No. 21-0909

IN THE

Supreme Court of the United States

IN RE TERRAPIN STATION, LLC, DEBTOR,

TOUCH OF GREY ROASTERS, INC.,
PETITIONER,

v.

CASEY JONES, CHAPTER 7 TRUSTEE,
RESPONDENT.

ON APPEAL FROM THE UNITED STATES COURT OF APPEALS FOR THE THIRTEENTH CIRCUIT

BRIEF FOR THE RESPONDENT

TEAM NUMBER 28
COUNSEL FOR RESPONDENT

JANUARY 20, 2022

QUESTIONS PRESENTED

I. Whether an amount paid under 11 U.S.C. § 503(b)(9) for goods delivered pre-petition may serve as new value under 11 U.S.C. § 547(c)(4) to reduce a creditor's preference exposure.

II. Whether under 11 U.S.C. § 365(d)(3) a trustee must perform a debtor's unexpired nonresidential real property triple-net lease obligations allocable to the period after the debtor's effective rejection of the lease.

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The decision of the Thirteenth Circuit Court of Appeals is available at No. 20-0803 and reprinted at Record 3. Both the Bankruptcy Court for the District of Moot and the United States District Court for the District of Moot decided in favor of Casey Jones (the "Trustee"). On appeal, the United States Court of Appeals for the Thirteenth Circuit affirmed the lower courts' decision.

STATEMENT OF JURISDICTION

The formal statement of jurisdiction is waived pursuant to Competition Rule VIII.

STATUTORY PROVISIONS

The relevant statutory provisions are listed below and their pertinent text are reproduced in Appendix A.

11 U.S.C. § 365(d)(3)

11 U.S.C. § 503(b)(9)

11 U.S.C. § 547(c)(4)

STATEMENT OF THE CASE

This appeal arises out of Petitioner's attempt to obtain prejudicial payments that go against the procedural requirements of the Bankruptcy Code (the "Code").[1] Thus, the bankruptcy proceeding underlying this appeal threatens to hold the petitioner in priority over other creditors, thereby reducing the estate's value to the detriment of those other creditors.

Factual history

William Tell ("Tell") founded Terrapin Station, LLC (the "Debtor") in 2005. R. at 2. The Debtor was formerly a successful independent coffeehouse in Terrapin, Moot. R. at 2-3. However, by 2017, the Debtor's sales had become stagnant, and it needed renovations. R. at 4. Meanwhile, Touch of Grey Roasters, Inc. ("Touch of Grey"), an international coffee company, actively sought independent coffeehouses to franchise as part of its efforts to grow in new markets. R. at 4. In 2017, Touch of Grey approached Tell about a potential franchise agreement with the Debtor. R. at 4. Subsequently, the Debtor, as a franchisee, entered into a franchise agreement with Touch of Grey, as the franchisor, in June 2018. R. at 4.

Due to increased consumer demand for local, independent businesses, the franchise agreement required the Debtor to operate under its current name, "Terrapin Station Coffeehouse," rather than the Touch of Grey brand. R. at 4. Additionally, the franchise agreement required the Debtor to exclusively sell Touch of Grey's "Dark Star" coffee products. R. at 4. This was done to hide the Debtor's relationship with the large coffee company from its customers. R. at 4.

The Debtor also entered into a lease agreement (the "Lease") with Touch of Grey as landlord and the Debtor as a tenant. R. at 4. Touch of Grey agreed to purchase, renovate, and lease

[1] The Bankruptcy Code is set forth in 11 U.S.C. §§ 101 et seq. (2020). Specific sections of the Bankruptcy Code are identified herein as "section __."

to the Debtor a warehouse space at 5877 Shakedown Street (the "Premises"). R. at 4. The Lease was a twenty-year triple-net lease with a monthly rental obligation of $25,000, due on the first day of each month. R. at 4. The Debtor hoped to capitalize on the Premises' location in the entertainment district by hosting live music and serving alcohol well past regular coffeehouse hours. R. at 4.

Touch of Grey completed the renovations in November 2018, and the new franchise opened on December 1, 2018. R. at 5. However, the Debtor encountered issues from the start. R. at 5. First, local coffeehouse owners soon learned of the Debtor's relationship with Touch of Grey and launched an ad campaign that mercilessly characterized the Debtor as "big coffee in disguise." R. at 5. The campaign was successful, and the Debtor's sales suffered. R. at 5. Next, the Debtor's efforts to expand its operations into Shakedown Street's nightlife scene failed due to the competitive night scene in the entertainment district. R. at 5. These factors coupled with the Debtor's above-market rental obligation and various business costs caused the Debtor to begin missing its debt payments as they became due beginning in September 2019. R. at 5.

By November 2019, the Debtor owed Touch of Grey over $700,000 for Dark Star-branded goods. R. at 5. Due to outstanding debt, Touch of Grey sent the Debtor a notice of default on December 5, 2019. R. at 5. In the notice, Touch of Grey threatened to terminate the franchise agreement. R. at 5. However, on December 7, 2019, the parties entered into a forbearance agreement wherein Touch of Grey agreed to forebear terminating the franchise agreement in exchange for: (i) a $250,000 payment towards the outstanding invoices, (ii) reaffirmation by the Debtor of its obligations under the Lease, (iii) and a release of all claims that the Debtor had against Touch of Grey. R. at 5. That same day, the Debtor paid Touch of Grey $250,000. R. at 5.

Subsequently, the Debtor purchased an additional $200,000 worth of Dark Star products on credit as evidenced by an invoice dated December 18, 2019 (the "Invoice Date"). R. at 5. To facilitate the sale, Tell was forced to sign a personal guarantee regarding payment of the goods. R. at 5-6. Touch of Grey delivered the goods on December 21, 2019. R. at 6.

Eighteen days after the Invoice Date, on January 5, 2020 (the "Petition Date"), the Debtor filed a petition for relief under chapter 11 of the Code. R. at 6. As of the Petition Date, the Debtor was current on its lease payments; however, the Debtor owed Touch of Grey $650,000 for goods purchased and over $500,000 to other unsecured creditors. R. at 6. In addition to its petition, the Debtor also filed several "first-day" motions supported by Tell's reorganization strategy. R. at 6. Further, Tell said he would attempt to find a sub-lessee to reduce the monthly rental burden. R. at 6. Importantly, the reorganization strategy intended to return the Debtor to its traditional coffeehouse operations while still selling Dark Star-branded products as required by the franchise agreement. R. at 6.

Two weeks after the "first-day" hearing, the Debtor filed a motion requesting authority to pay Touch of Grey $200,000 for the goods purchased on the Invoice Date. R. at 6. The Debtor asserted that absent the payment, Touch of Grey was unwilling to sell goods on credit after the petition date. R. at 6. In other words, the Debtor argued that Touch of Grey was a critical vendor without which the reorganization plan would fail. R. at 6. The Debtor further asserted that the debt was entitled to priority payment as an administrative expense under section 503(b)(9). R. at 7. Therefore, the payment would not prejudice other creditors. R. at 7. The court did not classify the payment as a critical vendor payment because the court was uncertain whether the Code allowed such payments. R. at 7. Still, the bankruptcy court granted Touch of Grey an administrative expense claim under section 503(b)(9) for the value of the goods sold and allowed an immediate

payment. R. at 7. Days later, the Debtor made the $200,000 payment to Touch of Grey, and Touch of Grey resumed credit sales to the Debtor. R. at 7.

Unfortunately, the reorganization plan failed to revive the Debtor's business, in large part because the COVID-19 pandemic forced the Debtor to temporarily close its doors in March 2020. R. at 7. After its temporary shutdown, the Debtor resumed operations in April 2020. R. at 7. However, the Debtor's customers did not return, and the business continued to struggle. R. at 7. Consequently, On May 5, 2020, during the peak of the COVID-19 pandemic, the Debtor permanently ceased operations, vacated the Premises, and returned the keys to Touch of Grey. R. at 7.

Procedural History

On May 6, 2020, the Debtor filed a motion to reject the Lease and the franchise agreement with Touch of Grey under section 365(a). R. at 7. In response, Touch of Grey filed a motion on May 8, 2020, to compel payment of the May rent, which became due on May 1, 2020, according to the Lease, arguing it was entitled to payment in full for the May rent under section 365(d)(3) because the rent came due before the date of rejection. R. at 7-8. On May 29, 2020, the bankruptcy court held a hearing on both motions. R. at 8.

Upon a motion by the Debtor under section 1112(a), the court entered an order to convert the case to a chapter 7 bankruptcy and appointed the Trustee. R. at 8. The bankruptcy court also granted, and Touch of Grey did not dispute, the Debtor's motion rejecting the Lease and franchise agreements effective May 5, 2020. R. at 8. The court issued an order requiring additional briefing on the May rent issue. R. at 8.

After unsuccessful mediation, the parties filed cross-motions for summary judgment. R. at 8. The Trustee raised two legal arguments that survive to this appeal. R. at 8. First, under sections

547(b) and 550(a), the Trustee sought to avoid and recover the $250,000 payment that the Debtor made due to the forbearance agreement. R. at 8. In response, Touch of Grey asserted that under section 547(c)(4), it may reduce any preference exposure by the $200,000 in goods sold to the Debtor on the Invoice Date. R. at 8. The bankruptcy court ruled in favor of the Trustee, holding that because the Debtor paid for the goods under section 503(b)(9), Touch of Grey could not use the new value defense to reduce its preference exposure. R. at 9.

Second, the Trustee objected to Touch of Grey's motion to compel payment for the entirety of the May rental obligation under section 365(d)(3). R. at 8. The bankruptcy court ruled in favor of the Trustee, holding that section 365(d)(3) only required the Trustee to pay rent for the five days that the Debtor had occupied the Premises prior to rejection. R. at 9. In subsequent appeals, the District Court of Moot and the Thirteenth Circuit Court of Appeals affirmed the bankruptcy court's decision on both issues. Touch of Grey appeals. R. at 9.

STANDARD OF REVIEW

The facts as stated in this brief are not disputed by the parties. Rather, the issues before this court are based on statutory interpretation of the Code and are issues of pure law. Therefore, the standard of review is *de novo*. *Pierce v. Underwood*, 487 U.S. 552, 558 (1988).

SUMMARY OF THE ARGUMENT

The Code aims to strike a balance between the rights of debtors and creditors. Here, two issues that jeopardize that balance are (1) a creditor's ability to use goods satisfied by an administrative expense payment under the new value defense to decrease its preference exposure and (2) the adoption of the "billing approach" versus the "proration approach" for post-rejection unexpired leases. The Thirteenth Circuit correctly found this balance according to the Code, and therefore, its decision should be affirmed.

On the first issue, Touch of Grey may not use the same value satisfied as an administrative expense payment to decrease its preference exposure as new value under section 547(c)(4). Courts are divided on this issue. *See Beaulieu Liquidating Tr. v. Fabric Sources, Inc. (In re Beaulieu Grp., LLC)*, 616 B.R. 857, 872-73 (Bankr. N.D. Ga. 2020), *appeal docketed sub nom Auriga Polymers Inc. v. PMCM2, LLC,* No. 20-14647 (11th Cir. Dec. 11, 2020). Section 547(c)(4), also known as the new value defense, allows creditors to limit their preference exposure by new value they contribute "to or for the benefit of the debtor."11 U.S.C. § 547(c)(4). Further, "[t]he subsequent new value defense reflects the understanding that when a debtor makes a preferential payment to the creditor - thereby depleting the pool of funds available to other creditors - that pool is replenished when the creditor subsequently provides new value to the debtor." *In re Beaulieu Grp., LLC*, 616 B.R. at 875. For this reason, "if the debtor makes a further payment on account of the new value that cannot be clawed back, the estate is once again depleted, and the new value cannot be used to offset preference liability." *Id*. Offering similar protection to creditors, section "503(b)(9) allows for post-petition payment to a creditor for the pre-petition transfer of goods from the creditor to the debtor." *TI Acquisition, LLC v. Southern Polymer, Inc. (In re TI Acquisition)*, 429 B.R. 377, 380 (Bankr. N.D. Ga. 2010).

Here, Touch of Grey received a post-petition payment as an administrative expense of $200,000 for goods delivered pre-petition, and this precludes them from reducing their preference exposure by asserting the $200,000 as new value under section 547(c)(4). First, the payment of the administrative expense was a transfer from the debtor within the meaning of section 547(c)(4)(B). And because the administrative expense payment was approved by the Court post-petition, it may not be avoided under § 549 or any of the other Trustee's avoiding powers. Like *Beaulieu Group, LLC*, Touch of Grey received payment for the new value that could not be avoided by the trustee,

and "the estate [was] once again depleted." *In re Beaulieu Grp., LLC*, 616 B.R. at 875. For these reasons, that value can no longer count towards the new value defense.

Further, the Code's policy supports the ruling of the Thirteenth Circuit because it ensures the equal treatment of creditors. Allowing creditors to use administrative expense payment towards a new value defense would not further the policy of encouraging creditors to continue to do business with financially distressed companies. Finally, the case of an administrative expense payment is different from critical vendor orders which have been allowed to go towards the new value defense in other courts. In sum, the Thirteenth Circuit properly held that Touch of Grey may not use their satisfied administrative expense claim to decrease their preference exposure under the new value defense.

Turning to the second issue in this case, the Thirteenth Circuit correctly held that section 365(d)(3) does not require the Trustee to satisfy the Debtor's unexpired lease obligations allocable to the post-rejection period. The ambiguity in the text of section 365(d)(3) has caused courts to split as to what exactly Congress intended when it passed section 365(d)(3). Hence, courts have taken two different approaches: the proration approach and the billing date approach. Looking beyond the isolated text in section 365(d)(3), all other canons of statutory construction, as well as the Code's overall purposes and policies, overwhelmingly support the proration approach adopted by the Thirteenth Circuit.

First, the proration approach perfectly fits within the Code's statutory scheme. The Code clearly establishes that unperformed post-rejection obligations become unsecured claims deemed to have occurred prepetition, not administrative expenses. *See* 11 U.S.C. §§ 365(g), 502(g), 502(b)(6). Furthermore, section 365(d)(4) commands the trustee to immediately surrender the property to the landlord after rejection. 11 U.S.C. § 365(d)(4). Therefore, mandating the Trustee

to pay lease obligations allocable to the post-rejection period in which the Debtor enjoyed no right of use or occupancy makes little sense within the Code's statutory scheme.

Second, before Congress enacted section 365(d)(3), courts overwhelmingly applied the proration approach, and the Code should not be interpreted "to erode past bankruptcy practices absent a clear indication that Congress intended such a departure…." *Cohen v. De La Cruz*, 523 U.S. 213, 221 (1998). There exists no such clear indication in the legislative history that Congress intended to abrogate the proration approach. On the contrary, the simultaneous enactment of section 365(d)(4) provides support for the proration approach. Additionally, Congress enacted section 365(d)(3) to prevent landlords from having to provide "current services … without current payment." 130 Cong. Rec. (1984), *as reprinted in* 1984 U.S.C.C.A.N. 576, 598-99 (statement of Sen. Hatch). Proration accomplishes this here by ensuring that Touch of Grey receives adequate consideration for the post-petition period in which it provides the benefit of use and occupancy of the Premises to the Debtor.

Lastly, the proration approach completely adheres to the purposes and policies of the Code, while the billing date approach produces nonsensical, inequitable outcomes and encourages strategic behavior by debtors and landlords. "[O]ne of the prime purposes of the bankruptcy law [is] to bring about a ratable distribution among creditors of a bankrupt's assets; to protect the creditors from one another." *Young v. Higbee Co.*, 324 U.S. 204, 210 (1945) (citations omitted). By ensuring landlords adequate consideration for the services they provide the estate, while also preventing any potential windfall to the landlord that would harm the estate and its creditors, the proration approach perfectly adheres to the purpose of the Code articulated by the Supreme Court in *Young*. Further, by producing fair and consistent outcomes, the proration approach curbs the incentive for debtors and landlords to engage in strategic behavior aimed at receiving a windfall.

Conversely, the billing date approach produces inequitable outcomes based arbitrarily on the date in which the debtor files bankruptcy or the date in which the trustee rejects the lease. The Thirteenth Circuit correctly recognized this and ruled consistently with the Supreme Court's statement that "[s]tatutes should be interpreted to avoid untenable distinctions and unreasonable results whenever possible." *Am. Tobacco Co. v. Patterson*, 456 U.S. 63, 71 (1982).

In conclusion, for these reasons and others expanded in the arguments below, the Thirteenth Circuit correctly held that section 365(d)(3) does not require the Trustee to satisfy the Debtor's unexpired Lease obligations allocable to the post-rejection period.

ARGUMENT

I. THE THIRTEENTH CIRCUIT CORRECTLY HELD THAT TOUCH OF GREY COULD NOT USE THE VALUE SATISFIED UNDER 11 U.S.C. § 503 TO DECREASE THEIR PREFERENCE EXPOSURE UNDER 11 U.S.C. § 547(c)(4).

Touch of Grey may not use the same value satisfied by an administrative expense payment to decrease their preference exposure under the new value defense contained in section 547(c)(4). The Code empowers a trustee "to avoid certain transfers made prior to the bankruptcy filing if the elements of Bankruptcy Code § 547(b) are met." *In re TI Acquisition, LLC,* 429 B.R. at 380 (citing 11 U.S.C. § 547). However, "[c]ertain transfers are not avoidable if a defendant can avail itself of one of the defenses set out in § 547(c)." *Id.* Section 547(c)(4), also known as the "new value" defense, provides that a trustee may not avoid a transfer . . .

> (4) to or for the benefit of a creditor, to the extent that, after such transfer, such creditor gave new value to or for the benefit of the debtor—
>
> (A) not secured by an otherwise unavoidable security interest; and
>
> (B) on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor

11 U.S.C. § 547(c)(4). Section 547(a)(2) defines new value as "money or money's worth in goods, services, or new credit . . . that is neither void nor voidable by the debtor or the trustee under any applicable law." 11 U.S.C. § 547(a)(2). Further, "Code § 503(b)(9) allows for an administrative expense for the value of the goods 'received by the debtor within 20 days before the date of commencement of the case,' provided that those goods have been 'sold to the debtor in the ordinary course of such debtor's business.'" *Siegel v. Sony Elecs., Inc. (In re Cir. City Stores, Inc.),* 515 B.R. 302, 313 (Bankr. E.D. Va. 2014) (citing 11 U.S.C. § 503(b)(9)). Parties stipulated and the Thirteenth Circuit agreed that new value does not need to remain unpaid to qualify for the new value defense. R. 11 n.5; *See Miller v. JNJ Logistics LLC (In re Proliance Int'l Inc.),* 514 B.R. 426, 438 (Bankr. D. Del. 2014). However, because an administrative expense payment is authorized by the Code it is an otherwise unavoidable transfer that does not qualify for the new value defense.

Here, because the administrative expense payment was an otherwise unavoidable transfer from the Debtor for Touch of Grey's benefit, it may not be used in the new value defense to decrease its preference exposure. First, the payment of the administrative expense meets the criteria in the statute as a transfer from the debtor for the benefit of the creditor that is otherwise unavoidable within the plain meaning of the statute. Second**,** there is no temporal limitation contained in the language of section 547(c)(4); therefore, post-petition transfers, like an administrative expense payment, may be considered in the new value defense analysis. Third, precluding creditors from using value satisfied by an administrative expense to reduce their preference exposure furthers the policy goals of the Code, ensuring equal treatment of creditors and encouraging creditors to continue business with financially troubled entities. Finally, the case

at hand may be distinguished from other cases reaching different conclusions on the interaction between critical vendor orders and the new value defense.

A. Touch of Grey's administrative expense claim does not qualify for the new value defense because it is an otherwise unavoidable transfer from the debtor described in 11 U.S.C. § 547(c)(4)(B).

Touch of Grey's administrative expense payment is an otherwise unavoidable transfer from the Debtor within the meaning of section 547(c)(4); therefore, it is excluded from the new value defense. Under section 547(c)(4)(B), Touch of Grey's administrative expense payment is (1) a transfer to or for the benefit of the creditor, (2) from the debtor, (3) that was otherwise unavoidable, and therefore, the administrative expense value is not entitled to the new value defense. *See* 11 U.S.C. § 547(c)(4)(B).

1. An administrative expense payment is a "transfer," as defined by 11 U.S.C. § 101(54)(D) from the Debtor for the benefit of Touch of Grey.

Because the administrative expense payment is a transfer from the Debtor for Touch of Grey's benefit within the meaning of section 547(c)(4)(B), it meets the first criteria of the statutory provision. In section 101(54)(D), the "Code defines a transfer 'as each mode, direct or indirect, absolute or conditional, voluntary or involuntary of disposing of or parting with— (i) property, or (ii) and interest in property.'" *In re Beaulieu Grp., LLC,* 616 B.R. at 870 (quoting 11 U.S.C. § 101(54)(D)). Further, "[n]othing in the definition of 'transfer' excludes distributions." *Id.*

Some have argued that the language in section 547(c)(4)(B) limits that provision to transfers made from the debtor pre-petition because the debtor becomes the debtor-in-possession post-petition. *See, e.g., Friedman's Liquidating Tr. v. Roth Staffing Cos., LP (In re Friedman's Inc.),* 738 F.3d 547, 555 (3d. Cir. 2013) (citing *Phoenix Rest. Grp., Inc. v. Ajilon Prof'l Staffing LLC (In re Phoenix Rest. Grp., Inc.),* 317 B.R. 491, 497 (Bankr. M.D. Tenn. 2004)). Proponents

of this view urge that any post-petition payment may not limit a creditor's new value defense because it will be paid by the debtor-in-possession rather than the debtor. *Id.* However, the Supreme Court held in *Bildisco*, "[i]t is sensible to view the debtor-in-possession as the same entity which existed before the filing of the bankruptcy petition, but empowered by virtue of the Bankruptcy Code to deal with its contracts and property in a manner it could not have employed absent the bankruptcy filing." *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 528 (1984).

Here, the bankruptcy court authorized the Debtor to pay Touch of Grey a $200,000 administrative expense, which the Debtor paid days later. This was a transfer for the benefit of Touch of Grey within the definition of the Code as it was a direct mode of voluntarily disposing of property as described in section 101(54)(D). Further, as supported by *Bildisco*, a post-petition payment from the debtor-in-possession has the same effect as a payment from a pre-petition Debtor within the meaning of section 547(c)(4)(B). In sum, the payment to Touch of Grey was a transfer made by the Debtor.

2. Touch of Grey's administrative expense claim is an otherwise unavoidable transfer that cannot be included in the new value defense.

Because the payment of the administrative expense claim to Touch of Grey may not be avoided under any of the Trustee's other avoiding powers, it may not be included in the new value defense. To be eligible for the new value defense, the transfer may not be "an otherwise *unavoidable* transfer." 11 U.S.C. § 547(c)(4)(B) (emphasis added). An administrative expense payment is granted post-petition. *Cir. City Stores, Inc. v. Mitsubishi Dig. Elecs. Am. (In re Cir. City Stores, Inc.),* 2010 WL 4956022, at *8 (Bankr. E.D. Va. Dec. 1, 2010). For this reason, the only avoiding power that may apply to it is section 549. *Id.* The other avoiding powers of the trustee apply only to pre-petition transfers or to the fixing of a lien. *Id.* However, "[b]ecause the Code authorizes payments of § 503(b)(9) expenses, they are not avoidable under § 549 or any other

section of the Code." *In re Beaulieu Grp., LLC,* 616 B.R. at 869. Section 549 provides that "the trustee may avoid a transfer of property of the estate . . . *that is not authorized under this title or by the court*." 11 U.S.C. § 549(a) (emphasis added). Further, if "the transfer on account of the new value is not itself avoidable, then it cannot be said that the estate has received the full value of the new value, because something has been given back on account of it, and therefore, the preference must be recalculated after the reduction in new value." *MMR Holding Corp. v. C & C Consultants, Inc. (In re MMR Holding Corp.),* 203 B.R. 605, 609 (Bankr. M.D. La. 1996).

Here, the court's authorization of the $200,000 administrative expense claim makes this transfer unavoidable under section 549(a), the only avoiding power that could apply as supported by *Circuit City Stores, Inc*. For this reason, the administrative expense payment is an otherwise unavoidable transfer, and it must be excluded from Touch of Grey's new value defense as it does not meet the requirements of the statute. As expressed in *MMR Holding Corporation,* the Trustee cannot claw back the administrative expense payment, and the estate is no longer enhanced by that new value.

B. Because there is no temporal limitation on the new value defense analysis, Touch of Grey's post-petition administrative expense payment reduces its new value defense.

The correct interpretation of the statute is that post-petition transactions may impact the new value defense analysis. This interpretation is supported by the plain statutory language, as no express temporal limitation exists in the provision. Neither the title of the Code section nor the legislative history of section 503 or section 547 may overcome this plain language interpretation.

The post-petition payment of Touch of Grey's administrative expense worked to exclude the goods delivered pre-petition as new value to reduce their preference exposure. Touch of Grey argues that section 547(c)(4) should be interpreted as having a cutoff as of the Petition Date. However, as explained above, there is no temporal limitation, and one should not be read in.

1. 11 U.S.C. § 547(c)(4) contains no express temporal limitation.

Because there is no temporal limitation in the statute, the payment of Touch of Grey's post-petition administrative expense claim reduces its available new value defense. There is a double negative in section 547(c)(4)(B); however, "this fact makes the statute *complicated*, not ambiguous." *Boyd v. The Water Doctor (In re Check Reporting Servs., Inc.)*, 140 B.R. 425, 434 (Bankr. W.D. Mich. 1992). All statutory interpretation should begin with the plain language of the statute. *Conn. Nat'l Bank v. Germain,* 503 U.S. 249, 253-54 (1992).

Turning to the plain language, section "547(c)(4)(B) does not contain any limitation as to when new value may be repaid." *In re Cir. City Stores, Inc.*, 515 B.R. at 314; *See also In re Beaulieu Grp., LLC*, 616 B.R. at 873. Further, "[t]he plain language of Bankruptcy Code § 547(c)(4)(B) does not allow for the assertion of a § 503(b)(9) claim as a new value defense after the creation of a reserve account by the debtor to pay all administrative claims." *In re Cir. City Stores, Inc.*, 515 B.R. at 314.

Considering section 547(c)(4) within the context of the Code also supports the conclusion that there is no temporal limitation for the new value defense analysis. The court in *Beaulieu* argues that "indication that the omission [of a temporal limitation in § 547(c)(4)] was intentional is found in § 547(c)(5), which is limited to transfers made 'as of the date of the filing of the petition,' as it shows Congress knew how to impose such a limitation when it intended to do so." *In re Beaulieu Grp., LLC*, 616 B.R. at 872 (citing 11 U.S.C. § 547(c)(5)); *Accord Whitman v. Am. Trucking Ass'ns, Inc.*, 531 U.S. 457, 468 (2001).

Here, because the Debtor paid Touch of Grey for the value of the pre-petition invoice post-petition, they may not decrease their preference exposure by using this new value. There is no timing requirement in the statute. This case goes further than the case of *Circuit City Stores*, where

only a reserve of money was available to pay the claims. Touch of Grey's claim was paid days after it was granted. Further, because Congress included temporal limitations elsewhere in section 547, the absence of such a limitation in section 547(c)(4) suggests that it was intentionally left out.

2. The title of the Code section nor the legislative history can overcome the statute's plain language.

The defense argues that the title "Preferences" implies that the new value defense must not consider any transfers that occur post-petition. However, while a court may consider the title of a statutory provision to determine its meaning, it "cannot trump the plain meaning of the text." *United Mine Works of Am. Combined Benefit Fund v. Toffel (In re Water Energy, Inc.)*, 911 F.3d 1121, 1154 n.38 (11th Cir. 2018).

Similarly, the legislative history may not overcome the plain language of the statute. This is because "the best evidence of Congress' intent is the language of the statute, which does not include any requirement that the otherwise unavoidable transfers take place pre-petition." *In re Beaulieu Grp., LLC*, 616 B.R. at 872 (citing *American Gen. Fin., Inc. v. Paschen (In re Paschen)*, 296 F.3d 1203, 1207 (11th Cir. 2002)). Congress enacted section 503(b)(9) with The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"). 4 Collier on Bankruptcy P 503.LH (16th 2021) (citing Pub. L. No. 109-8, §§ 445, 1103, 1227(b) (2005)). However, "[w]hile no legislative history exists [on section 503(b)(9)] one can only surmise that these amendments reflect Congress's intent to better ensure that ordinary course of business sellers of goods received by the debtor in the 20 days before the petition date gain priority in payment over most other creditors." *In re TI Acquisition, LLC*, 410 B.R. 742, 746 (Bankr. N.D. Ga. 2009). Further, words should not be read into a statute where there is "a plain, nonabsurd meaning in view." *Lamie v. U.S. Tr.*, 540 U.S. 526, 538 (2004).

Here, the title of section 547, "Preferences," does not overcome the interpretation of the statute's plain language. Hence, the payment that Touch of Grey received must decrease the new value defense. For these reasons, there is no temporal limitation that a transfer must occur pre-petition to be considered in the new value defense analysis.

C. The policy of the Code supports that Touch of Grey may not use value satisfied by an administrative expense payment as part of a new value defense.

Allowing Touch of Grey to use the same value that it received an administrative expense payment for to reduce its preference exposure would run contrary to the policy goals of the Code. The purpose behind "the new value defense is to preserve the policy objectives underlying preference provisions of the Bankruptcy Code." *In re TI Acquisition, LLC*, 429 B.R. at 384. First, it is intended "to encourage creditors to continue extending credit to financially troubled entities while discouraging a panic-stricken race to the courthouse." *Charisma Inv. Co., N.V. v. Airport Sys., Inc. (In re Jet. Fla. Sys., Inc.)*, 841 F.2d 1082, 1083. Second, "[a]nother related objective of this section is to promote equality of treatment among creditors." *Id.*

1. *Because Touch of Grey was paid for the $200,000 worth of value it delivered pre-petition, allowing it to use the same value to decrease its preference exposure would run counter to the policy of equal treatment of creditors.*

Touch of Grey may not use value otherwise unavoidable towards the new value defense. Section 547(c)(4) "fosters [Bankruptcy policy objectives] because it limits the defense to the extent by which the bankruptcy estate has been enhanced by the creditor's actions." *In re TI Acquisition, LLC*, 429 B.R. at 384 (citing *Kroh Bros. Dev. Co. v. Cont'l Constr. Eng'rs, Inc.,* (*In re Kroh Bros. Dev. Co.)*, 930 F.2d 648, 654 (8th Cir. 1991)). Further, "[i]f the estate is not enlarged, no new value is given." *In re TI Acquisition, LLC*, 429 B.R. at 384. In *TI Acquisition*, the court found that while the creditor's "delivery of goods to Debtor pre-petition enlarged the Debtor's estate . . . [u]pon full payment to [the creditor], the Debtor's estate [was] no longer enlarged by the delivery."

Id. For this reason, the creditor "[had] no new value for which it has yet to receive full credit and should not be entitled to the new value defense." *Id.*

Precluding creditors from using an administrative expense payment to reduce their preference exposure in the new value defense ensures equal treatment of creditors because it disallows creditors to "double dip" for the same value. As one court describes, "[a]llowing BOTH new value credit and payment of the 503(b)(9) claim elevates the claim of that creditor and results in double payment to that creditor." *Id.* at 385. Further, "[a] contrary interpretation of the statute would result in inequitable treatment of creditors, as the Trustee would be required to pay the administrative claim while simultaneously not being permitted to challenge potentially avoidable preferential transfers." *In re Cir. City Stores, Inc.*, 515 B.R. at 314. This result may also lead to "perverse incentives" for debtors to favor certain creditors on the eve of bankruptcy. *See* Nick Sears, *Defeating the Preference System: Using the Subsequent New Value Defense and Administrative Expense Claims to "Double Dip,"* 28 EMORY BANKR. DEV. J. 593, 622-25 (2012).

Notably, section 503(b)(9) was intended to benefit trade creditors. *In re Arts Dairy, LLC,* 414 B.R. 219, 220 (Bankr. N.D. Ohio 2009). However, priority treatment of creditors should be allowed "only when clearly authorized by Congress." *Howard Delivery Serv., Inc. v. Zurich Am. Ins. Co.*, 547 U.S. 651, 655 (2006). Allowing value satisfied by an administrative expense payment to decrease a creditor's preference exposure under section 547(c)(4) would result in "general unsecured creditors [being] penalized by the reduction of the amount available to pay its claims while the § 503(b)(9) claimant [receives] payment in full plus new value credit, which reduces what it must pay to the estate on account of its preference liability." *In re Beaulieu Group, LLC,* 616 B.R. at 877. If Congress intended for Touch of Grey to receive full payment on their

administrative claims while also using that same satisfied value to limit their preference exposure, Congress would have specified that directly in the statute.

Similar to *TI Acquisition LLC*, Touch of Grey was paid for their delivery of goods by an unavoidable transfer; therefore, no new value remains. Initially, Touch of Grey's receipt of payment for the goods delivered pre-petition as an administrative expense claim helped other creditors. This is because Touch of Grey continued to ship to the Debtor on credit, allowing it to continue as an on-going concern, increasing the likelihood that other creditors would be paid. However, allowing Touch of Grey to reduce their preference exposure for this same value would solely benefit Touch of Grey while simultaneously harming other creditors by depleting the estate's available assets.

2. Allowing creditors to use their administrative expense claim in a new value defense will not further encourage creditors to continue business with financially troubled entities.

If creditors like Touch of Grey were able to use value satisfied by an administrative expense payment towards their new value defense, this would not further the policy goal of encouraging creditors to do business with debtors. Importantly, "creditors' knowledge of the availability of the new value defense encourages continued commerce with the debtor." *In re TI Acquisition*, 429 B.R. at 384-85. Section 503(b)(9) has similar policy goals in mind to section 547(c)(4) as "it seeks to encourage trade creditors to continue to extend credit to a debtor potentially heading for bankruptcy." *In re Arts Dairy, LLC*, 414 B.R. at 220. However, "[f]rom the creditor's pre-petition perspective, there is no difference in incentive if the new value defense the creditor may have relied on is lost as a result of a 503(b)(9) claim." *In re TI Acquisition*, 429 B.R. at 385. This is because "[w]hen a creditor ships goods pre-petition . . . the creditor never knows whether a bankruptcy will be filed within 20 days of the shipment." *Id.* Thus, the creditor does not know if

it has a section 503(b)(9) claim. Further, "when an allowed § 503(b)(9) claim is guaranteed payment . . . the creditor will get paid in full for the value delivered to the debtor, and paying creditors in full for their claims is the ultimate method of encouraging them to continue trade with the debtor." *Id.*

Here, Touch of Grey did not know on December 18, 2019 that the goods delivered to the Debtor would be within the 20-day pre-petition window and eligible to an administrative expense. Therefore, they would not know if they would be able to classify the goods as an administrative expense. As touched on in *TI Acquisition*, there was no incentive difference for Touch of Grey if their new value defense was lost to their administrative expense claim. Finally, Touch of Grey received their $200,000 payment in full days after the administrative expense claim was granted, and this was the ultimate incentive to continue in business with the Debtor.

D. The case of an administrative expense is distinct from other cases which have allowed the payment of a critical vendor order to go towards the new value defense.

In this case, Touch of Grey's administrative expense is distinguishable from cases concerning critical vendor orders. In two cases, "the courts allowed the assertion of a new value defense when the new value had been paid as a result of an authorization in a critical vendor order." *In re TI Acquisition, LLC*, 429 B.R. at 382 (citing *Phoenix Rest. Grp., Inc. v. Proficient Food Co. (In re Phoenix Rest. Grp.)*, 373 B.R. 541, 546-549 (M.D. Tenn. 2007) and *Kaye v. Accord Mfg., Inc. (In re Murray, Inc.)*, 2007 WL 5595447 (Bankr. M.D. Tenn. 2007)). However, "[o]ne of the conditions that can be negotiated by the parties and incorporated into the order is how to deal with the potential preference liability of a critical vendor creditor, which can ensure that the value received by the debtor-in-possession is sufficient to justify the favored treatment." *In re TI Acquisition, LLC*, 429 B.R. at 382 (citation omitted). On the other hand, "[a] pre-petition debtor could not use the power and protection of the Bankruptcy Court to negotiate terms on goods

provided within the §503(b)(9) period the way a post-petition debtor can negotiate for terms on critical vendor orders." *Id.* at 382.

Here, the negotiations that could have existed in a critical vendor context did not exist. As explained in *TI Acquisition*, there was no way to ensure that the value provided would benefit the Debtor and its creditors enough to justify an additional priority provided by the new value defense. Therefore, Touch of Grey may not extend the new value defense to the same value it received as an administrative expense payment.

II. THE THIRTEENTH CIRCUIT CORRECTLY HELD THAT 11 U.S.C. § 365(D)(3) DOES NOT REQUIRE THE TRUSTEE TO SATISFY THE DEBTOR'S UNEXPIRED LEASE OBLIGATIONS ALLOCABLE TO THE POST-REJECTION PERIOD.

A chapter 7 trustee has the authority under section 365 of the Code to assume or reject any executory contracts or unexpired leases to which the debtor is a party. 11 U.S.C. § 365(a). In an ongoing chapter 11 case, as is the case here at the time of rejection, the debtor-in-possession, Terrapin, generally has all the rights and powers of a chapter 7 trustee. 11 U.S.C. § 1107(a).

Section 365(d)(3) of the Code applies to unexpired leases for nonresidential real property and states:

> The trustee 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 . . .

11 U.S.C. § 365(d)(3)(A). Accordingly, section 365(d)(3) provides direction as to *what* a trustee must do in the period between an order for relief and effective assumption or rejection of an

unexpired lease for nonresidential real property. However, courts have adopted two different approaches to *when* the trustee's obligation to do so arises.

One such approach, deemed the "proration" approach, interprets section 365(d)(3) to require the trustee to only perform the debtor's obligations under the lease allocable to the post-petition, pre-rejection period. *See, e.g., El Paso Props. Corp. v. Gonzales (In re Furr's Supermarkets, Inc.)*, 283 B.R. 60, 69-70 (B.A.P. 10th Cir. 2012); *In re Ames Dep't Stores, Inc.*, 306 B.R. 43, 64-5 (Bankr. S.D.N.Y. 2004) ("[T]he section 365(d)(3) duty to pay post-petition lease obligations, when addressed after rejection, must be prorated to cover only the portion allocable to the pre-rejection period.").

Alternatively, other courts take the rigid "billing date" approach to section 365(d)(3). Under this approach, courts require the trustee to perform the entirety of the debtor's obligations under the unexpired lease, regardless of an intervening rejection of the lease. *See, e.g.*, *Centerpoint Props. v. Montgomery Ward Holding Corp. (In re Montgomery Ward Holding Corp.)*, 268 F.3d 205, 209-10 (3d Cir. 2001); *Koenig Sporting Goods, Inc. v. Morse Road Co. (In re Koenig Sporting Goods, Inc.)*, 203 F.3d 986, 989 (6th Cir. 2000).

The Thirteenth Circuit correctly adopted the proration approach to section 365(d)(3), holding that the Trustee was only required to pay the portion of rent to Touch of Grey that is allocable to the pre-rejection period (the first five days of the month) during which time the Debtor enjoyed the benefit of use and occupancy of the Premises. First, because the text in section 365(d)(3) is ambiguous when read in isolation, the Thirteenth Circuit correctly considered other means of statutory construction, all of which support the proration approach. Second, because the proration approach is wholly consistent with the purposes and policies of the Code, this Court should adopt it and make its application uniform across jurisdictions.

A. Because the meaning of the text in 11 U.S.C. § 365(d)(3) is ambiguous when read in isolation, the Thirteenth Circuit correctly considered other canons of statutory construction, all of which support the proration approach.

When discerning the congressional intent behind a statute, courts should first turn to the cardinal canon of statutory construction: the plain meaning of the text within the statute. *See Conn. Nat'l Bank*, 503 U.S. at 253; *Lamie*, 540 U.S. at 534. The Supreme Court has time and again instructed that "courts must presume that a legislature says in a statute what it means and means in a statute what it says there." *Conn. Nat'l Bank*, 503 U.S. at 253-54.

However, when a plain language interpretation of a provision within the Code results in ambiguity, the Supreme Court requires further textual analysis through interpreting the statute within the larger context of the Code, considering pre-Code practices related to the subject matter of the statute, and probing the legislative history surrounding the birth of the statute. *See Roberts v. Sea-Land Servs., Inc.*, 566 U.S. 93, 101 (2012); *Cohen*, 523 U.S. at 221. As the arguments below explain, deeper probing into these canons of statutory construction reveals overwhelming support for the proration approach.

1. *The split amongst courts on the meaning of 11 U.S.C. § 365(d)(3), along with the multiple possible interpretations of the statute's language in isolation, evince the presence of ambiguity within the statute.*

First, "[t]he existence of a split … in the interpretation of § 365(d)(3) is, in itself, evidence of the ambiguity in the language." *In re Furr's Supermarkets, Inc.*, 283 B.R. at 66 n.8 (citation omitted). Judge Tjoflat illustrates the problem with concluding a statute's meanings is as plain as one insists when others have reached different conclusions: "While the statute's meaning may appear obvious to an individual reader, a court cannot responsibly declare language to be "clear" when, as a matter of empirical reality, significant numbers of jurists have reasonable, good-faith disputes over its meaning." *Allapattah Servs., Inc. v. Exxon Corp.*, 362 F.3d 739, 747 (11th Cir.

2004) (Tjoflat, J., dissenting). Considering the long-standing debate amongst courts over what section 365(d)(3) commands, the dissent's assertion that "[t]he majority does backflips to find ambiguity in a statute where none exists" is unpersuasive. R. at 28.

Second, the Code does not define the term "arises" or the term "obligation" in section 365(d)(3). R. at 17; *In re GCP CT Sch. Acquisition, LLC*, 443 B.R. 243, 254 (Bankr. D. Mass. 2010). When considered in relation to each other, one can reasonably draw two different meanings. "A debtor's 'obligation' under a nonresidential real property lease may arise as it is accrued, or it may arise when the landlord submits the bill to the debtor-tenant." *In re Phar-Mor, Inc.*, 290 B.R. 319, 324 (Bankr. N.D. Ohio 2003). In other words, a debtor's obligations under section 365(d)(3) can reasonably be read to arise as they accrue or arise as an absolute occurrence. *See, e.g., In re GCP CT Sch. Acquisition, LLC,* 443 B.R. at 254 n.70 (collecting cases). Even the court in *Koenig*, which held in favor of the billing-date approach, recognized that "[b]oth a performance date and an allocation interpretation of section 365(d)(3) are consistent with the statutory language." *In re Koenig Sporting Goods, Inc.*, 221 B.R. 737, 740 (Bankr. N.D. Ohio 1998).

Further, courts have also pointed out that the grammatical placement of the phrase "until such lease is assumed or rejected" in section 365(d)(3) is ambiguous. The phrase could either modify the term "perform" or the term "obligations." The former would require the trustee to "make any payment due under a lease until such time as it is assumed or rejected." R. at 18 (citing *In re Ames Dep't Stores, Inc.*, 306 B.R. at 67). The latter would mean that "the trustee's duty to perform the obligation ceases upon rejection." *In re Ames Dep't Stores, Inc.*, 306 B.R. at 67.

Third, the ambiguity in section 365(d)(3) becomes apparent when one reads the statute in conjunction with other provisions in the Code that relate to "claims" and their treatment. *In re Phar-Mor, Inc.*, 290 B.R. at 324. The Code defines a "claim" as a "right to payment, *whether or*

not such right is . . . matured," and a claim is determined as of the debtor's petition date. 11 U.S.C. § 101(5) (emphasis added); *see* 11 U.S.C. § 502(b). Further, several sections of the Code provide requirements for the payments of claims. *See, e.g.*, 11 U.S.C. §§ 726, 1129, 1325. Hence, as one court explained, "[i]f obligation [was] interpreted to refer to the entire amount that matures and becomes payable on a given date, without regard to whether any part of the amount accrued prepetition, then . . . § 365(d)(3) would conflict with, and constitute an exception to, the provisions governing claims." *In re Learningsmith, Inc.*, 253 B.R. 131, 134 (Bankr. D. Mass. 2000).

Considering the disagreement amongst courts and the multiple interpretations that section 365(d)(3) is subject to, the Thirteenth Circuit correctly concluded that an isolated reading of section 365(d)(3) results in ambiguity.

2. A reading of 11 U.S.C. § 365(d)(3) within the context of the overall statutory scheme of the Code provides strong support for the proration approach.

Concluding that an isolated reading of section 365(d)(3) results in ambiguity, one must then turn to the "fundamental canon of statutory construction that the words of a statute must be read in their context and with a view to their place in the overall statutory scheme." *Roberts*, 566 U.S. at 101; *See In re Handy Andy Home Improvement Ctrs., Inc.*, 144 F.3d 1125, 1128 (7th Cir. 1998) ("When context is disregarded, silliness results.").

After the order for relief, the trustee or debtor-in-possession, *see* 11 U.S.C. § 1107(a), has the authority to assume or reject an unexpired lease upon court approval. 11 U.S.C. § 365(a). Functionally, this authority allows the trustee to make a business decision as to whether the lease "is a good deal for the estate going forward." *Mission Prod. Holdings, Inc. v. Tempnology, LLC*, 139 S. Ct. 1652, 1658 (2019). On one hand, assumption allows the estate to benefit from the terms of the lease, but also burdens the estate with the "obligations under the lease as an administrative claim." *In re NETtel Corp.*, 289 B.R. 486, 491 (Bankr. D.D.C. 2002). On the other hand, upon

rejection, the estate is not saddled "with the obligations under the lease as an administrative claim." *Id.* Instead, rejection represents a breach of the lease, 11 U.S.C. § 365(g), that is deemed to have occurred prepetition. 11 U.S.C. § 502(g). And because the resulting breach is deemed to have occurred pre-petition, the breach becomes a general unsecured claim for damages capped under section 502(b)(6). 11 U.S.C. § 502(b)(6). Moreover, in passing section 365(d)(3), Congress removed the requirement that landlords satisfy section 503(b)(1) by including the phrase "notwithstanding section 503(b)(1) of this title." Notably, nowhere in section 365(d)(3) does it also say "and notwithstanding sections 365(g), 502(g), and 502(b)(6)." *See Gwinnett Prado, L.P. v. Rhodes, Inc. (In re Rhodes, Inc.)*, 321 B.R. 80, 88 (Bankr. N.D. Ga. 2005).

Taken together, sections 365(g), 502(g), and 502(b)(6) "clearly establish that unperformed obligations after rejection are treated as general unsecured claims, not administrative expenses under section 503(b)." R. at 18 (citation omitted). Additionally, section 365(d)(4) commands the trustee to immediately surrender the property to the landlord after rejection. 11 U.S.C. § 365(d)(4). Considering this statutory scheme, "there ought not be any administrative claim attributable to the estate's nonexistent right of occupancy during the postrejection period, otherwise the estate will be saddled with a burden that rejection is designed to avoid." *In re NETtel Corp.*, 289 B.R. at 492; *accord Mission Prod. Holdings, Inc.*, 139 S. Ct. at 1665 ("Through rejection, the debtor can escape all of its future contract obligations, without having to pay much of anything in return.").

In this case, both the Debtor and Touch of Grey agree that the effective date of rejection of the Lease was May 5, 2020, the date the Debtor vacated the Premises and returned the keys to Touch of Grey. Under the Code, that rejection constituted a breach of the Lease deemed to have occurred pre-petition. 11 U.S.C. §§ 365(g), 502(g). Therefore, Touch of Grey is allowed a general unsecured claim for the damages flowing from the breach. But, the Debtor occupied the Premises

for the first five days of May. Accordingly, applying section 365(d)(3) within the context of the Code's statutory scheme, Touch of Grey should receive a portion of the May rent as an administrative expense prorated to the five-day period in which the Debtor deprived Touch of Grey of the occupancy and use of the Premises. As for any other damages flowing from the breach, Touch of Grey's only remedy should be to file an unsecured claim for damages and receive equal treatment with the Debtor's other general creditors. Moreover, this application of section 365(d)(3) aligns with the stated congressional intent behind the statute of ensuring landlords receive "current payment" for the "current services provided." *See* 130 CONG. REC. (1984), *as reprinted in* 1984 U.S.C.C.A.N. 576, 598-99 (statement of Sen. Hatch).

Additionally, the dissent argues that the terms of the Lease clearly required the Debtor to pay the full month's rent on May 1, 2020. However, the dissent ignores the Debtor's legal status during this "twilight zone" between the order for relief and rejection of the Lease. *See* Victoria Kothari, *11 U.S.C. § 365(d)(3): A Conceptual Status Argument for Proration*, 13 AM. BANKR. INST. L. REV. 297, 301 (2005). Kothari makes a compelling argument that a debtor-in-possession does not have the same legal status as the pre-bankrupt entity. Instead, the debtor-in-possession is merely the holder of a temporary right to use and possession pending assumption or rejection of the lease, and section 365(d)(3) simply governs the "cost" of that right. *Id.* at 302-3. The proration approach to determining the "cost" of this temporary right "best comports with the statutory scheme Congress intended to implement to determine the post order for relief, prerejection obligations of the [debtor-in-possession] under section 365(d)(3), as well as with … economic reality[.]" *Id.* at 304.

3. Before Congress enacted 11 U.S.C. § 365(d)(3), courts overwhelmingly applied the proration approach, and the legislative history reveals no clear indication that Congress intended courts to depart from that approach.

Before section 365(d)(3) was enacted in 1984, courts handled debtor-tenants' lease obligations during the post-petition, pre-rejection period under the administrative expense statute section 503. *Child World Inc. v. Campbell/Massachusetts Tr. (In re Child World, Inc.)*, 161 B.R. 571, 574 (S.D.N.Y. 1993). In applying section 503 to a debtor's lease obligations such as rent and property taxes, courts would only allow as an administrative expense the prorated amount over the post-petition, pre-rejection period. *Id.* (collecting cases from before 1984). Even the Third Circuit, a billing date jurisdiction, has recognized that proration was the pre-Code practice. *See In re Montgomery Ward Holding Corp.*, 268 F.3d at 211.

Strengthening the argument for proration is the Supreme Court's instruction that courts not "read the Bankruptcy Code to erode past bankruptcy practices absent a clear indication that Congress intended such a departure…." *Cohen*, 523 U.S. at 221; *accord Midlantic Nat'l Bank v. New Jersey Dep't of Env't. Prot.*, 474 U.S. 494, 501 (1986) ("[I]f Congress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific[.]") (citation omitted).

Examining the scant legislative history to section 365(d)(3), one finds no clear indication or specific intent to abrogate the proration approach. In fact, one can make a stronger argument for congressional *reinforcement* of the proration approach by considering the simultaneous enactment of section 365(d)(4), which clearly mandates that the trustee immediately surrender the premises to the landlord upon rejection of an unexpired lease for nonresidential real property. 11 U.S.C. § 365(d)(4).

The enactment of section 365(d)(4) signals Congress's recognition of the debtor "ceasing to have a right under the lease to enjoy occupancy once the lease is rejected." *In re NETtel Corp.*, 289 B.R. at 489 n.6. Combining this with the sentiment expressed by Senator Orrin Hatch that the enactment of section 365(d)(3) sought to ensure landlords receive "current payment" for the "current services provided", *See* 130 CONG. REC. (1984), *as reprinted in* 1984 U.S.C.C.A.N. 576, 598-99 (statement of Sen. Hatch), it intuitively follows that Congress intended for rejection to prevent the trustee from having to perform lease obligations for "unused and unoccupied real property that has been returned to the landlord." R. at 19. And while the dissent correctly asserts that section 365(d)(3) was intended to "ameliorate the perceived inequities that lessors of nonresidential real property had faced," R. at 32, there exists no support that Congress intended to tip the scales in the other direction and elevate landlords above other general creditors - an unavoidable result of adhering to the billing date approach.[2] *See Santa Ana Best Plaza, LTD. v. Best Prods. Co. (In re Best Prods. Co.)*, 206 B.R. 404, 407 (Bankr. E.D. Va. 1997).

B. Unlike the billing date approach, the proration approach is entirely consistent with the purposes and policies of the Code, prohibits absurd and inequitable results, and limits strategic behavior by debtors and landlords.

One of the most important, long-standing policy goals of the Code is to provide equal treatment to similarly situated creditors by ensuring equal distribution among them. *Howard Delivery Serv., Inc.*, 547 U.S. at 655 (citation omitted). Equally important in this case is the "complementary principle that preferential treatment of a class of creditors is in order only when clearly authorized by Congress." *Id.* The following sections illustrate that the proration approach

[2] Here, the billing date approach would force the Trustee to pay approximately 84% of May's rent to Touch of Grey without the Debtor receiving any benefit of use or occupancy in return. This, in turn, would reduce assets in the estate that would otherwise be distributed equally amongst the Debtor's general creditors.

comports with these policy goals much better than the billing date approach and prevents inequitable results and curbs perverse incentives to engage in strategic behavior.

1. *The proration approach ensures equal treatment amongst creditors, while the billing date approach results in arbitrary and inequitable outcomes based solely on the fortuity of the timing of the order for relief or rejection of the lease.*

"[O]ne of the prime purposes of the bankruptcy law [is] to bring about a ratable distribution among creditors of a bankrupt's assets; to protect the creditors from one another." *Young*, 324 U.S. at 210 (citations omitted). Furthermore, "[b]ecause the presumption in bankruptcy cases is that the debtor's limited resources will be equally distributed among his creditors, statutory priorities are narrowly construed." *Trs. of Amalgamated Ins. Fund v. McFarlin's, Inc.*, 789 F.2d 98, 101 (2d Cir.1986). Construing section 365(d)(3) in favor of proration best serves the goal of treating creditors equally by ensuring landlords receive adequate consideration for the "benefits provided to the estate" while simultaneously "circumscribing any windfall to the landlord that could otherwise arise under the billing date approach." R. at 20.

Conversely, the billing date approach carries the potential to produce arbitrary, inequitable results by making the outcome of a dispute contingent solely on the timing of the order for relief or the rejection of the lease. The majority illustrates this potential in the hypothetical situation it articulates. R. at 20-1. With this in mind, the proration approach is further strengthened by the Supreme Court's statement that "[s]tatutes should be interpreted to avoid untenable distinctions and unreasonable results whenever possible." *Am. Tobacco Co.*, 456 U.S. at 71.

