE