Team 10R

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.

On Writ of Certiorari
to the United States Court of Appeals
for the Thirteenth Circuit

BRIEF FOR RESPONDENT

Team 10R
Counsel for Respondent

QUESTIONS PRESENTED

I. Whether a seller of goods is entitled to reduce its preference exposure pursuant to an 11 U.S.C. § 547(c)(4) new value defense when such new value is subject to a fully paid 11 U.S.C. § 503(b)(9) administrative expense claim?

II. Whether a trustee must pay rent that comes due in the post-petition, prerejection period at a prorated basis that reflects the time the debtor actually held possession of the premises under 11 U.S.C. § 365(d)(3), regardless of the lease's billing dates?

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OPINIONS BELOW

The United States Bankruptcy Court in this case held for the Trustee on both issues, and the United States District Court for the District of Moot affirmed those rulings. R. at 3. The United States Court of Appeals for the Thirteenth Circuit then affirmed those rulings. *Id*. The Court of Appeals held, first, that section 547(c)(4) of the Bankruptcy Code precludes a defendant from asserting a new value defense for goods that are subject to a satisfied administrative expense claim under section 503(b)(9), and second, that section 365(d)(3) does not require the trustee to satisfy obligations allocable to the post-rejection period. *Id*. at 10, 15. This Court granted the Creditor's petition for writ of certiorari. *Id*. at 1.

STATEMENT OF JURISDICTION

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

STATUTES INVOLVED

The relevant federal laws controlling this case are 11 U.S.C. §§ 365(d)(3), 547, and 503(b)(9) of the United States Bankruptcy Code. These provisions are attached in full in Appendix A.

STATEMENT OF THE CASE

I. Facts

In 2005, William Tell (the Debtor) opened an independent coffeehouse in the Town of Terrapin, which he operated successfully for several years. R. at 3. Touch of Grey Roasters (Touch of Grey) is a large international coffee company with coffeehouses located around the world. *Id*. In 2017, Touch of Grey decided to expand its company by opening “neighborhood coffeehouses,” which would be franchised by owners of existing independent coffeehouses. R. at 4.

In Fall 2017, the Debtor agreed to franchise one of these neighborhood coffeehouses with Touch of Grey. *Id*. As part of the franchise agreement, Touch of Grey agreed to lease a new building in Terrapin’s downtown entertainment district. *Id*. The lease agreement was a twenty-year triple net lease that required the debtor to pay $25,000 a month in rent on the first day of each month. *Id*.

The new building for the coffeehouse was completed in November 2018. *Id*. at 5. The new “Terrapin Station Coffeehouse” opened for business on December 1, 2018, and the Debtor’s old coffeehouse officially closed the same day. *Id*. For various reasons, the new location immediately began to struggle. *Id*. By September 2019, the Debtor was unable to keep up with his debts. *Id*. In November of 2019, those unpaid debts had risen to over $700,000. *Id*. On December 5, 2019, Touch of Grey sent the Debtor a notice of default threatening to terminate the franchise agreement. *Id*.

On December 7, 2019, the parties entered into a forbearance agreement wherein Touch of Grey would continue the franchise agreement if the Debtor, among other things, agreed to pay Touch of Grey $250,000 and reaffirmed its obligations under their original lease agreement. *Id*.

That day, the Debtor made the $250,000 forbearance payment. *Id*. Less than two weeks later, on December 18, the Debtor purchased an additional $200,000 worth of Touch of Grey products on credit, which was set out in a signed, personally guaranteed invoice. *Id*. at 5-6. Those goods were delivered on December 21. *Id*. at 6.

Unfortunately, circumstances did not improve. The Debtor had to close the coffeehouse in March 2020 because of the pandemic. *Id*. However, when he reopened in April of 2020, his business did not recover. *Id*. On May 5, the Debtor ceased operations, vacated the premises, and returned the keys to Touch of Grey. *Id*.

II. Procedural History

On January 5, 2020, the Debtor filed chapter 11 bankruptcy. *Id*. At that time, he was current under the lease agreement, but owed Touch of Grey $650,000 for purchased goods. *Id*. On January 19, the Debtor filed a motion requesting to pay $200,000 to Touch of Grey as a "critical vendor" payment. *Id*. He emphasized that this payment would go towards the December 18 invoice. *Id*. at 7. The Bankruptcy court declined to authorize the critical vendor payment, but instead authorized the $200,000 payment from the Debtor to Touch of Grey as a 503(b)(9) administrative expense payment. *Id*. The Debtor made that administrative expense payment days later. *Id*.

On May 6, 2020, after ceasing operations and vacating the business premises, the Debtor filed a motion to reject the lease and franchise agreements with Touch of Grey. *Id*. On May 8, Touch of Grey sought an order compelling payment of the May rent under the lease agreement. *Id*. Touch of Grey did not oppose the motion to reject, but still argued that it was owed the full May rent of $25,000. *Id*. at 7-8.

On May 29, the Debtor converted the case to a chapter 7. *Id*. at 8. The Bankruptcy Court granted the Debtor's motion to reject the lease and franchise agreements, but did not rule on the issue of the May rent payment. *Id*. Once a trustee was assigned to the case, he objected to the motion to compel the May rent and sought to recover the $250,000 forbearance agreement under the § 547(b) claw back of preferential payments power. *Id*. Touch of Grey responded by asserting a § 547(c)(4) new value defense. *Id*. The parties attempted to mediate these disputes, but were unsuccessful. *Id*.

The parties filed cross-motions for summary judgment on the preference payment issue and agreed to address the May rent issue at the same hearing. *Id*. at 9. The Bankruptcy court ruled in favor of the Trustee on both issues. *Id*. Touch of Grey then made a timely appeal to the United States District Court for the District of Moot. *Id*. The District Court affirmed, and Touch of Grey then timely appealed to The United States Court of Appeals for the Thirteenth Circuit. *Id*. The Appeals Court affirmed on both issues. *Id*. at 3. This Court granted Touch of Grey's petition for writ of certiorari. *Id*. at 1.

STANDARD OF REVIEW

The parties do not dispute the facts in this case. R. at 3. The two questions on appeal, whether a creditor can assert a section 547(c)(4) new value defense when they have received full payment for that new value under a section 503(b)(9) administrative expense payment and whether section 365(d)(3) requires a trustee to pay either a prorated amount or all bills that come due in the post-petition, pre-rejection period, are both questions of law. Therefore, these questions are reviewed under a de novo standard. *Highmark Inc v. Allcare Health Mgmt. Sys. Inc.*, 572 U.S. 559, 536 (2014).

SUMMARY OF THE ARGUMENT

The Thirteenth Circuit properly held that Touch of Grey may not reduce its preference liability with a 547(c)(4)(B) new value defense when such new value is subject to a fully paid

503(b)(9) administrative expense claim. Under section 547(b), a trustee can claw back payments made by the debtor within ninety days before the petition date as preferential payments. Section 547(c) provides defenses for a creditor to assert to lessen its preference liability. One such defense is the 547(c)(4) new value defense, which allows a creditor to reduce its liability by the amount of new value it subsequently provided the estate. The plain language of section 547(c)(4)(B) prohibits a creditor from asserting a new value defense where such new value has been accounted for by an otherwise unavoidable transfer. Because 547(c)(4) contains no temporal limitation, a 503(b)(9) administrative expense payment does qualify as an otherwise unavoidable transfer.

Similarities in the practical effects of 503(b)(9) administrative expense claims and 546(c) reclamation claims demonstrate that the treatment of 546(c) claims can provide helpful guidance in answering the current question. The new value defense rests on the premise that the estate gets an enhancement from the creditor's subsequent transfer that justifies reducing the creditor's preference liability. With both reclamation and administrative expense claims, the estate is depleted by the same amount it was initially enhanced, functionally cancelling out the creditor's enhancement. Because of this depletion, goods subject to reclamation cannot constitute new value for the purpose of a section 547(c)(4) defense. Similarly, because of the same type of depletion, value subject to a 503(b)(9) administrative expense claim also cannot constitute new value under 547(c)(4).

Policy concerns also prohibit a creditor from asserting a new value defense with value that is subject to a fully paid 503(b)(9) administrative expense claim. The Bankruptcy Code must always strike a delicate balance between incentivizing creditors to work with financially distressed entities and promoting equal treatment among creditors in bankruptcy. Prohibiting creditors from participating in this double dipping strategy is the only way to advance one of these goals without negatively affecting the other. Allowing creditors to employ one of these protective strategies, the new value defense or the administrative expense claim, properly advances the Bankruptcy Code's policy goals without offending any one particular goal.

Furthermore, the Thirteenth Circuit properly held that section 365(d)(3) did not require trustees to depart from the longstanding practice of prorating post-petition, prerejection expenses arising under a nonresidential lease. Specifically, the billing date approach offered by the Petitioner and supported by only a minority of courts is not supported by a plain reading of section 365(d)(3), legislative history, or public policy.

Section 365(d)(3) is an ambiguous statute. The precise definition of "obligation" is unclear in and of itself, and the modifying effect subsequent language in the statute has on "obligation" only increases uncertainty. Proponents of the billing date approach argue that "obligation" unambiguously refers to legal duties arising from a lease, but this position fails by using a modern definition instead of one that was contemporaneous to the drafting of section 365(d)(3). Additionally, the billing date's definition of obligation, when read in context with the rest of section 365(d), would have to include a legal obligation to pay for services never rendered- a suggestion that is absurd on its face. By reading section 365(d)(3) as an endorsement of the historical proration approach, rather than the new billing date approach, absurd results are avoided.

Given that section 365(d)(3) is ambiguous, an evaluation of the statute's legislative history is proper. Notably, the burden is on the Petitioner to prove that the Legislature intended to depart from pre-Code practices, as this Court has repeatedly expressed its hesitance to do so without at least some discussion to do so in the legislative history. The Petitioner is unable to meet that burden, however, because the legislative history surrounding section 365(d)(3) endorses the proration method. Statements from a congressman involved in the creation of section 365(d)(3) illuminate that the purpose of the section was to provide landlords with current payment for current services. Nothing in the legislative history of section 365(d)(3) indicates that Congress wanted to grant a windfall to landlords, which is the inevitable consequence of the billing date approach.

Finally, the proration method upholds the overarching policy goals of the Bankruptcy Code by treating creditors equally and increasing the likelihood that a debtor is able to successfully reorganize. This is in stark contrast to the billing date approach, which elevates nonresidential landlords far above other creditors.

ARGUMENT

I. THE THIRTEENTH CIRCUIT PROPERLY HELD THAT THE BANKRUPTCY CODE DOES NOT PERMIT A CREDITOR TO REDUCE ITS PREFERENCE LIABILITY BY APPLYING NEW VALUE UNDER SECTION 547(C) WHEN SUCH NEW VALUE IS PAID FOR IN FULL THROUGH A POST-PETITION SECTION 503(B)(9) CLAIM.

The issue at bar involves the interplay of several Bankruptcy Code sections, namely sections 547(b), 547(c), and 503(9)(b). When examining the relationship between these sections, it is important to keep in mind that the Code is always trying to maintain a precarious balance between protecting creditors and protecting the estate. Under section 547(b), the trustee is able to claw back payments made to creditors within ninety days before the petition date. 11 U.S.C. § 547(b). Payments made within this time period could unfairly preference the recipient creditor because that payment decreases the pool of funds available for distribution to the other general unsecured creditors in bankruptcy. *See* 11 U.S.C. § 547(b). However, when a creditor takes on the risk of continuing business with a financially at-risk debtor by providing further goods or value after such a payment, the creditor can assert a section 547(c)(4) new value defense. *See* 11 U.S.C. § 547(c)(4). This defense allows a creditor to reduce its preferential liability, or the monetary amount the trustee can claw back under section 547(b), by the monetary amount of the new value the creditor later provided. *See id*. Importantly, this defense has its own requirements, including section 547(c)(4)(B), which prohibits the use of this claim if the debtor has made an "otherwise unavoidable transfer" on account of the creditor's claimed new value. 11 U.S.C. § 547(c)(4)(B).

Further complicating the interaction in this case is a section 503(b)(9) administrative expense claim. This section also provides creditors who continue to deal with financially distraught debtors with protection for that risk. *See* 11 U.S.C. § 503(b)(9). A section 503(b)(9) claim is a prioritized payment in bankruptcy, meaning it gets paid before other general unsecured creditors are paid. *See id*. Under this section, a creditor can make a prioritized claim for the monetary value of any goods it delivered to the debtor within twenty days before the petition date. *See id*. Because the section 503(b)(9) claim receives priority status, this claim also confers upon the creditor a type of Code-sanctioned preference, similar to that allowed under section 547(c)(4).

The issue on appeal is whether a creditor can reduce its preferential liability by applying the new value defense under section 547(c)(4) when such value has been paid in full under a section 503(b)(9) claim. This Court has never considered this particular issue before, but a majority of lower courts hold that a creditor cannot use new value to reduce its preferential liability when it has been paid in full for that new value. *See, e.g., In re Beaulieu Grp., LLC*, 616 B.R. 857, 878 (Bankr. N.D. Ga. 2020); *In re TI Acquisition, LLC*, 429 B.R. 377, 385 (Bankr. N.D. Ga. 2010); *see also, e.g., In re Circuit City Stores, Inc.*, 2010 WL 4956022 at *9 (Bnkr. E.D. Va. Dec. 1, 2010); *In re Login Bros. Book Co., Inc.*, 294, B.R. 297, 301 (Bankr. N.D. Il. 2003); *cf.*, *In re Phoenix Restaurant Grp., Inc.*, 373 B.R. 541, 549 (M.D. Tenn. 2007). These courts reason that because there is no temporal limitation attached to section 547(c)(4), a section 503(b)(9) claim constitutes an otherwise unavoidable transfer and prevents a creditor from limiting its preference liability under section 547(c)(4).

A. The plain language of 547(c)(4)(B) is prevents a creditor from reducing its preferential liability with new value that has been accounted for through a 503(b)(9) administrative expense payment.

To interpret section 547(c)(4), we "must begin with the language employed by Congress." *Gross v. FBL Financial Services, Inc.*, 577 U.S. 167, 175 (2009) (quoting *Engine Mfrs. Assn. v. South Coast Air Quality Mgmt. Dist.*, 541 U.S. 246, 252 (2004)) (internal quotation marks omitted). It is well established that when the language of a statute is clear, the judicial inquiry ends with the words themselves. *Rubin v. United States*, 449 U.S. 424, 430 (1981). In order to employ any other canons of interpretation, the court must first find an ambiguity. *Id*.

i. There is no temporal limitation attached to section 547(c)(4) of the Bankruptcy Code.

The language of section 547(c), while admittedly complex, is not ambiguous. *Beaulieu*, 616 B.R. at 872. The plain language of 547(c)(4) does not contain any temporal limitation regarding when an "otherwise unavoidable transfer" is made "on account of the new value" at issue. *See* 11 U.S.C. § 547(c)(4). Because the wording of this statute has a "plain and unambiguous meaning…the inquiry is over." *In re BFW Liquidation, LLC*, 899 F.3d 1178, 1188 (2018). Contrary to the wishes of the Petitioner, the Court simply cannot read words that are not in the text of the statute. *See Conn. Nat'l Bank v. Germain*, 503 U.S. 249, 253-254 (1992) (citations omitted).

The petitioner argues that 547(c)(4)(B) applies only to prepetition payments, but it requires an exercise in rhetorical gymnastics to arrive at such a conclusion. R. at 14. While it is true that section 547(c) uses the term "transfer" as opposed to "distribution" (as a post-petition payment may typically be described), the Bankruptcy Code's definition of the term "transfer" makes it clear that any type of payment, including a distribution, can be referred to as a transfer. *See* 11 U.S.C. §

101(54)(D). Similarly, the use of the term "debtor" in section 547(c)(4)(B) does not establish the temporal limitation the petitioner desires. *In re Friedman's Inc.*, 738 F.3d 547, 555 (3d Cir. 2013). Although post-petition payments are necessarily made by a trustee or debtor-in-possession, the Bankruptcy Code does not define the term "debtor" as restricted to prepetition actions; further, the Code employs the term debtor in other sections that refer only to post-petition functions. *Friedman's*, 738 F.3d at 555.

Moreover, if Congress had intended to impose a temporal limitation on the transfers described in 547(c)(4)(B), it would have used more specific terminology. For example, the Bankruptcy Code is clear that a transfer can only be classified as preferential if it happens within ninety days before the petition date. *See* 11 U.S.C. § 547(b). Congress could have been just as specific with the transfer described in 547(c)(4)(B), but no such temporal limitation is present. This Court has been clear that it must be assumed that Congress intends what it includes in a statute and intends to omit what it does not. *Rubin*, 449 U.S. at 430. Thus, it can be presumed that the lack of such a specification was intended to keep the transfer referred to in 547(c)(4)(B) broad as opposed to temporally limited. *See Beaulieu,* 616 B.R. at 871.

The plain language of the following provision, section 547(c)(5), further indicates that this omission of a temporal limitation was intentional. *Beaulieu*, 616 B.R. at 872. That provision includes an express and clear temporal limitation: transfers that are made "as of the date of the filing of the petition." 11 U.S.C. § 547(c)(5). It seems unlikely that Congress unintentionally omitted a temporal limitation in 547(c)(4)(B), but knew well how to include one in the next provision of the same section. *See Beaulieu*, 616 B.R. at 872. As discussed, when the plain language of a statute is unambiguous, the court cannot read into it an ambiguity that does not exist in order to create room for its own interpretation. *See Conn Nat'l Bank*, 503 U.S. at 253-254. On this issue, the plain language of the Bankruptcy Code is clear: there is no temporal limitation that determines whether a payment qualifies as an otherwise unavoidable transfer made on account of new value asserted under 547(c)(4)(B). *See* 11 U.S.C. § 547(c)(4)(B).

ii. A section 503(b)(9) payment constitutes an otherwise unavoidable transfer under section 547(c)(4)(B).

Having determined that the plain language of the statute does not impose a temporal limitation on the transfers described in section 547(c)(4)(B), we can next establish that a 503(b)(9) administrative expense claim does constitute an otherwise unavoidable transfer under 547(c)(4)(B). *Beaulieu*, 616 B.R. at 869. Courts have interpreted this phrase to mean a "transfer that is unavoidable for reasons other than 547(c)(4)." *BFW Liquidation*, 899 F.3d. at 1199; *In re Phoenix Rest. Grp., Inc.*, 317 B.R. 491, 499 (Bankr. M.D. Tenn. 2004); *In re Check Reporting Servs., Inc.*, 140 B.R. 425, 432 (Bankr. W.D. Mich. 1992). There are several sections in the Bankruptcy Code that allow the trustee to avoid payments the debtor made, both prepetition and post-petition. *See* 11 U.S.C. §§ 548 and 549. However, because a 503(b)(9) payment can only occur post-petition, section 549 is the only other applicable statute. *Beaulieu*, 616 B.R. at 869. Section 549 allows for the avoidance of post-petition transfers unless those transfers were authorized by the Bankruptcy Code or the Court. 11 U.S.C. § 549. In the case at bar, the debtor sought the court's permission to make the $200,000 section 503(b)(9) payment, and the debtor's request was granted. R. at 9. This authorization rendered the debtor's section 503(b)(9) payment an otherwise unavoidable transfer under section 547(c)(4)(B), as it could not be avoided by any provision other than section 547(b). *Beaulieu*, 616 B.R. at 869.

B. <u>Although the statutory language of section 547(c)(4) is unambiguous, an analysis of how courts treat a section 546(c) reclamation claim provides useful guidance for this issue.</u>

The 2005 Bankruptcy Abuse Prevention and Consumer Protection Act's addition of section 503(b)(9) administrative expense claims appears to be a codified extension of reclamation rights for creditors. *TI Acquisition*, 429 B.R. at 380. As such, some courts have evaluated section 503(b)(9) claims under a framework similar to that used for section 546(c) reclamation claims. *Id.* at 385. Courts that follow this approach use a functionalist framework, focusing on the practical effects of the claims. This functionalist approach illustrates why reclamation claims can be used to "deplete" a creditor's new value claim, and why section 503(b)(9) claims should also be given the same effect. *In re Phoenix*, 373 B.R. 541, 547-48 (M.D. Tenn. 2007). The essence of the new value claim is that the creditor provided value to the estate, ultimately enhancing the overall worth of the estate, and balancing out any benefit the creditor received from a preferential payment. *Beaulieu*, 616 B.R. at 877. This enhancement to the estate is what justifies reducing the creditor's preferential liability. Thus, if there is no enhancement to the estate, then there can be no "new value" added to the estate, meaning there is no justification for the reduction. *See id*.

With both a section 546(c) reclamation claim and a section 503(b)(9) administrative expense claim, the estate is depleted the same amount by which it was ostensibly enhanced. *TI Acquisition*, 429 B.R. at 381. As its name suggests, a reclamation claim allows the creditor to reclaim the goods that it gave to the estate. 11 U.S.C. § 546(c). Similarly, a section 503(b)(9) administrative expense claim removes the monetary value of the goods from the estate and returns it to the creditor. *TI Acquisition*, 429 B.R. at 380-81. Both of these actions ensure that the estate receives no real enhancement from the creditor's transfer of goods, meaning the creditor provides no new value to the estate. *Id.* at 381. Without providing new value to the estate, the creditor also does not balance out any benefit that it received from a preferential payment.

Despite these functional similarities, some courts have focused on conceptual differences between these two claims. *In re Commissary Operations, Inc.*, 421 B.R. 873, 878 (M.D. Tenn. 2010). For example, a section 503(b)(9) claim can only arise post-petition while section 546(c) reclamation claims can arise any time the debtor is insolvent, regardless of whether a bankruptcy case is filed. *Commissary Operations*, 421 B.R. at 877. Because a section 503(b)(9) claim is only cognizable in bankruptcy, the lien provided by a reclamation claim may offer more security for a creditor. *Id.* at 878. However, this difference is irrelevant in cases such as the one at bar, where a section 503(b)(9) claim has already been paid in full. *See TI Acquisition*, 429 B.R. at 381. Touch of Grey obviously is not vulnerable to non-payment, as it has already been paid. R. at 9.

In a similar vein, opponents of the reclamation claim analogy argue that a reclamation claim carries with it "strings" that provide the creditor with protection—tugging on those strings ensures that the goods are returned to the creditor. *Commissary Operations*, 421 B.R. at 877. This argument asserts that there are no strings associated with a 503(b)(9) claim to provide such protection, making these two claims incomparable. *See id*. However, courts have found that because the debtor must award a creditor who lends goods within twenty days before the petition date priority status, there are sufficient "strings" to make a useful analogy between these two types of claims. *TI Acquisition*, 429 B.R. at 381. Ultimately, the minor conceptual differences between these two claims do not render the analogy useless. *See id*. Rather, the similarities between these claims and their intertwined history indicates that they should receive similar treatment. *Id*. Because of the functional effects these claims have on the bankruptcy estate, a fully paid section 503(b)(9) claim should also prevent a creditor from proffering a 547(c)(4) new value defense. *Id*. at 385.

C. <u>The policy goals of bankruptcy law are better served by prohibiting creditors from reducing their preferential liability under section 547(c)(4) with new value that is</u>

subject to a fully paid section 503(b)(9) claim, preventing them from double dipping from the estate.

Bankruptcy courts are courts of equity, meaning that the practical effects and policy concerns of their rulings must be taken into account. *Pepper v. Litton*, 308 U.S. 295, 304 (1939). There are two primary goals of bankruptcy law at play in this issue: first, bankruptcy law aspires to ensure equality between creditors; second, bankruptcy law tries to encourage creditors to continue working with financially at-risk entities by helping to mitigate some of the risk. *TI Acquisition*, 429 B.R. at 384. Here, disallowing a creditor from asserting a section 547(c)(4) new value claim when it has been paid in full for such value is the only approach that promotes one of these policies, equality among creditors, while having no negative effect on the other, encouraging creditors to continue deal with a financially at-risk debtor. *TI Acquisition*, 429 B.R. at 384-385.

i. Prohibiting creditors from making section 547(c)(4) new value defense claims for value that is already subject to a section 503(b)(9) claim in no way disincentivizes creditors from continuing to do business with financially distressed entities.

One primary purpose of the preferences provisions is to encourage creditors to continue working with financially at-risk entities. *Friedman's*, 738 F.3d at 557-58. When creditors continue to deal with financially distraught debtors, they are fueling the possibility that the debtor will be able to avoid bankruptcy. *See id.* Further, even if the debtor does ultimately have to file, by continuing to do business with the debtor, the creditor has helped to enhance the estate as a whole, which benefits all creditors when it comes to distribution. *See TI Acquisition*, 429 B.R. at 385. The defense provided in section 547(c)(4) and the priority status that accompanies a section 503(b)(9) administrative expense claim both serve to reward a creditor who has assumed the financial risk associated with continuing to lend to a financially at-risk entity. *See id*. By rewarding creditors who assume this risk, these sections help incentivize creditors to continue doing business with debtors as opposed to initiating court actions that will only force the debtor into bankruptcy more quickly. *See Commissary Operations*, 421 B.R. at 876-77.

Because these sections serve such a powerful incentive, any decision that potentially limits or eliminates this incentivization should be carefully considered. Fortunately, the majority approach, denying creditors the power to "double dip" from the estate, in no way mitigates the reward these sections provide to creditors who continue to deal with at-risk debtors. *Beaulieu*, 616 B.R. at 876; *TI Acquisition*, 429 B.R. at 385. Because the temporal requirements for section 503(b)(9) claims create space for some uncertainty, as one court explained, "from 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." *TI Acquisition*, 429 B.R. at 385. Basically, the creditor will still be rewarded either way: it will either reduce its preferential liability under 547(c), or it will receive priority payment status under 503(b)(9). *See TI Acquisition*, 429 B.R. at 385. Both of these avenues of protection still ensure that creditors are encouraged to continue lending to financially distraught debtors.

ii. Preventing creditors from using section 547(c)(4) new value claims to double dip from the estate is the only way to protect the overarching policy goal of promoting equality among creditors.

Imposing a temporal limitation on the transfers described in section 547(c)(4)(B) essentially allows a creditor to "double dip" from the estate. *Beaulieu*, 616 B.R. at 876. The first dip from the estate is the reduction in preference liability for the creditor's new value under section 547(c)(4). *Id.* This reduction effectively allows the creditor to keep money in its pocket instead of returning it to the estate as a way to account for the new value the creditor supplied to the estate. The second dip occurs in the post-petition otherwise unavoidable transfer that is also made on account of the new value the creditor offered. *Id.* In the instant case, this transfer was in the form of a section 503(b)(9) administrative expense payment. R. at 9. Each of these options is a method of repaying the creditor for the new value it supplied the financially at-risk estate. *Beaulieu*, 616 B.R. at 876. The combination of both, however, results in the creditor being repaid for the same new value twice, a "payment plus" strategy. *Id.*

This double dipping not only unfairly benefits the particular creditor making the claims, but it also unfairly disadvantages other creditors who will only receive payment from what is left of the estate in bankruptcy. Again, the problem centers on a delicate balancing act. When a debtor makes a preferential payment, that payment depletes the estate, leaving less for the other general unsecured creditors to receive in bankruptcy. *See Beaulieu*, 616 B.R. at 877. When a trustee claws back the preferential payment, the estate is replenished and balance is restored. If a creditor later provides new value to the estate, the balance is once again disrupted, albeit this time in favor of the estate. *See id*. In order to restore balance, section 547(c) allows the creditor to reduce its preference liability by the amount of the new value. *See id*. With this reduction, the estate is properly balanced once more. But when a debtor then makes an otherwise unavoidable transfer on account of that same new value, whether the payment is made prepetition or post-petition, it depletes the estate without offering recourse for replenishment. *Beaulieu*, 616 B.R. at 876; *TI Acquisition*, 429 B.R. at 385. The estate is imbalanced in the creditor's favor, and thus leaves less for the other general unsecured creditors to receive in bankruptcy. Allowing this double dipping ensures that there cannot be equal treatment among creditors in bankruptcy, wholly defeating one of the most important policy goals of the Bankruptcy Code. *Beaulieu*, 616 B.R. at 877; *TI Acquisition*, 429 B.R. at 385.

Creditors have contended that this equality of treatment argument does not apply to creditors with section 503(b)(9) claims, as the award of a section 503(b)(9) claim itself gives a creditor priority status. *Friedman's*, 738 F.3d at 560. Under this reasoning, the goal of treating similarly situated creditors equally in bankruptcy is irrelevant to creditors with section 503(b)(9) claims, as their priority status already signals that they deserve better treatment than other unsecured creditors. *Id*. at 560-61. Courts have disagreed with this assertion, instead focusing on the practical effects of this strategy. *Beaulieu*, 616 B.R. at 876. Functionally, denying this double dipping mechanism does not detract from a creditor's priority status under section 503(b)(9). *See id*. But there is no policy or statutory interpretation that requires the court to grant creditors multiple code-sanctioned advantages just because it first grants a section 503(b)(9) priority status. The goal of treating general creditors equally in bankruptcy is not eliminated by one status-improving provision. Rather, these provisions are a part of the balance the Bankruptcy Code intentionally strikes, and must be evaluated in accordance with the Code's overarching goals. Promoting equality among creditors is always a primary concern of the Bankruptcy Code, and as such, this double dipping mechanism must be definitively prohibited. *Beaulieu*, 616 B.R. at 877-78.

II. THE THIRTEENTH CIRCUIT CORRECTLY HELD THAT SECTION 365(D)(3) CONTINUES THE HISTORICAL APPROACH OF PRORATING POST-PETITION, PREREJECTION OBLIGATIONS.

Balance between a debtor's "protections and obligations" is a primary goal of the Bankruptcy Code. *Midland Funding, LLC v. Johnson*, 137 S. Ct. 1407, 1415 (2017). The Code strikes such symmetry in the context of obligations arising under nonresidential leases. With court approval, a bankruptcy trustee has the power to either assume or reject a debtor's unexpired, nonresidential lease. 11 U.S.C. § 365(a). In making the decision to either assume or reject a lease, the trustee determines whether the lease is beneficial to the estate. *Mission Prod. Holdings, Inc. v. Tempnology, LLC*, 139 S. Ct. 1652, 1658 (2019). If a lease does not pass muster, a trustee's rejection will result in the estate being exempt from further performance. Upon the rejection of a lease, a debtor must immediately surrender the property. 11 U.S.C. § 365(d)(4)(a).

Unsurprisingly, there is often a lapse in time between the debtor's initial petition for relief and the trustee's ultimate rejection of a lease. Section 365(d)(3) spells out the responsibilities of a trustee in this twilight zone, providing in relevant part:

> 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.

11 U.S.C. § 365(d)(3). Prior to the enactment of the Bankruptcy Code, it was the "long-standing practice" for trustees to view a debtor's obligations as accruing on a day-by-day basis, rather than on a fixed billing date. *In re All for A Dollar, Inc.*, 174 B.R. 358, 361 (Bankr. D. Mass. 1994). A majority of courts have interpreted section 365(d)(3) as consistent with this historical proration approach. *In re McCrory Corp.*, 210 B.R. 934, 937 (S.D.N.Y. 1997) (noting courts within the First, Second, Sixth, and Ninth Circuits follow the proration approach). Notably, this Court also favors the continuation of pre-Code practices, holding that it "will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure." *Cohen v. Cruz*, 523 U.S. 213, 223 (1998).

The issue on appeal is whether this Court should depart from the long-standing practice of proration and instead adopt a "billing date" approach that would "radically alter the priority and distribution scheme under the Bankruptcy Code." *All for A Dollar, Inc*, 174 B.R. at 361. The minority of courts who follow the billing date approach require that a trustee pay out any bills that come due post-petition and prerejection, without regard for when (or even if) the corresponding benefit is conferred to the estate. *See In re Koenig Sporting Goods, Inc.*, 229 B.R. 388, 391 (B.A.P.

6th Cir. 1999). This Court should agree with the Thirteenth Circuit's conclusion that a trustee is only obligated to pay a prorated amount that reflects a debtor's actual occupancy of the premises in the post-petition, prerejection period.

A. The text of section 365(d)(3) is ambiguous, warranting an examination of legislative history and policy concerns.

To interpret section 365(d)(3), this Court must first look to the text of the statute itself. *Lamie v. U.S. Tr.*, 540 U.S. 526, 534 (2004). In looking at the text, words should be given "their ordinary meaning at the time Congress adopted them." *Niz-Chavez v. Garland*, 141 S. Ct. 1474, 433 (2021). This Court must also consider the context in which the language of the text is used, and the "broader context of the statute as a whole." *Robinson v. Shell Oil Co.*, 519 U.S. 337, 341 (1997).

i. "*Obligation", as used in the context of section 365(d)(3), is ambiguous.*

From the outset, the precise definition of "obligation" is uncertain. The Fourth Edition of Black's Law Dictionary describes an obligation as a "generic word […] having many, wide, and varied meanings, according to the *context* in which it is used." *Obligation, Black's Law Dictionary* (4th ed. 1958) (emphasis added). Indeed, it is the context in which section 365(d)(3) uses "obligation" that has led courts to conclude that the statute is ambiguous. Specifically, a majority of courts view "obligation" as being modified by the subsequent phrase "arising from and after the order of relief." This modification creates confusion as to when an obligation actually arises. *Nat'l Terminals Corp. v. Handy Andy Home Imp. Centers, Inc.*, 222 B.R. 149, 153 (N.D. Ill. 1997) (finding that "the language of § 365(d)(3) is ambiguous with respect to when the debtor's 'obligation' arises."); *In re Best Prod. Co., Inc.*, 206 B.R. 404, 407 (Bankr. E.D. Va. 1997) (holding that, although the word "obligation" is unambiguous, "the time at which that obligation "arises" under § 365(d)(3) is subject to more than one reasonable interpretation."); *McCrory Corp.*, 210

B.R. at 939 (questioning "whether the phrase 'until such lease is assumed or rejected' limits the 'obligation' in question to those actually accruing before rejection."). The Bankruptcy Code does not resolve the ambiguity found in section 365(d)(3), as it chooses not to define obligation. However, in the context of domestic support obligations, the Bankruptcy Code does use accrual language that is consistent with the proration approach. 11 U.S.C. § 101(14A).

In light of section 365(d)(3)'s ambiguity, the majority of courts have relied on pre-Code practices, legislative history, and policy considerations to interpret the statute. After careful consideration, these courts have determined that a section 365(d)(3) "obligation" is something that accrues daily, rather than something that arises on a fixed billing date. *All for A Dollar, Inc*, 174 B.R. at 361. As such, the trustee pays a prorated amount, based on the lease rate, that reflects the number of days the debtor occupied the premises in the post-petition, prerejection period.

A minority of courts fail to appreciate the inherent ambiguity that permeates section 365(d)(3). These jurisdictions, which follow the billing date approach, believe that an "obligation" in the context of section 365(d)(3) is a legal duty, and a legal duty is arises from billing dates listed in a lease. *Koenig Sporting Goods, Inc.*, 229 B.R. at 391. For a number of reasons, the logical foundation of this position fails. First, those supporting the minority position often use the modern, condensed definition of "obligation" offered by more recent editions of Black's Law Dictionary. (R. at 29). Use of the modern definition is contrary to this Court's position that words should be given their ordinary meaning at the time Congress adopted them. *Niz-Chavez*, 141 S. Ct. at 433.

Second, an "obligation" referenced in section 365(d)(3) cannot be considered in isolation; rather, it must be considered in the context of section 365(d) as a whole. *See Robinson*, 519 U.S. at 341. As such, section 365(d)(3) must be read in light of section 365(d)(4)(A). Section 365(d)(5)(A) requires a trustee to immediately surrender nonresidential property to the landlord upon rejection. 11 U.S.C. § 365(d)(4)(a). Under the billing date approach, a trustee could very well pay nearly a month (or, if the lease provides for annual billing, nearly a year) of expenses on a property that the debtor is forbidden from using. Beyond the obvious inequity, the likelihood of such a situation occurring means that the definition of "obligation" offered by the minority includes a legal duty to pay for services never rendered. The plain meaning of obligation, modern or historical, has never included something so extreme.

ii. *The minority's interpretation of section 365(d)(3) would lead to absurd results.*

Even if this Court believes that section 365(d)(3) could be interpreted in the manner proposed by a minority of courts, it has a duty to avoid interpretations that would produce absurd results. *Griffin v. Oceanic Contractors, Inc.*, 458 U.S. 564, 575 (1982). This is especially true in light of the fact that the proration method, which is "consistent with the legislative purpose," is available. *Id*.

The arbitrariness of the billing date approach is readily apparent, as it "make[s] the rights of creditors turn on the happenstance of the dating of tax bills and the strategic moves of landlords and tenants." *Matter of Handy Andy Home Improvement Centers, Inc*., 144 F.3d 1125, 1128 (7th Cir. 1998). By ignoring context, "silliness results" when the billing date approach is applied to real-world scenarios. *Id*. Take, for example, a landlord who leases out a warehouse for one million dollars annually. Rent for the coming year is due on the first of January. The tenant, experiencing financial hardship but ultimately hoping to reorganize, files for bankruptcy in December. The trustee eventually rejects the lease on January 2. Under the billing date approach, the trustee would still have to pay an entire year's worth of rent- one million dollars- for the debtor's single day of use. However, if the trustee rejected the lease just two days prior, the estate would pay out nothing. The fact that two extra days of occupation could result in an extra year's worth of rent being squeezed out of the debtor's estate is a result that can only be described as absurd. Such an expense, which would result in no benefit to the estate given section 365(d)(4)(A)'s requirement to vacate, could very well be the death blow to an already struggling business.

The majority's proration approach results in a different-and vastly more equitable-outcome. Instead of a one million-dollar charge, the estate would pay only a few thousand dollars for the two days in which it occupied the premises. By viewing obligations as something that accrues over time, as opposed to an immutable legal duty that stems from a lease, the proration approach is able to easily avoid an absurd result in a way that the billing date approach cannot.

B. <u>The legislative history surrounding section 365(d)(3) weighs heavily in favor of the proration approach.</u>

When a statute is unclear, this Court can look to legislative history to "illuminate ambiguous text." *Azar v. Allina Health Servs.*, 139 S. Ct. 1804, 1814 (2019) (internal citations omitted). Given the ambiguity of section 365(d)(3), an analysis of legislative history is appropriate. *Handy Andy Home Improvement Centers, Inc.*, 144 F.3d at 1128.

Importantly, the Petitioner carries the burden of proving that Congress intended to depart from the pre-Code practice of proration. *Dewsnup v. Timm,* 502 U.S. 410, 419, (1992) (ruling that "this Court has been reluctant to accept arguments that would interpret the Code […] to effect a major change in pre-Code practice that is not the subject of at least some discussion in the legislative history). This Court's resistance to changing pre-Code practices is so strong that lower courts believe it to have "tempered its application of the plain meaning rule*." McCrory Corp.*, 210 B.R. at 939. Given that all of section 365(d)(3)'s legislative history weighs in favor of the proration method, the Petitioner will not be able to meet the burden this Court placed upon it.

Before the enactment of section 365(d)(3), landlords who sought payment in the post-petition, prerejection period had to jump through the hoops of section 503(b)(1). Under section 503(b)(1), landlords had to prove that rent and other expenses were "actual, necessary costs of preserving the estate." *In re Child World, Inc.*, 161 B.R. 571, 576 (S.D.N.Y. 1993). Even if a landlord was granted an administrative expense under section 503(b)(1), there was always a question of when payment would actually be given. Bankruptcy judges have broad discretion over when to pay an administrative expense. *In re Photo Promotion Assocs., Inc.*, 881 F.2d 6, 9 (2d Cir. 1989). As such, landlords could not rely upon prompt payment for property being leased and (prior to rejection) occupied by the debtor.

The 1984 amendments to the Bankruptcy Code attempted to ameliorate this problem by including an exception to section 503(b)(1) in the form of section 365(d)(3). Senator Hatch, who was involved in the making of the amendments, gave the following explanation for section 365(d)(3):

> A second and related problem is that during the time the debtor has vacated space but has not yet decided whether to assume or reject the lease, the trustee has stopped making payments due under the lease. These payments include rent due the landlord and common area charges which are paid by all the tenants according to the amount of space they lease. 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.

H.R.Conf.Rep. No. 882, 98th Cong. (1984). It is evident that the Legislature's purpose behind section 365(d)(3) was not to grant landlords "a windfall at the expense of other creditors," but rather to put landlords on an equal footing. *Best Prod. Co., Inc.*, 206 B.R. at 407. Landlords, unlike other creditors who provide services to a debtor post-petition, are not "dealing voluntarily with a bankrupt." *Handy Andy Home Improvement Centers, Inc.*, 144 F.3d at 1128. Because the automatic stay prevents eviction, a landlord is forced to provide current services to the debtor in the post-petition period. Id. Senator Hatch's statement makes it clear that the timely payment provided by section 365(d)(3) is for those current services.

C. Policy considerations support the proration approach taken by the majority of courts.

In addition to providing balance between a debtor's rights and obligations, a fundamental purpose of the Bankruptcy Code is to "secure equal distribution among creditors." *Howard Delivery Serv., Inc. v. Zurich Am. Ins. Co.*, 547 U.S. 651, 655 (2006). For a class of creditors to be treated preferentially, there must be clear authorization by Congress. *Id.* "Because the presumption in bankruptcy cases is that the debtor's limited resources will be equally distributed among his creditors, statutory priorities are narrowly construed." *Child World, Inc.*, 161 B.R. at 574.

The proration approach best secures equal distribution amongst creditors by balancing the benefit a landlord provides the estate in the post-petition, prerejection period with the overall cost that section 365(d)(3) imposes on the estate. Under the proration approach, a landlord is credited with current payment for current services. By mandating current payment for current services, the proration approach ensures that no windfalls land in the lap of a landlord that would come at the detriment of other creditors. *In re Stone Barn Manhattan LLC*, 398 B.R. 359, 366 (Bankr. S.D.N.Y. 2008).

The billing date approach, on the other hand, wreaks havoc on the Code's goal of equal distribution. Returning to the hypothetical discussed earlier, imagine that the debtor leasing the million-dollar warehouse has assets amounting to $1.5 million when he files for bankruptcy in December. Two general unsecured creditors, A and B, each have a one million dollar general unsecured claim against the debtor. However, the debtor is current on his annual rent payment to his landlord when his bankruptcy petition is filed. The trustee over the debtor's estate rejects the lease on January 2, a day after the next year's rent comes due. Under the billing date approach, the landlord would receive one million of the estate's $1.5 million for the single day that the debtor occupied the premises. The landlord is not obligated to mitigate the debtor's damages, and can pocket both the debtor's million dollars and whatever money a new tenant brings in. Creditors A and B, who are owed a million dollars apiece, would only be given $250,000 each towards their million-dollar claim.

The proration approach results in far more equal treatment. Under proration, the landlord would receive 1/365 of the million-dollar annual rent, which calculates to $2,739.73. Creditors A and B would receive nearly $750,000 each, triple what they would have gotten under the billing date approach.

In addition to treating creditors equally, the Bankruptcy Code also has an "overriding policy favoring debtor reorganization and rehabilitation." *In re Pub. Serv. Co. of New Hampshire*, 884 F.2d 11, 15 (1st Cir.1989). The debtor discussed above would have a much greater chance of successfully reorganizing under the proration approach, as only $500,000 would be left outstanding. Under the billing date approach, however, the debtor would still owe $1.5 million dollars. Proponents of the billing date approach argue that the trustee, as the one in control of the date of rejection, cannot claim unfairness if the estate is negatively impacted by a billing date. (R. at 33). However, lower courts have protested this position given that a rejection under section 365(d)(3) first requires court approval. *Stone Barn Manhattan LLC*, 398 B.R. at 367. If the bankruptcy court refuses to schedule a hearing before a looming billing date, the trustee has no recourse. *Id*.

CONCLUSION

This Court should affirm the Thirteenth Circuit. The plain text of section 547(c)(4) and section 547(c)(4)(B) clearly prohibits creditors from asserting a new value defense for value that is subject to a fully paid section 503(b)(9) administrative expenses claim. Furthermore, an evaluation of section 365(d)(3) upholds the conclusion that a trustee need only pay a prorated amount for a debtor's occupation of a nonresidential property in the post-petition, prerejection period. Moreover, the holdings of the Thirteenth Circuit best further the Bankruptcy Code's policy goal of promoting equality among creditors.

APPENDIX A

11 U.S.C. § 365 (2020).

(d) (3) 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. The court may extend, for cause, the time for performance of any such obligation that arises within 60 days after the date of the order for relief, but the time for performance shall not be deemed to affect the trustee's obligations under the provisions of subsection (b) or (f) of this section. Acceptance of any such performance does not constitute waive or relinquishment of the lessor's rights under such lease or under this title.

…

(4) (A)Subject to subparagraph (B), an unexpired lease of nonresidential real property under which the debtor is the lessee shall be deemed rejected, and the trustee shall immediately surrender that nonresidential real property to the lessor, if the trustee does not assume or reject the lease by the earlier of

(i) the date that is 120 days after the date of the order for relief; or

(ii) the date of the entry of an order confirming the plan

11 U.S.C. § 547 (2020).

(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;

11 U.S.C. § 503 (2020).

(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.