The dissent contends that any unfairness befalling the estate under the billing date approach is illusory because the trustee is in control of the rejection date. R. at 33. While true that the trustee, or the Debtor-in-possession in this case, controls the rejection date, the dissent fails to acknowledge that the potential for unfairness under the billing date approach is real, unavoidable,

and has the potential to cut both ways. *See* Aaron Stulman, *Stub Rent Under Section 365(d)(3): A Call for a Unified Approach*, 36 DEL. J. OF CORP. L. 655, 663 (2011). In his article, Stulman makes a persuasive plea to courts to unify under the proration approach:

> [C]reditors are supposed to be treated equally, but in following the strict Billing-date method, landlords will have a pre-petition claim for the month of the filing even though most of the month is technically post-petition. Conversely, the Billing-date method could work in the landlord's favor, treating a pre-petition claim like an administrative claim. Nevertheless, in both instances, the statutory priority scheme laid out by Congress in the Code is violated.

Id.

In this case, the unfairness would cut the Debtor and its other creditors' way if this Court adopts the billing date approach. Further, because the Lease is a triple-net lease, there would be no well-reasoned limitation preventing Touch of Grey from also forcing the Trustee to bear the entire month's property taxes and insurance premiums when the Debtor only received five days of benefit from the use and occupancy of the Premises.[3] Accordingly, depending on the structure of the lease, adopting the billing date approach presents a slippery slope with the potential to produce arbitrary, nonsensical outcomes that advantage either landlords or debtors at the expense of the other.

Conversely, had the Debtor initially filed its bankruptcy petition on May 5, 2020, Touch of Grey would stand to receive no administrative compensation for the five days of occupancy it provided the Debtor in May. Put plainly, neither of the above results comport with section 365(d)(3)'s goal of providing landlords with "current payment" for the "current services

[3] Adding to the absurdity is the question of whether an insurance company would continue to insure the Debtor after it had forfeited its possessory interest in the Premises by vacating and returning the keys to Touch of Grey. While Touch of Grey has not sought to compel payment for May's taxes and insurance premiums, this point is made to illustrate the potential for inequitable outcomes under the billing date approach.

provided," nor is either result sensible, fair, or equitable. In fact, some billing date courts have even conceded that their approach creates windfalls. *See In re Comdisco, Inc.*, 272 B.R. 671, 675 (Bankr. N.D. Ill. 2002) (explaining that the Billing-date method will "often result in windfalls to the landlord, at the expense of other creditors and stakeholders (including other landlords) with equally worthy claims.").

The proration approach solves this problem, preventing windfalls and absurd results for both debtors and landlords by calculating what the lease obligations would be pre-petition and post-petition on a per-day basis, regardless of the billing date under the lease. *See In re Stone Barn Manhattan, LLC*, 398 B.R. 359, 366 (Bankr. S.D.N.Y. 2008).

2. The proration approach limits strategic behavior by debtors and landlords and produces predictable, equitable outcomes.

When the law provides opportunities for parties to receive a windfall at other parties' expense, it naturally creates an incentive for the parties to position themselves in a way to best seize these opportunities. Such is the case under the billing date approach: debtors can wait until the day after the billing date to file their petitions, forcing landlords to receive that month's rent as an unsecured prepetition claim; likewise, landlords can manipulate when bills come due "so that the amounts due become a post-petition claim." *In re Trak Auto Corp.*, 277 B.R. 655, 663 (Bankr. E.D. Va. 2002). The Third Circuit, a billing date jurisdiction, has recognized the potential for strategic behavior by debtors and landlords under the billing date approach. *See In re Montgomery Ward Holding Corp.*, 268 F.3d at 212.

The dissent correctly points out that the Sixth Circuit's decision in *Koenig* is directly on point with the case at bar. R. at 30. However, that case presents a perfect example of the potential for strategic behavior under the billing date approach. In *Koenig*, the debtor rejected its nonresidential real property lease and vacated the premises on the second day of the month, the

day after the month's rent came due under the lease. *In re Koenig Sporting Goods, Inc.*, 203 F.3d at 989. Even though the debtor rejected the lease for thirty of the thirty-one days, the court held that the debtor was obligated to pay the entire month's rent. *Id.* at 990. Illustrating the potential for strategic behavior, the court stated "[i]f the debtor had rejected the lease effective November 30, 1997, rather than December 2, it would not have been obligated to pay rent for December under 11 U.S.C. § 365(d)(3)." *Id.* at 989. While the debtor in *Koenig* failed to employ strategic timing to its benefit, the case represents a good example of the harsh, nonsensical results of adopting the billing date approach.

Here, had the Debtor strategically rejected the Lease on April 30, 2020, Touch of Grey would have no argument to compel the payment of May's rent. Likewise, had the Debtor strategically not paid its January rent before it filed its petition on January 5, 2020, Touch of Grey would be forced to receive that month's rent as an unsecured claim under the billing date approach.

It is clear that no one benefits from incentivizing debtor-tenants to engage in this type of strategic behavior. For instance, in April 2020, the Debtor was trying to revive its business from the hardships the COVID-19 pandemic brought the month before. Ultimately, it did not work out, but the Debtor was making an effort to succeed. Had the Debtor succeeded, it would have benefitted all of its creditors, including Touch of Grey. It makes little sense for the Code's statutory scheme to encourage a business in chapter 11 like the Debtor to close its doors prematurely in order to avoid incurring an entire month's costs under a triple-net lease. Instead, proration ensures that debtors and landlords know where they stand at the time of the order for relief and the time of rejection of the lease. From a debtor's perspective, proration allows debtors-in-possession to continue reorganization efforts with confidence that they will only be obligated to pay for the time in which they benefit from the occupancy of the premises. From a landlord's perspective, proration

removes the worry that their tenant will force it to receive an entire month's rent as an unsecured claim when the tenant enjoyed the majority of the month's occupancy post-petition. In sum, the proration approach guarantees that landlords will receive current payment for current services provided and removes the incentive to engage in strategic petition filing and lease rejection.

CONCLUSION

Because an administrative expense payment is not an otherwise avoidable transfer under the Code, value satisfied by an administrative expense may not count towards a creditor's new value defense to reduce their preference exposure. Moreover, because the proration approach perfectly fits within the Code's statutory scheme and furthers the purposes and policies of the Code, it is the correct approach to applying section 365(d)(3). The decision of the Thirteenth Circuit should be *affirmed*.

APPENDIX A

11 U.S.C. § 365. Executory contracts and unexpired leases

(a) Except as provided in sections 765 and 766 of this title and in subsections (b), (c), and (d) of this section, the trustee, subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor.

…

(d)(3)(A) The trustee shall timely perform all the obligations of the debtor, except those specified in section 365(b)(2), 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 . . .

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11 U.S.C. § 503(b)(9). Allowance of Administrative Expenses

(a) An entity may timely file a request for payment of an administrative expense, or may tardily file such request if permitted by the court for cause.
(b) After notice and a hearing, there shall be allowed administrative expenses, other than claims allowed under section 502(f) of this title, including--

…

(9) the value of any goods received by the debtor within 20 days before the date of commencement of a case under this title in which the goods have been sold to the debtor in the ordinary course of such debtor's business.

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11 U.S.C. § 547. Preferences

…

(b) Except as provided in subsections (c), (i), and (j) of this section, the trustee may, based on reasonable due diligence in the circumstances of the case and taking into account a party's known or reasonably knowable affirmative defenses under subsection (c), avoid any transfer of an interest of the debtor in property--

(1) to or for the benefit of a creditor;
(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
(3) made while the debtor was insolvent;

(4) made--

(A) on or within 90 days before the date of the filing of the petition; or

(B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and

(5) that enables such creditor to receive more than such creditor would receive if--

(A) the case were a case under chapter 7 of this title;

(B) the transfer had not been made; and

(C) such creditor received payment of such debt to the extent provided by the provisions of this title.

(c) The trustee may not avoid under this section a transfer--

…

(4) to or for the benefit of a creditor, to the extent that, after such transfer, such creditor gave new value to or for the benefit of the debtor--

(A) not secured by an otherwise unavoidable security interest; and

(B) on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor.