ST. JOHN'S UNIVERSITY
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30th Annual
Duberstein Bankruptcy
Moot Court Competition
Saturday, February 26, 2022
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AMERICAN BANKRUPTCY INSTITUTE

Competition Problem

30TH ANNUAL
DUBERSTEIN BANKRUPTCY
MOOT COURT COMPETITION

February 26 – February 28, 2022

No. 21-0909

IN THE

Supreme Court of the United States

OCTOBER TERM, 2021

IN RE TERRAPIN STATION, LLC, DEBTOR,

TOUCH OF GREY ROASTERS, INC., PETITIONER

V.

CASEY JONES, CHAPTER 7 TRUSTEE, RESPONDENT.

THE PETITION FOR A WRIT OF CERTIORARI IS GRANTED, LIMITED TO THE FOLLOWING QUESTIONS:

1. Whether a seller of goods is entitled to reduce its preference exposure pursuant to 11 U.S.C. § 547(c)(4) by the value of goods sold even though the debtor in possession paid for such goods in full pursuant to 11 U.S.C. § 503(b)(9).

2. Whether a trustee must timely perform the obligations of a debtor under 11 U.S.C. § 365(d)(3) by paying rent due prior to the rejection of an unexpired non-residential real property lease but allocable to the period after the effective date of rejection.

Written by Hon. John T. Gregg and Paul R. Hage.
The authors express no opinion on the issues presented herein. This problem may not be used or reproduced for any purpose other than the Duberstein Bankruptcy Moot Court Competition.

Recommended for Full Text Publication

UNITED STATES COURT OF APPEALS
FOR THE THIRTEENTH CIRCUIT

IN RE TERRAPIN STATION, LLC,

DEBTOR.

CASE NO. 20-0803

______________________________________/

TOUCH OF GREY ROASTERS, INC.,

APPELLANT,

V.

CASEY JONES, CHAPTER 7 TRUSTEE,

APPELLEE.

______________________________________/

Appeal from the United States District
Court for the District of Moot

Decided: March 4, 2021

Before: Garcia, Lesh and Weir, Circuit Judges

OPINION

Garcia, Circuit Judge:

This appeal arises out of the bankruptcy case of Terrapin Station, LLC (the "Debtor"). It involves two disputes between Casey Jones, the chapter 7 trustee for the Debtor's bankruptcy estate (the "Trustee"), and Touch of Grey Roasters, Inc. ("Touch of Grey"), the Debtor's former supplier and landlord. The first issue requires us to determine whether Touch of Grey, in its capacity as a seller of goods to the Debtor, is entitled to reduce its preference exposure pursuant

to section 547(c)(4) of the Bankruptcy Code[1] by the value of goods that it sold to the Debtor during the twenty days prior to the commencement of the case even though it received payment in full for such goods pursuant to section 503(b)(9). The second issue requires us to determine whether Touch of Grey, this time in its capacity as the Debtor's landlord under an unexpired non-residential real property lease, is entitled under section 365(d)(3) to the rent due under the lease prior to the effective date of rejection, but allocable to the period after the effective date of rejection.

The Bankruptcy Court for the District of Moot ruled in favor of the Trustee and against Touch of Grey on both questions. In a two-page opinion and order adopting the bankruptcy court's findings of fact and conclusions of law in their entirety, the United States District Court for the District of Moot affirmed. We likewise AFFIRM the bankruptcy court on both issues.

Factual Background and Procedural History

The Debtor's long strange trip into bankruptcy began in 2005, when the Debtor was founded by its sole member, William Tell ("Tell"), for the purpose of establishing a coffeehouse. For several years thereafter, the Debtor operated a popular and successful independent coffeehouse in the Town of Terrapin, Moot. Indeed, the Debtor was recognized as "Independent Coffeehouse of the Year" in 2009 by The Java Digest, a leading coffee industry trade magazine.

Touch of Grey is an international coffee company and coffeehouse chain headquartered in San Francisco, California. There are over 1,900 Touch of Grey coffeehouses all around the world, some of which are corporate-owned stores and others of which are franchised. The namesake "Touch of Grey" brand is associated with certified free-trade coffee beans, full and loose-leaf teas, pastries, and other dry goods. Touch of Grey is known for its highly rated and award-winning light roast, "Morning Dew," as well as its "Dire Wolf" blend.

[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 __."

As part of its efforts to grow in new markets, and in response to increased consumer demand for local, independent businesses, Touch of Grey decided to open a series of new "neighborhood coffeehouses" in 2017. The neighborhood coffeehouses would not be branded as Touch of Grey stores. Rather, they would quietly be franchised with owners of existing, independent coffeehouses. The neighborhood coffeehouses would sell a new line of coffee products created by Touch of Grey called "Dark Star," reportedly so that consumers would not immediately realize that, in fact, they were patronizing Touch of Grey stores. In addition to selling traditional coffeehouse fare, the neighborhood coffeehouses would provide expanded food offerings and, at night, would offer alcoholic beverages and host live music and poetry readings.

In the fall of 2017, Touch of Grey approached Tell to see if the Debtor would be interested in franchising a neighborhood coffeehouse in Terrapin. Although the Debtor had a loyal customer base, its earnings had become stagnant and its store was in need of remodeling. Tell was intrigued by the neighborhood coffeehouse concept and the opportunity to partner with an industry giant like Touch of Grey. The parties agreed to move forward with the venture.

To facilitate the opening of the new coffeehouse, Touch of Grey agreed that it would purchase and lease to the Debtor a recently renovated warehouse space located at 5877 Shakedown Street (the "Premises") in the downtown entertainment district of Terrapin. On July 1, 2018, the Debtor, as tenant, and Touch of Grey, as landlord, entered into a *Lease Agreement* (the "Lease") for the Premises. The Lease was a twenty-year triple-net lease that required the Debtor to pay monthly rent in the amount of $25,000, with such rent being "due in advance on the first day of each month." That same day, Touch of Grey, as franchisor, and the Debtor, as franchisee, entered into a franchise agreement whereby the Debtor would exclusively sell "Dark Star" branded products, which it would purchase from Touch of Grey.

The buildout of the Premises was completed in November 2018, and the new "Terrapin Station Coffeehouse" opened on December 1, 2018. Simultaneously, the Debtor's original coffeehouse closed. Unfortunately, the new location encountered difficulties from the start. First, an ad hoc group of local independent coffeehouse owners reacted viscerally when it learned of the Debtor's affiliation with Touch of Grey. The group started an effective local advertising campaign that mercilessly characterized the Debtor as "big coffee in disguise." Second, the Debtor's efforts to join the competitive Shakedown Street nightlife scene failed to gain traction.

Burdened by lower than expected sales and above-market rent under the Lease, the Debtor struggled throughout 2019. According to the first day declaration signed by Tell in the Debtor's bankruptcy case, the Debtor was unable to pay its debts as they became due as early as September 2019. Although the Debtor remained current on its rent obligations under the Lease, by November 1, 2019, it owed Touch of Grey over $700,000 for Dark Star-branded goods that it had purchased. Troubled by the Debtor's poor performance, Touch of Grey sent the Debtor a notice of default on December 5, 2019 threatening, among other things, to terminate the franchise agreement.

On December 7, 2019, the parties entered into a forbearance agreement wherein Touch of Grey agreed to forbear from terminating the franchise agreement in exchange for: (i) a payment of $250,000 from the Debtor on account of the outstanding invoices for Dark Star products, (ii) reaffirmation by the Debtor of its obligations under the Lease, and (iii) a release of any and all claims or causes of action that the Debtor had against Touch of Grey. That same day, the Debtor made the $250,000 payment to Touch of Grey.

On December 18, 2019, the Debtor purchased an additional $200,000 worth of Dark Star products from Touch of Grey on credit, as set forth on an invoice dated December 18, 2019 (the "<u>Invoice</u>"). In order to induce Touch of Grey to sell the Debtor such goods, Tell signed a personal

guarantee with respect to the Invoice. The goods identified on the Invoice were delivered to the Debtor on December 21, 2019.

After reviewing its disappointing sales numbers from the holiday season, the Debtor filed a petition for relief under chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the District of Moot on January 5, 2020 (the "Petition Date"). On the Petition Date, the Debtor was current on its obligations to Touch of Grey under the Lease. However, the Debtor owed Touch of Grey $650,000 (including the amount due under the Invoice) for goods that it had purchased. The Debtor had no secured debt but owed over $500,000 to other unsecured creditors, some of whom were refusing to provide the Debtor with goods and services on credit.

The Debtor filed several "first day" motions along with its bankruptcy petition. The motions were supported by the declaration from Tell, wherein he stated that he intended to reorganize the Debtor by returning to traditional coffeehouse operations and hours. He also stated that he hoped to find a sub-lessee for a portion of the Premises, thereby reducing the Debtor's rent burden. The Debtor proposed to continue selling Dark Star-branded products, as it was required to do under the franchise agreement. Counsel for Touch of Grey appeared at the first day hearings and stated that, although her client had serious concerns with the Debtor's reorganization strategy, it was engaged in ongoing, good faith discussions with the Debtor about a path forward.

Two weeks later, the Debtor filed a motion requesting authority to pay $200,000 to Touch of Grey, asserting that it was a "critical vendor." In support of the motion, the Debtor argued that an ongoing relationship with Touch of Grey was critical to the Debtor's reorganization plans, and that Touch of Grey was unwilling to sell goods on credit to the Debtor post-petition absent the payment. The Debtor argued that, notwithstanding the general rule that pre-petition claims should not be paid by a debtor in bankruptcy post-petition, critical vendor motions have been met with

increasing favor by bankruptcy courts in recent years. The Debtor emphasized that the $200,000 payment would be applied to the Invoice, which was entitled to priority in payment as an administrative expense pursuant to section 503(b)(9). Therefore, the Debtor posited, other creditors would not be prejudiced by the payment. The United States Trustee opposed the motion, arguing that critical vendor payments are not authorized under the Bankruptcy Code. At the hearing, counsel for the newly appointed creditors' committee stated that the committee supported the motion given the importance of Touch of Grey to the Debtor's reorganization.[2]

After oral argument, the bankruptcy court stated that it was not inclined to approve the critical vendor payment, as it was uncertain as to whether such payments are permitted under the Bankruptcy Code. Nevertheless, the court stated that it would award Touch of Grey an administrative expense under section 503(b)(9) for the value of the goods sold (as reflected on the Invoice) and would allow immediate payment of such administrative expense. Days later, the Debtor made the $200,000 payment to Touch of Grey. Thereafter, Touch of Grey resumed selling goods to the Debtor on credit, which allowed the Debtor to continue operating.

Unfortunately, the Debtor's reorganization efforts were anything but successful. The Debtor was forced to temporarily close its doors in March 2020 due to the COVID-19 pandemic. Although the Debtor reopened in April 2020, its customers did not return. On May 5, 2020, the Debtor permanently ceased operations, vacating the Premises and returning the keys to Touch of Grey. The next day, the Debtor filed a motion with the bankruptcy court to reject the Lease and the franchise agreement with Touch of Grey as of the date of the motion pursuant to section 365(a).

On May 8, 2020, Touch of Grey filed a motion seeking to compel payment of the May rent, which became due under the Lease on May 1st. In that motion, Touch of Grey stated that it

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[2] All parties stipulated at the hearing that the goods reflected on the Invoice satisfied the requirements for an administrative expense under section 503(b)(9).

did not oppose rejection of the Lease effective May 5, 2020. Nevertheless, it asserted that it was entitled to payment in full for the May rent, pursuant to section 365(d)(3), as such rent came due prior to the date of rejection. Because the bankruptcy courthouse remained closed to the public due to the pandemic, a virtual hearing on both motions was scheduled for May 29, 2020.

At the outset of the hearing on May 29, 2020, the Debtor announced that it was converting its chapter 11 case to a case under chapter 7 of the Bankruptcy Code pursuant to section 1112(a). No parties objected to this request, and an order converting the case and appointing the Trustee as the chapter 7 trustee for the Debtor's estate was entered. At that same hearing, the bankruptcy court granted the Debtor's motion to reject the Lease and the franchise agreement effective as of May 5, 2020. The court did not rule on Touch of Grey's request for payment of the May rent but instead issued an order requiring additional briefing on the issue.

After retaining counsel, the Trustee took an aggressive posture with respect to Touch of Grey. First, the Trustee objected to Touch of Grey's motion to compel payment for the entirety of the May rent pursuant to section 365(d)(3), arguing that such relief was inequitable to other creditors because the Debtor only occupied the Premises for the first five days of May 2020. Second, the Trustee commenced an adversary proceeding seeking to avoid and recover the $250,000 payment that the Debtor had made to Touch of Grey pursuant to the forbearance agreement as a preferential transfer pursuant to sections 547(b) and 550(a). Touch of Grey immediately filed its answer and affirmative defenses asserting, among other things, that it was entitled to reduce any preference exposure by the $200,000 in goods that it sold to the Debtor (as reflected on the Invoice) pursuant to section 547(c)(4).

In lieu of litigation, the parties stipulated to a stay of all proceedings while they attempted to resolve their disputes through mediation. Regrettably, the mediation was unsuccessful. At a

status conference with the court on July 23, 2020, the parties stipulated that because the subsequent new value dispute was purely a legal issue, they would file cross-motions for summary judgment.[3] They also stipulated to hold the hearing on Touch of Grey's request for payment of the May 2020 rent at the same time as the hearing on the motions for summary judgment.

After briefing and oral argument, the bankruptcy court ruled in favor of the Trustee on both issues. The court concluded that section 365(d)(3) only required the Debtor to pay rent for the five days that it had occupied the Premises prior to rejection. Thus, instead of requiring payment of the full $25,000, the court granted Touch of Grey an administrative expense in the amount of $4,032.26 for the pre-rejection portion of the May 2020 rent. In the adversary proceeding, the bankruptcy court granted summary judgment to the Trustee, holding that Touch of Grey could not use the value of the goods reflected on the Invoice as new value to reduce its preference exposure given that the Invoice was paid pursuant to section 503(b)(9). Accordingly, a judgment in the amount of $250,000 was entered in favor of the Trustee and against Touch of Grey.

Touch of Grey timely appealed both decisions on a consolidated basis to the United States District Court for the District of Moot. The district court affirmed on both issues, and Touch of Grey thereafter timely filed a notice of appeal with this court. For the following reasons, we AFFIRM the decisions of the bankruptcy court.

Discussion

I. Legal Standard

The parties do not dispute the facts as set forth herein. Rather, the issues that we address in this appeal involve questions of law. Thus, our review is *de novo*. *See, e.g.*, *Texas v. Soileau*

[3] The Trustee and Touch of Grey stipulated that the Trustee could establish each of the elements of a preference under section 547(b). They also stipulated that none of the section 547(c) defenses to a preference, other than the subsequent new value defense set forth in section 547(c)(4), were applicable.

(In re Soileau), 488 F.3d 302, 305 (5th Cir. 2007). Under a *de novo* standard of review, the reviewing court decides an issue as if the court were the original trial court in the matter. *See, e.g.*, *Razavi v. Comm'r of Internal Revenue*, 74 F.3d 125, 127 (6th Cir. 1996) (quotation omitted).

II. Section 547(c)(4) Precludes a Defendant from Asserting New Value for Goods Subject to a Satisfied Administrative Expense Under Section 503(b)(9)

The first issue before us involves the intersection of sections 547 and 503(b)(9), the latter of which was enacted nearly twenty-five years after the former. Under section 547(b), a trustee may avoid a transfer of an interest in the debtor's property to a creditor like Touch of Grey if the trustee can demonstrate, among other things, that the transfer was made on or within ninety days before the petition date. *See* 11 U.S.C. § 547(b), (g). The concept is that when a debtor makes a payment to a creditor shortly before its bankruptcy filing, the payment results in such creditor being preferred vis-à-vis other creditors who did not receive a payment. The Bankruptcy Code allows a trustee to claw back such payments, so that they can be shared among all creditors.

The trustee's ability to avoid a preferential transfer under section 547(b) is subject to the defenses available to a defendant under section 547(c), including when a transfer is made –

> (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 avoidable transfer to or for the benefit of such creditor*.

11 U.S.C. § 547(c)(4) (emphasis added).[4] Section 547(c)(4) thus permits a defendant to reduce its liability for a preferential transfer by subtracting the value of the goods or services provided to the debtor subsequent to the receipt of the transfer.[5] To the extent that such goods or services are paid

[4] The term "new value" is defined in section 547(a).

[5] The parties have stipulated, and we agree, that new value need not "remain unpaid" in order for a creditor to establish a defense under section 547(c)(4). *See, e.g.*, *Miller v. JNJ Logistics LLC (In re Proliance Int'l,*

for by the debtor, the creditor can still assert a new value defense for the value of such goods and services provided that such payment is itself avoidable. 11 U.S.C. § 547(c)(4)(B).

In 2005, Congress amended the Bankruptcy Code to include section 503(b)(9). *See* Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23, § 1227 (Apr. 20, 2005) ("BAPCPA"). Similar to section 547(c)(4), section 503(b)(9) focuses on value by providing that the creditor is entitled to an administrative expense for the value of goods received by, and sold to, the debtor in the ordinary course of its business within twenty days before the petition date. 11 U.S.C. § 503(b)(9); *see also* 11 U.S.C. § 507(a)(2).

Courts have struggled when asked to determine, as we are today, whether a creditor may reduce its preference exposure by applying new value under section 547(c)(4) even though such new value was paid for in full post-petition under section 503(b)(9). Although relatively few on point decisions have been published, a narrow majority of courts hold that a creditor cannot be both paid in full for value it provided to the debtor under section 503(b)(9) and, at the same time, use that same value to reduce its preference exposure. *See, e.g.*, *Beaulieu Liquidating Tr. v. Fabric Sources, Inc. (In re Beaulieu Grp., LLC)*, 616 B.R. 857, 878 (Bankr. N.D. Ga. 2020), *appeal docketed sub nom Auriga Polymers Inc. v. PMCM2, LLC*, No. 20-14647 (11th Cir. Dec. 11, 2020); *see also Circuit City Stores, Inc. v. Mitsubishi Dig. Elecs. Am. (In re Circuit City Stores, Inc.)*, 2010 WL 4956022, at *9 (Bankr. E.D. Va. Dec. 1, 2010). The majority of courts reason that because section 547(c)(4) contains no temporal limitation, the payment of an administrative expense under section 503(b)(9) constitutes an "otherwise unavoidable transfer" under section 547(c)(4).

Inc.), 514 B.R. 426 (Bankr. D. Del. 2014); *see also* Deborah L. Thorne and Jesus E. Batista, *Are All Creditor "Animals" Equal? Treatment of New Value Under § 547*, 23 AM. BANKR. INST. J., Apr. 2004, at 22.

Relying on the minority approach, Touch of Grey contends that the satisfaction of an administrative expense under section 503(b)(9) is not an "otherwise unavoidable transfer," meaning that it can apply the value associated with its fully satisfied administrative expense as "new value" under section 547(c)(4). *See Commissary Operations, Inc. v. Dot Foods, Inc. (In re Commissary Operations, Inc.)*, 421 B.R. 873, 879 (Bankr. M.D. Tenn. 2010); *see also Friedman's Liquidating Tr. v. Roth Staffing Cos. LP (In re Friedman's Inc.)*, 738 F.3d 547, 554-55 (3d Cir. 2013). According to Touch of Grey, the petition date serves as a "hard stop" for preferences, thereby rendering inconsequential to its new value defense anything that occurs post-petition, including a transfer that satisfies its administrative expense under section 503(b)(9).

As always, we begin our analysis with the statute's plain meaning. The United States Supreme Court has "stated time and again that courts must presume that a legislature says in a statute what it means and means in a statute what it says there. When the words of a statute are unambiguous, then, this first canon is also the last: 'judiciary inquiry is complete.'" *Conn. Nat'l Bank v. Germain*, 503 U.S. 249, 253-54 (1992) (citations omitted). As a threshold matter, we note that section 547(c)(4) is anything but user friendly, as it contains a double negative, not to mention a grinding progression of analytical subparts. *See Boyd v. The Water Doctor (In re Check Reporting Servs., Inc.)*, 140 B.R. 425, 434 (Bankr. W.D. Mich. 1992). Nonetheless, a complicated statute is not necessarily an ambiguous one. *Id.*

At the forefront of our plain meaning analysis is the question of *when* an otherwise unavoidable transfer must be made in order to preclude a creditor from using the underlying value as new value to reduce its preference exposure under section 547(c)(4). We find section 547(c)(4) to be unequivocally unambiguous. The text of the statute contains no limitation at all regarding the time to consider whether a payment on account of new value is "otherwise unavoidable."

Touch of Grey directs us elsewhere in the text. It argues that because the Debtor's estate made a distribution and not a "transfer" when it satisfied Touch of Grey's administrative expense, section 547(c)(4)(B) does not preclude Touch of Grey from asserting new value. We disagree. The term "transfer" is broadly defined by section 101(54)(D) to mean "each mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with," among other things, "property . . . or an interest in property." It therefore includes any distribution, including a payment to satisfy an administrative expense under section 503(b)(9). *See In re Beaulieu Grp., LLC*, 616 B.R. at 870. We likewise reject any argument that the use of the word "debtor" in section 547(c)(4) somehow limits that section to prepetition transfers. *See, e.g.*, *In re Friedman's Inc.*, 738 F.3d at 555; *see also NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 528 (1984).

With the plain meaning of the text established, we must still answer the specific question before us – whether payment of an administrative expense under section 503(b)(9) is an "otherwise unavoidable" transfer under the statute. Because an administrative expense, even one under section 503(b)(9), is paid post-petition, we turn to section 549, which is the only avoidance power that could apply based on the facts in this case. *Cf.* 11 U.S.C. §§ 544, 545, 547, 548, 553, 724(a). That section provides that a trustee may avoid a transfer made after the petition date if the transfer was not authorized by either the Bankruptcy Code or the bankruptcy court. 11 U.S.C. § 549(a).

In this case, the Debtor was authorized by the bankruptcy court to pay Touch of Grey's administrative expense. Thus, such payment was an "otherwise unavoidable transfer" that cannot constitute new value under section 547(c)(4). *See In re Circuit City Stores, Inc.*, 2010 WL 4956022, at *8; *see also MMR Holding Corp. v. C & C Consultants, Inc. (In re MMR Holding Corp.)*, 203 B.R. 605, 609-611 (Bankr. M.D. La. 1996). Touch of Grey is therefore precluded from using the value reflected on the Invoice to reduce its preference exposure.

Touch of Grey asserts that certain other provisions of the Bankruptcy Code contextualize section 547(c)(4)(B), the effect of which is to proscribe consideration of post-petition payments. *See King v. St. Vincent's Hosp.*, 502 U.S. 215, 221 (1991) ("[T]he meaning of statutory language, plain or not, depends on context."). According to Touch of Grey, when section 547(c)(4) is read in context with other relevant provisions, it becomes clear that any analysis under section 547(c)(4) ends at the petition date. To that end, Touch of Grey directs us to section 547(b)(4) and the preamble to section 547(c). While we acknowledge that references to the term "transfer" in those sections impose temporal restrictions, Touch of Grey's argument is misplaced. *See, e.g.*, *In re Friedman's Inc.*, 738 F.3d at 554-55; *accord Barnhill v. Johnson*, 503 U.S. 393, 402 (1992) (applying different rules for the time of transfer under sections 547(b) and 547(c)(4)). To our knowledge, no court has concluded that the transfer at issue under section 547(c)(4) must independently satisfy all of the elements of a preference. We decline to be the first.

Nor do we find persuasive Touch of Grey's attempt to grammatically dissect the phrase "on account of which new value the debtor did not make an otherwise unavoidable transfer" by emphasizing it was drafted in the past tense. True, the phrase is backward looking. Again though, nothing in the text of section 547(c)(4) designates the petition date as the cutoff for determining whether a transfer is "otherwise unavoidable."

Rather, we are mindful that Congress knows how to expressly impose temporal limitations, as it did in section 547(c)(5). *See also* 11 U.S.C. §§ 502(d), 542(c), 550, 551, 749, 766, 783, 1101. Congress did not do so in section 547(c)(4), leading to the inescapable conclusion that the statute contains no temporal component whatsoever. *Accord Whitman v. Am. Trucking Ass'ns, Inc.*, 531 U.S. 457, 468 (2001) (Congress "does not, one might say, hide elephants in mouseholes." (citations omitted)). Moreover, we must forego any invitation to import words into section

547(c)(4) that are simply not there. *See, e.g.*, *Lamie v. U.S. Tr.*, 540 U.S. 526, 538 (2004) (declining to enlarge the statute where a plain, non-absurd meaning is "in view.").

Touch of Grey persists. It contends that we should adopt the nominally contextual analysis undertaken in *Friedman's*, wherein the Third Circuit concluded that the time period for determining whether a transfer is "otherwise unavoidable" ends on the petition date. *In re Friedman's*, 738 F.3d at 555-57. While we aspire for uniformity with our sister circuits, we cannot subscribe to the Third Circuit's strained analysis for the same reasons articulated by other courts. *See, e.g.*, *In Beaulieu Grp., LLC*, 616 B.R. at 873-76; *Siegel v. Sony Elecs., Inc. (In re Circuit City Stores, Inc.)*, 515 B.R. 302, 313-14 (Bankr. E.D. Va. 2014); *TI Acquisition, LLC v. Southern Polymer, Inc. (In re TI Acquisition, LLC)*, 429 B.R. 377, 384-85 (Bank. N.D. Ga. 2010).

Finally, a brief word about policy. Although we find no ambiguity within the text of section 547(c)(4), our conclusion today is further supported by an overarching purpose of bankruptcy law – the equality of distribution among creditors. *See Union Bank v. Wolas*, 502 U.S. 151, 161 (1991). Here, Touch of Grey wants to have it both ways by reducing its preference exposure through the new value defense after being *paid in full for that exact same value* under section 503(b)(9). We cannot endorse Touch of Grey's attempted "double dip" given that it would be such a radical departure from a fundamental and well-settled tenet of bankruptcy law.

III. Section 365(d)(3) Does Not Require the Trustee to Satisfy Obligations Allocable to the Post-Rejection Period

Section 365 gives a trustee[6] the authority to assume or reject an executory contract or unexpired lease upon court approval. 11 U.S.C. § 365(a). In other words, it allows the trustee to decide whether an agreement "is a good deal for the estate going forward." *Mission Prod.*

[6] In a case pending under chapter 11, a debtor in possession such as the Debtor generally has all of the rights and powers of a trustee. 11 U.S.C. § 1107(a).

Holdings, Inc. v. Tempnology, LLC, 139 S. Ct. 1652, 1658 (2019). If, upon the exercise of the trustee's business judgment, it is a "good deal," the trustee will assume the agreement by "fulfilling [his or her] obligations while benefiting from the counterparty's performance." *Id.* If, however, the agreement is not a "good deal" for the estate, the trustee will reject the agreement, thereby "repudiating any further performance of [his or her] duties" subject to limited exceptions. *Id.*

Section 365(d)(3) specifically applies to unexpired leases for non-residential real property, like the Lease in this case, by providing, in relevant part, that:

> 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). Section 365(d)(3) thus establishes *what* the trustee must do (*i.e.*, perform) pending assumption or rejection. Courts are sharply divided, however, with respect to *when* the obligation to do it arises.

A slight majority of courts have adopted what has become known as the "proration" approach by interpreting section 365(d)(3) to mean that a trustee's obligations during the post-petition, prerejection period should extend no further than the point of rejection. *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, 65 (Bankr. S.D.N.Y. 2004) (Gerber, J.). Nonetheless, a minority of courts, including some of our sister circuits, have adopted the more rigid "billing date" approach, which requires the trustee to strictly perform the debtor's obligations in accordance with the lease notwithstanding the intervening act of rejection. *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).

Upon careful consideration, we conclude that the proration approach better comports with principles of statutory interpretation, including the canons of construction, the legislative history, and the underlying purposes and policies of the Bankruptcy Code.[7] Accordingly, the bankruptcy court below got it right when it determined that, under section 365(d)(3), the Trustee was only required to pay Touch of Grey for the rent that had accrued through the effective date of rejection. *See Bullard v. Blue Hills Bank*, 575 U.S. 496, 507 (2015) (expressing confidence that "bankruptcy courts . . . rule correctly most of the time.").

Our first inquiry, of course, is the statute's plain meaning. The Supreme Court has repeatedly reminded us that "when the statute's language is plain, the sole function of the courts – at least where the disposition required by the text is not absurd – is to enforce it according to its terms." *Lamie v. U.S. Tr.*, 540 U.S. 526, 534 (2004) (internal citations and quotations omitted). The term "arises" is not defined by the Bankruptcy Code. Yet when considered in relation to the term "obligations," it is susceptible to more than one meaning. It can be either an absolute occurrence or something that is continuing to accrue. *See, e.g.*, *In re GCP CT School Acquisition, LLC*, 443 B.R. 243, 254 n.70 (Bankr. D. Mass. 2010) (collecting cases). In other words, the term

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[7] While it is true that the circuits generally seek uniformity, *Ultra Petroleum Corp. v. Ad Hoc Comm. of Unsecured Creditors (In re Ultra Petroleum Corp.)*, 943 F.3d 758, 763 (5th Cir. 2019), we are nonetheless duty-bound to conduct our own independent analysis. This is particularly true in this case given the prevalence of conflicting decisions. *Compare HA-LO Indus. v. CenterPoint Props. Tr.*, 342 F.3d 794, 799 (7th Cir. 2003), *and In re Koenig Sporting Goods, Inc.*, 203 F.3d at 989, *with In re Handy Andy Home Improvement Ctrs.*, 144 F.3d 1125, 1127 (7th Cir. 1998); *see also In re Montgomery Ward Holding Corp.*, 268 F.3d 205, 213 (3d Cir. 2001) (Mansmann, J., dissenting); *Koenig Sporting Goods, Inc. v. Morse Road Co. (In re Koenig Sporting Goods, Inc.)*, 229 B.R. 388, 395 (B.A.P. 6th Cir. 1999) (Rhodes, J., dissenting).

"arises" fails to definitively tell us exactly *when* a debtor's obligations arise under section 365(d)(3). As astutely noted by one of our colleagues in another circuit:

> [T]he statute says nothing about how to determine when the obligation arises. Nothing in the text is inconsistent with the common-sense view that when an obligation arises may be fixed by its intrinsic nature and/or by the extrinsic circumstances of its accrual. An obligation attributable to a particular time may well be said to "arise" at that time, and an obligation that accrues over time may be said to "arise" as it accrues, without doing violence to the statutory language.

In re Montgomery Ward Holding Corp., 268 F.3d at 213 (Mansmann, J., dissenting).

The phrase "until such lease is assumed or rejected" is likewise subject to two plausible interpretations given its grammatical placement. The phrase can be construed to modify the term "perform," such that the trustee must make any payment due under a lease until such time as it is assumed or rejected. *See In re Ames Dep't Stores, Inc.*, 306 B.R. at 67. However, the phrase can also be construed to modify the term "obligations," meaning that the trustee's duty to perform the obligation ceases upon rejection. *Id.* Accordingly, we agree with the majority of courts –*when read in isolation*, the text of section 365(d)(3) is ambiguous.

With that said, "[s]tatutory language . . . cannot be construed in a vacuum." *Roberts v. Sea-Land Servs., Inc.*, 566 U.S. 93, 101 (2012). Rather, "[i]t is a 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." *Id.*; *see In re Handy Andy Home Improvement Ctrs., Inc.*, 144 F.3d at 1128 ("When context is disregarded, silliness results."). In this case, we need look no further than sections 365(g), 502(b)(6) and 502(g), all of which clearly establish that unperformed obligations after rejection are treated as general unsecured claims, not administrative expenses under section 503(b). *See, e.g.*, *In re NETtel Corp., Inc.*, 289 B.R. 486, 491-92 (Bankr. D.D.C. 2002); *accord Mission Prod. Holdings*, 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.").

Our interpretation of section 365(d)(3) is further strengthened by the canon that the Bankruptcy Code should not be "read . . . to erode past bankruptcy practice absent a clear indication that Congress intended such a departure. . . ." *Cohen v. De La Cruz*, 523 U.S. 213, 221 (1998) (internal quotations and citations omitted). The "normal rule of statutory construction is that if Congress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific," particularly in the context of bankruptcy codifications. *Midlantic Nat'l Bank v. New Jersey Dep't of Envtl. Prot.*, 474 U.S. 494, 501 (1986) (citation omitted).

Prior to the enactment of section 365(d)(3), courts overwhelmingly applied the proration approach when a trustee rejected an unexpired lease of non-residential real property. *See, e.g.*, *Child World, Inc. v. Campbell/Massachusetts Trust (In re Child World, Inc.)*, 161 B.R. 571, 574-75 (S.D.N.Y. 1993) (collecting cases). When Congress enacted section 365(d)(3) in 1984, the proration approach was in no way abrogated. *Id.* at 575-76. To the contrary, Congress reinforced the proration approach when it simultaneously enacted section 365(d)(4), which expressly requires the trustee to, "immediately" upon rejection, surrender to the landlord the premises subject to an unexpired lease for non-residential real property. *See In re NETtel Corp., Inc*., 289 B.R. at 489-90. Quite logically then, the trustee should no longer be obligated to pay for unused and unoccupied real property that has been returned to the landlord.

Indeed, the legislative history to section 365(d)(3) is understandably bereft of any statement even remotely intimating that Congress intended to adopt the billing date approach. 130 CONG. REC. (1984), *as reprinted in* 1984 U.S.C.C.A.N. 576, 598-99 (statement of Sen. Hatch). Through section 365(d)(3), Congress only sought to ensure that a landlord received "current payment" for, crucially, the "current services provided," thereby negating any requirement that the landlord satisfy section 503(b)(1) for the period of time in which the trustee occupied the premises. *Id.*; *see*

In re Handy Andy Home Improvement Ctrs, Inc., 144 F.3d at 1128. We find no support in the legislative history for Touch of Grey's contention that Congress intended to elevate a portion of a landlord's post-rejection damages claim to the status of an administrative expense based on nothing more than the billing date set forth in a lease.

Finally, we must emphasize that unlike the billing date approach, the proration approach is wholly consistent with the purposes and policies of the Bankruptcy Code. We are guided by long-standing bankruptcy jurisprudence from the Supreme Court:

> [T]he Bankruptcy Code aims, in the main, to secure equal distribution among creditors. We take into account, as well, the complementary principle that preferential treatment of a class of creditors is in order only when clearly authorized by Congress.

Howard Delivery Serv., Inc. v. Zurich Am. Ins. Co., 547 U.S. 651, 655 (2006) (citations omitted).

At its core, the proration approach balances the rights of a landlord on the one hand, and the estate and its creditors on the other. *See* Victoria Kothari, *11 U.S.C. § 365(d)(3): A Conceptual Status Argument for Proratio*n, 13 AM. BANKR. INST. L. REV. 297 (2005). It ensures that a landlord like Touch of Grey receives fair consideration for the benefits it provides to the estate by removing the strictures of section 503(b)(1). At the same time, the proration approach carefully adheres to one of the fundamental tenets of the Bankruptcy Code by circumscribing any windfall to the landlord that could otherwise arise under the billing date approach.[8]

To illustrate these points, we need look no further than a hypothetical situation where a trustee rejects the debtor's lease with the landlord and vacates the premises a mere two days after an advance monthly rental payment is due. If the billing date approach is applied, the trustee must

[8] Our colleague in dissent contends that no unfairness befalls the estate because the trustee is at all times in control of the effective date of rejection. We find this rationale to be misguided. *See In re Stone Barn Manhattan LLC*, 398 B.R. 359, 368 (Bankr. S.D.N.Y. 2008); *see also In re GCP CT School Acquisition, LLC*, 443 B.R. at 252-53.

pay, to the detriment of the estate and its creditors, approximately 93% of the monthly rent without receiving anything in return. *Contra Young v. Higbee Co.*, 324 U.S. 204, 210 (1945) ("[H]istorically one of the prime purposes of the bankruptcy law has been to bring about a ratable distribution among creditors of a bankrupt's assets; to protect the creditors from one another." (citations omitted)). Taken further, the billing date approach produces even more absurd and egregious results when, for example, in a retail bankruptcy case multiple leases requiring the payment of millions of dollars of advance rent on a quarterly or annual basis are rejected after the obligations become due under those leases. This cannot possibly be what Congress had in mind when it enacted section 365(d)(3).[9]

The proration approach, in contrast, equitably balances the interests of the estate, including its creditors, and the landlord. Applying the proration approach to the situation above, the landlord would receive payment in accordance with the lease rate for the time in which it was deprived of use and occupancy of the premises. Equity would further serve the trustee, and ultimately the creditors of the bankruptcy estate, who would only be required to pay for the use and occupancy of the premises at the rental rate prescribed under the lease through the date of rejection. Or, to paraphrase Senator Hatch, the trustee would only need to provide "current payment" for "current services."

Conclusion

For the reasons set forth herein, we AFFIRM the decisions of the bankruptcy court below.

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[9] To make matters worse, upon rejection, which, again, is accompanied by immediate surrender under section 365(d)(4), the landlord has an opportunity to lease the vacated premises to a third party without any obligation to mitigate its damages (for which it received payment in full). To put this imbalance another way, funds that would otherwise be used to satisfy claims of general unsecured creditors are instead used to satisfy *in full* what would otherwise be the landlord's general unsecured claim under section 365(g).

Weir, Circuit Judge, dissenting:

On both of the issues that the court tackles today, the majority rules in favor of the Debtor because, in its view, a contrary ruling would result in a windfall to Touch of Grey. To hear the majority tell it, if Touch of Grey prevails, "the world will end not in fire, or ice, but in a bankruptcy court." *Wellness Int'l Network, Ltd. v. Sharif*, 575 U.S. 665, 683 (2015). Contrary to the positions espoused by my colleagues, Touch of Grey's arguments are both consistent with the statutory text *and* equitable. Accordingly, I must dissent.

I. Section 547(c)(4) Does Not Preclude Touch of Grey from Reducing its Preference Exposure by the Value of the Invoice Paid Pursuant to Section 503(b)(9)

Section 503(b)(9) grants a creditor administrative expense priority for:

> the value of any goods received by the debtor within 20 days before the date of commencement of a case under [title 11] in which the goods have been sold to the debtor in the ordinary course of such debtor's business.

11 U.S.C. § 503(b)(9). This section, which was added to the Bankruptcy Code in 2005 as part of BAPCPA, elevates a group of trade creditors, who previously only held general unsecured claims, ahead of all other general and priority unsecured creditors. It is acknowledged that section 503(b)(9) was enacted to shield trade creditors, who so frequently have been burned in bankruptcy by debtors who purchase goods at a time when it is known that bankruptcy is imminent and that payment for the goods will not have to be tendered. Given the foregoing, I cannot interpret the subsequent new value defense in section 547(c)(4) in a manner that would result in section 503(b)(9) being used as a sword against such creditors. This is particularly true because, when viewed in its proper context, the most natural and only consistent reading of section 547(c)(4) is that the preference analysis window closes on the petition date.

In *Friedman's Liquidating Tr. v. Roth Staffing Cos., LP (In re Friedman's Inc.)*, 738 F.3d 547 (3d. Cir. 2013), the Third Circuit Court of Appeals held "that where 'an otherwise unavoidable

transfer' is made after the filing of a bankruptcy petition, it does not affect the new value defense." *Id.* at 549. *Friedman's* addresses the issue before us in a slightly different context.[10] Nevertheless, its well-reasoned analysis is equally applicable here. I would join the Third Circuit in concluding that post-petition payments are irrelevant for purposes of the subsequent new value defense. *Id.* at 555. I reach this conclusion based on an analysis of: (i) the plain language of section 547(c)(4), (ii) its statutory context, and (iii) the underlying policy goals of the Bankruptcy Code.

The plain language of section 547(c)(4) "closes the preference window at the petition, limiting the § 547(c)(4) defense to new value supplied and payments made before the debtor crosses into bankruptcy." *Phoenix Rest. Grp., Inc. v. Ajilon Prof'l Staffing LLC (In re Phoenix Rest. Grp., Inc.)*, 317 B.R. 491, 496 (Bankr. M.D. Tenn. 2004). The filing of a bankruptcy petition is understood to be a fundamental demarcation point between two different entities: (a) the debtor, and (b) the trustee/debtor in possession. Section 547(c)(4)(B) expressly limits the phrase "otherwise unavoidable transfer" to a transfer made by "the debtor." Payments made post-petition are made by the *trustee* or the *debtor in possession*, not the *debtor*.[11] *See Bergquist v. Anderson-Greenwood Aviation Corp. (In re Bellanca Aircraft Corp.)*, 850 F.2d 1275-1284 (8th Cir. 1988). As such, goods that are paid for post-petition pursuant to section 503(b)(9) actually remained unpaid by "the debtor" for purposes of calculating the section 547(c)(4) new value defense.

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[10] Although the payment at issue in this case was approved pursuant to section 503(b)(9), one must acknowledge that the circumstances surrounding such payment mirror a critical vendor payment, as in *Friedman's*. Indeed, the Debtor's request to pay Touch of Grey was initially made pursuant to the critical vendor doctrine, and the record reflects that such payment was proposed for purposes of inducing Touch of Grey to provide post-petition credit to the Debtor.

[11] Congress demonstrated that it knew how to distinguish between the "debtor" and a "trustee" in section 547(a), wherein it defined "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) (emphasis added). Interpreting the term "debtor" in section 547(c)(4)(B) to include the trustee would render the reference to "the debtor or the trustee" in the definition of "new value" superfluous. *See Hibbs v. Winn*, 542 U.S. 88, 101 (2004) ("A statute should be construed so that effect is given to all its provisions, so that no part will be inoperative or superfluous, void or insignificant. . . ." (citation omitted)).

Additionally, there are several contextual indicators in the Bankruptcy Code that point to the petition date as the cutoff for analysis of the new value defense. First, while far from controlling, it is worth noting that section 547 is titled "Preferences," which suggests that it concerns transactions occurring during the preference period, which is by definition pre-petition.

Second, the hypothetical liquidation test contained in section 547(b)(5), which requires courts to compare the payment received by a preference defendant with what the creditor would have received in a hypothetical liquidation if the payment had not been made, must be performed as of the petition date. *See* NORTON BANKR. L. & PRAC. § 66:12 (3d. ed. 2021). If the analysis of an "otherwise avoidable transfer" for purposes of section 547(c)(4) could be extended to take into account events beyond the petition date, the relevant time frame for that aspect of the statute would be incompatible with section 547(b)(5). *In re Friedman's Inc.*, 738 F.3d at 556.

Third, the statute of limitations for filing a preference action generally begins to run on the petition date. *See* 11 U.S.C. § 546(a). "The fact that the statute of limitations for a preference avoidance action under § 547 generally begins on the petition date suggests that the calculation of preference liability should remain constant post-petition." *In re Friedman's Inc.*, 738 F.3d at 556. It would defy logic for Congress to have triggered the commencement of a limitations period on the petition date while simultaneously leaving open the possibility that the injury to the estate could fluctuate after that time.

Fourth, it would be inequitable to allow a post-petition payment to affect the preference analysis when post-petition extensions of new value by a creditor cannot be used to reduce such creditor's preference exposure. *See In re Friedman's Inc.*, 738 F.3d at 557 (collecting cases); *see also Kaye v. Accord Mfg., Inc. (In re Murray, Inc.)*, 2007 WL 5595447, at *2 (Bankr. M.D. Tenn. June 6, 2007).

Fifth, the majority's conclusion that post-petition payments made pursuant to section 503(b)(9) constitute "otherwise unavoidable transfers" which remove the value of the underlying goods from the subsequent new value defense falls flat when one considers other post-petition transfers permitted under the Bankruptcy Code. Section 503(b)(9) administrative expenses are simply pre-petition unsecured claims. They were granted priority in payment pursuant to BAPCPA and, as a result, they are frequently paid in full. Because they are frequently paid in full, the majority concludes that the holder of a 503(b)(9) administrative expense is "double-dipping" if it can also utilize the same goods as new value to reduce its preference exposure. But consider the not so unusual situation where general unsecured creditors receive a substantial distribution (*e.g.,* 50 cents on the dollar) from the estate pursuant to a confirmed chapter 11 plan. In such a scenario, no one would argue that the creditor who receives the 50 cents on the dollar distribution is "double-dipping" by not reducing its new value defense by the 50% payment that it received for the goods it sold to the debtor during the preference period. Why should the analysis change depending on whether the unsecured distribution is 5%, 50% or, pursuant to section 503(b)(9), 100%? It shouldn't. Post-petition payments on account of general unsecured claims simply are not "otherwise unavoidable transfers" for purposes of the subsequent new value analysis. The same can be said of post-petition payments made pursuant to section 503(b)(9).

Finally, the policy goals of section 503(b)(9) and 547(c)(4) support Touch of Grey's argument. When Congress enacted section 503(b)(9), it intended: (i) to encourage trade creditors to continue to extend credit to a financially distressed debtor, and (ii) to discourage abuse by debtors who seek to acquire goods at a time when it is known that bankruptcy is imminent and that payment for the goods will not have to be tendered. *See In re Arts Dairy, LLC*, 414 B.R. 219, 220 (Bankr. N.D. Ohio 2009). The policy behind the subsequent new value defense is to encourage

trade creditors to continue dealing with troubled businesses by providing them a level of protection from their preference exposure. *See Roberds, Inc. v. Broyhill Furniture (In re Roberds, Inc.)*, 315 B.R. 443, 468 (Bankr. S.D. Ohio 2004).

Given the nearly identical policies behind the enactment of the two sections, section 503(b)(9) should not be interpreted in a manner that would cause harm to trade creditors who support a debtor by reducing their subsequent new value defense that existed prior to BAPCPA. Indeed, if Congress intended to significantly impact the subsequent new value defense when it enacted section 503(b)(9), one would think that there would be at least some discussion of such change in the legislative history. *See Dewsnup v. Timm,* 502 U.S. 410, 419 (1992) ("[T]his court has been reluctant to accept arguments that would interpret the Code, however vague the particular language under consideration might be, to affect a major change in pre-Code practice that is not the subject of at least some discussion in the legislative history." (citations omitted)).

It is important to reward trade creditors who provide new value to a distressed debtor, as such creditors replenish the estate when it is in extreme financial distress, thereby maximizing its reorganization hopes and minimizing the likelihood that the patient will die on the operating table. The fact that the trade creditor happens to get paid for such new value pursuant to section 503(b)(9) (particularly where, as here, it agreed to continue supporting the debtor post-petition by selling additional goods on creditor) does not negate this fact. As one court noted:

> The deliveries benefit the estate . . . regardless of whether the § 503(b)(9) claimants are paid at a later date for those deliveries. Even if the creditor receives a limited post-petition payment on its § 503(b)(9) claim to cover the "value" of the goods, the debtor-in-possession has realized the mark-up profit on the re-sale of the goods (or use of the goods incorporated into a finished product for sale, for a manufacturing or distributor debtor) and has the ability to fill an order to its customers' satisfaction. Meeting and fulfilling the expectation of customers achieves the most important goal of a business entity – to maximize its goodwill.

Commissary Operations Inc. v. Dot Foods, Inc. (In re Commissary Operations, Inc.), 421 B.R. 873, 878-79 (Bankr. M.D. Tenn. 2010).

The majority argues that my interpretation results in a windfall to Touch of Grey and the unequal treatment of creditors. In response, I would simply echo the words of the Third Circuit:

> If it is a rule in bankruptcy that all creditors must be treated equally, surely the exceptions swallow the rule. It could be said that some creditors are treated more equally than others. There are special provisions for aircraft leases and shopping center leases, and some claims are given priority over others. The balancing of interests in, for instance, wage orders, has been held to justify the type of unequal treatment condemned in cases that would include the post-petition payment in the preference analysis. Inequality *per se* is not to be avoided; indeed, reasoned and justified inequality sometimes prevails, usually based on what is in the best interest of the estate. For this reason, the courts positing that the interpretation that "results in absolutely equal treatment of all unsecured claims" is the "most reasonable interpretation of section 547(c)(4)" are misguided.

In re Friedman's Inc., 738 F.3d at 560 (quotations omitted).

I suspect anyone who has practiced bankruptcy law would agree that the bankruptcy preference laws are frequently far from equitable. Preference law is not about "equality" but, rather, requiring that if a creditor has been *improperly* preferred, it must disgorge the preferential payment. Section 503(b)(9), however, is one of those circumstances in the statute where a preference in favor of a subset of creditors is *entirely proper*. Congress clearly intended to afford special treatment to sellers of goods. Where, as here, the seller supports the debtor's reorganization efforts both prior to *and* after the petition date, the special treatment is particularly appropriate.

Forcing a creditor to choose between asserting an administrative expense and preserving its right to assert its full subsequent new value defense would work a disservice on Congress's aforementioned policy goals by "[chilling] their willingness to do business with troubled entities." *In re Commissary Operations*, 421 B.R. at 879. The inequity of the majority's approach is highlighted by the facts of this very case. Here, Touch of Grey's preference exposure on the

Petition Date was $50,000. Under today's ruling, its willingness to support the Debtor's reorganization efforts post-petition by selling goods on credit in exchange for immediate payment of its undisputed section 503(b)(9) administrative expense results in a $200,000 increase in its preference exposure. The majority's approach not only negates the benefits Congress intended to confer upon creditors like Touch of Grey, but it also cruelly creates liability where none previously existed. That cannot be correct.

Touch of Grey supported the Debtor both prior to and after the Petition Date, thereby giving it a fighting chance at reorganization. Did Congress intend that creditors like Touch of Grey be punished for such efforts? I think not. As such, I would reverse the decision of the bankruptcy court.

II. The Plain Language of Section 365(d)(3) Compels the Trustee to Perform All Obligations that Arise Prior to Rejection

The majority does backflips to find ambiguity in a statute where none exists in order to achieve a policy result that it deems equitable. While there are admittedly aspects to the proration approach that are desirable, policy determinations are left for Congress. Judges are tasked with applying the law as written. In section 365(d)(3), Congress clearly and unequivocally mandated that a trustee "shall timely perform all the obligations . . . arising from and after the order for relief under any unexpired lease of nonresidential real property, until such lease is assumed or rejected. . . ." 11 U.S.C. § 365(d)(3). Here, because the Lease mandated payment of the entirety of the May rent on May 1st, four days before rejection occurred, the Trustee is compelled to make such payment. The analysis is that simple.

The task of interpreting a statute "begins where all such inquiries must begin: with the language of the statute itself." *U.S. v. Ron Pair Enters., Inc.*, 489 U.S. 235, 241 (1989) (citation omitted). The statutory language "is also where the inquiry should end, for where . . . the statute's

language is plain, 'the sole function of the courts is to enforce it according to its terms.'" *Id.* (quotation omitted). For decades, the Supreme Court has told us that a court's job is to apply the law as written and leave policy determinations to Congress. *See, e.g.*, *N.Y. Cty. Nat'l Bank v. Massey*, 192 U.S. 138, 146 (1904) ("We are to interpret statutes, not to make them.").

Section 365(d)(3) requires that the trustee timely perform all "obligations" arising under an unexpired lease of nonresidential real property prior to assumption or rejection. Although not defined in the Bankruptcy Code, "the word 'obligation' in Section 365(d) [is] clear and unambiguous." *Bullock's, Inc. v. Lakewood Mall Shopping Ctr. (In re R.H. Macy & Co., Inc.)*, 1994 WL 482948, at *12 (S.D.N.Y. Feb. 23, 1994) (Sotomayor, J.). Traditional principles of statutory construction require that words in a statute be accorded their "ordinary, contemporary, common meaning." *Pioneer Inv. Serv. Co. v. Brunswick Assoc. Ltd. P'ship*, 507 U.S. 380, 388 (1993) (citation omitted). The common meaning of the word "obligation" is that an obligation is a legal duty to do something. *See* BLACK'S LAW DICTIONARY 491 (2d ed. 2001).

Quite simply, section 365(d)(3) means what it clearly and unambiguously says. To the extent a duty arises under an unexpired lease of nonresidential real property after the order for relief but before assumption or rejection, such duty must be timely performed. In this case, the duty is the payment of rent. It is not disputed that the Lease required the Debtor to pay the full monthly rent, in the amount of $25,000, "in advance on the first day of each month." Because the "obligation" to pay such rent arose on May 1, 2020, four days prior to rejection of the Lease, the Debtor (and the Trustee, as its successor) is required under the statute to "timely" pay such rent. It is irrelevant whether payment of such obligations is equitable to the estate and its creditors, or whether the estate received an actual benefit, as Congress expressly mandated in section 365(d)(3) that such obligations be paid "notwithstanding section 503(b)(1) of this title."

The majority states that the proration approach has been adopted by a "slight majority of courts." That may be true. However, my colleagues mysteriously fail to acknowledge that, prior to today's ruling, all circuit courts of appeal that have addressed this issue in the context of post-petition rent due under an unexpired lease of non-residential real property have adopted the billing date approach. *See Burival v. Roehrich (In re Burival)*, 613 F.3d 810 (8th Cir. 2010); *HA-LO Indus., Inc. v. Centerpoint Props. Tr.*, 342 F.3d 794, 799 (7th Cir. 2003); *Centerpoint Props. v. Montgomery Ward Holding Corp. (In re Montgomery Ward Holding Corp.)*, 268 F.3d 205 (3d Cir. 2001); *Koenig Sporting Goods, Inc. v. Morse Road Co. (In re Koenig Sporting Goods, Inc.)*, 203 F.3d 986 (6th Cir. 2000). If I had my druthers, we would not create a circuit split today. *See Ultra Petroleum Corp. v. Ad Hoc Comm. of Unsecured Creditors (In re Ultra Petroleum Corp.)*, 943 F.3d 758, 763 (5th Cir. 2019) ("We are always chary to create a circuit split.").

The Sixth Circuit Court of Appeals' decision in *Koenig* is directly on point. In *Koenig*, the debtor, a sporting goods retailer, appealed a determination that it was liable for an entire month's rent on its lease of nonresidential real property after it rejected the lease and vacated the premises on the second day of the month. *In re Koenig Sporting Goods, Inc.*, 203 F.3d at 990. There, as here, the terms of the debtor's lease with its landlord provided that monthly rent was due in advance on the first day of each month. *Id.* at 987.

The Sixth Circuit held that the statute's plain language required the debtor to pay rent for the entirety of the month during which the lease was rejected. The court rejected the debtor's argument that equity and "common sense" require adoption of the proration approach. It reasoned that the purpose of section 365(d) is to "prevent parties in contractual or lease relationships with the debtor from being left in doubt concerning their status vis-à-vis the estate" and "to relieve the burden placed on nonresidential real property lessors (or 'landlords') during the period between a

tenant's bankruptcy petition and assumption or rejection of a lease." *Id.* at 989 (quotations omitted). Therefore, the court concluded, equity likewise favors full payment to the landlord. *Id.*

In *In re Montgomery Ward Holding Corp.*, the Third Circuit Court of Appeals also rejected the proration approach based on the plain language of the statute, stating:

> The clear and express intent of § 365(d)(3) is to require the trustee to perform the lease in accordance with its terms. To be consistent with this intent, any interpretation must look to the terms of the lease to determine both the nature of the "obligation" and when it "arises." If one accepts this premise, it is difficult to find a textual basis for a proration approach. On the other hand, an approach which calls for the trustee to perform obligations as they become due under the terms of the lease fits comfortably with the statutory text.

In re Montgomery Ward Holding Co., 268 F.3d at 209. The Third Circuit concluded: "Finding a straightforward interpretation that produces a rational result and no other reasonable interpretation consistent with the text, we are constrained to hold that § 365(d)(3) is not ambiguous." *Id.* at 210.

Because the statutory language is unambiguous, it is unnecessary to resort to policy implications and legislative history. Nevertheless, I believe that the limited legislative history supports the billing date approach. The Bankruptcy Code, as initially enacted in 1978, treated landlords harshly. Section 365(d)(2) provided that a debtor has until confirmation of a plan to decide whether to assume or reject an unexpired lease. 11 U.S.C. § 365(d)(2). And rent due to a landlord post-petition was a mere administrative expense under section 503(b)(1)(A), assuming that the landlord could establish that the unpaid post-filing rent was an "actual, necessary cost . . . of preserving the estate." 11 U.S.C. § 503(b)(1)(A).[12] Combined, these two provisions meant that, absent a landlord filing a motion to compel payment and proving entitlement to an

[12] Because administrative expenses are to be construed narrowly, *see Trs. of the Amalgamated Ins. Fund v. McFarlin's, Inc.*, 789 F.2d 98, 101 (2d Cir. 1986), pre-1984 landlords were frequently subjected to arguments about whether continued occupation of non-residential real estate actually provided a benefit to the estate, or whether rental payment amounts should be adjusted according to the circumstances of the case or the current real estate market.

administrative expense, a debtor could conceivably stay in the rented premises indefinitely post-petition without paying rent.[13] Making matters worse, administrative expenses were (and are) paid in full only to the extent that the bankruptcy estate is administratively solvent.

Recognizing the unfairness of such an approach, Congress amended the Bankruptcy Code in 1984 to level the playing field between landlords and debtors. Among other provisions, section 365(d)(3) was enacted to ensure that a debtor timely performs all of its obligations under a nonresidential real property lease. Additionally, section 365(d)(4) was enacted to provide that a nonresidental real property lease is deemed rejected if it is not assumed or rejected within 120 days after the petition date. 11 U.S.C. § 365(d)(4). Collectively, these amendments ensure that decisions regarding the assumption or rejection of non-residential real property leases are timely made, and that landlords will receive payment of all lease obligations until such decision is made.[14]

The majority asserts that the legislative history with respect to these amendments is "bereft" of any statement suggesting that Congress intended to adopt the billing date approach. I respectfully disagree. The legislative history supports the conclusion that the 1984 amendments were intended to ameliorate the perceived inequities that lessors of nonresidential real property had faced prior to assumption or rejection of their lease by ensuring timely payment of all lease obligations. As Senator Orrin Hatch, a conferee to the original act, stated:

> In this situation, the landlord is forced to provide current services—the use of its property, utilities, security, and other services—without current payment. No other creditor is put in this position. In addition, the other tenants often must increase their common area charge payments to compensate for the trustee's failure to make the required payments for the debtor. *The bill would lessen these problems by*

[13] Administrative expenses ordinarily are not paid until the end of the case. *See* 11 U.S.C. § 1129(a)(9).

[14] The majority reasons that its interpretation is strengthened by the canon that the Bankruptcy Code should not be read to erode past bankruptcy practice absent a clear indication that Congress intended such departure. In this case, however, it is clear that Congress amended the Bankruptcy Code in 1984 for the purpose of altering the existing practice by enhancing the treatment afforded to non-residential real property lessors. *See In re Montgomery Ward Holding Corp.*, 268 F.3d at 211.

> *requiring the trustee to perform all the obligations of the debtor under a lease of nonresidential real property at the time required in the lease. This timely performance requirement will ensure that debtor-tenants pay their rent, common area, and other charges on time pending the trustee's assumption or rejection of the lease.*

130 CONG. REC. (1984), *as reprinted in* 1984 U.S.C.C.A.N. 576, 598-99 (emphasis added).

Finally, the majority concludes that application of the billing date approach results in a windfall for Touch of Gray. But the trustee, not the landlord, controls the date of rejection. *See, e.g.*, *In re Koenig Sporting Goods, Inc.*, 203 F.3d at 989; *HA-LO Indus., Inc. v. Centerpoint Props. Tr.*, 342 F.3d at 800. Here, had the Debtor simply rejected the lease a week earlier, no rent would be due for May 2020. The majority also suggests that the billing date approach results in a windfall because, in addition to receiving the rental payment, "the landlord has an opportunity to lease the vacated premises to a third party. . . ." While the majority's hypothetical is possible, it is far from realistic. The Debtor may have returned the keys to Touch of Grey on May 5th. But Touch of Grey likely would not have been able to locate a new tenant that month. Viewed from the landlord's perspective, receipt of the full month's rent is hardly a windfall.[15]

In conclusion, section 365(d)(3) clearly and unambiguously required the Debtor to timely perform all of its obligations under the Lease. Because the Lease mandated payment of the May rent on May 1st, four days prior to rejection of the Lease, the Debtor was required to *timely* make such payment. Accordingly, I would reverse the bankruptcy court and hold that Touch of Grey is entitled to immediate payment of the May 2020 rent in its entirety.

[15] Additionally, the billing date approach "can cut both ways." *See, e.g.*, *In re Oreck Corp.*, 506 B.R. 500, 504 (Bankr. M.D. Tenn. 2014) (citing *In re ½ Off Card Shop, Inc.*, 2001 WL 1822419, at *2-3 (Bankr. E.D. Mich. 2001)) (denying administrative expense for unpaid "stub rent" for the period between the chapter 11 petition and the first post-petition rent payment based on application of the billing date approach).