NO. 21-0909

IN THE

SUPREME COURT OF THE UNITED STATES

IN RE TERRAPIN STATION, LLC, DEBTOR,

TOUCH OF GREY ROASTERS, INC.,
PETITIONER

V.

CASEY JONES, CHAPTER 7 TRUSTEE,
RESPONDENT.

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

BRIEF FOR THE RESPONDENT

TEAM NUMBER 12

JANUARY 20, 2022

COUNSEL FOR RESPONDENT

QUESTIONS PRESENTED

I. 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).

II. 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.

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The Thirteenth Circuit Court of Appeals' decision is available at No. 20-0803 and reprinted at Record 2. Both the bankruptcy court and United States District Court for the District of Moot decided in favor of the Chapter 7 Trustee. On appeal, the United States Court of Appeals for the Thirteenth Circuit affirmed the bankruptcy court's decisions.

STATEMENT OF JURISDICTION

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

PERTINENT STATUTORY PROVISIONS

This action implicates statutory construction of certain provisions of Title 11 of the United States Code. The following are also restated in Appendix A.

The relevant portion of 11 U.S.C. § 365 provides:

> **(a)** Except as provided in sections 765 and 766 of this title and in subsections (b), (c), and (d) of this section, the trustee, subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor.
>
> **(d)(3)(A)** The trustee shall timely perform all the obligations of the debtor . . . 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 relevant portion of 11 U.S.C. § 503(b)(9) provides:

> **(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.

The relevant portion of 11 U.S.C. § 547(c)(4) provides:

(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.

STATEMENT OF THE CASE

The Appellant asks this Court to ignore Congressional intent, plain language of the Bankruptcy Code, and years of established bankruptcy practice in an attempt to enrich one creditor over all others. By affirming the rulings of the bankruptcy court, District Court of Moot, and Thirteenth Circuit, this Court would uphold the fundamental bankruptcy principles of maximizing value to all creditors and preventing double-recovery.

I. FACTUAL HISTORY

Respondent, Terrapin Station, LLC (the "Debtor") operated a popular, award-winning local coffeehouse in the Town of Terrapin, Moot. R. at 3. Petitioner, Touch of Grey Roaster, Inc., is an international coffee company operating thousands of stores worldwide. R. at 3. In response to increased demand from consumers for local businesses, Touch of Grey approached Terrapin Station in the fall of 2017 and proposed entering a franchise venture. R. at 4. Excited by the idea of partnering with an international chain, the Debtor agreed to the proposal. R. at 4.

A. The Debtor entered into business with Touch of Grey.

The parties agreed to close the original Terrapin Station and open a new coffeehouse, where Touch of Grey would purchase warehouse space (the "Premises") and lease it to the Debtor. R. at 4. On July 1, 2018, the Debtor, as tenant, and Touch of Grey, as landlord, entered into a Lease Agreement (the "Lease") for the Premises. R. at 4. The Lease was a twenty-year triple-net lease that required the Debtor to pay $25,000 per month, "due in advance on the first day of each month." R. at 4. Additionally, as part of the franchise agreement, the Debtor agreed to exclusively sell Touch of Grey's coffee products, branded "Dark Star," which it would purchase directly from Touch of Grey. R. at 4.

The newly franchised "Terrapin Station Coffeehouse" opened on December 1, 2018, and was met with immediate animosity from the local community when they discovered its affiliation with Touch of Grey. R. at 5. A local group formed a ruthless advertising campaign that characterized the Debtor as "big coffee in disguise." R. at 5. Other portions of Touch of Grey's franchise vision failed, including its foray into the nightlife scene by offering alcoholic beverages and live music at Terrapin Station. R. at 5.

B. The Debtor's financial problems intensified.

The Debtor continued to struggle through its first year and could not pay its debts as they became due as early as September of 2019. R. at 5. Although the Debtor remained current on its monthly rent payments, by November 1, 2019, it owed Touch of Grey over $700,000 for its purchases of Dark Star-branded coffee products. R. at 5. Concerned with this poor performance, Touch of Grey sent a notice of default on December 5, 2019, threatening to terminate the franchise agreement. R. at 5.

The parties entered into a forbearance agreement on December 7, 2019. R. at 5. Touch of Grey agreed to forbear from terminating the franchise agreement in exchange for a $250,000 payment from the Debtor for outstanding invoices for Dark Star products. R. at 5. The Debtor also reaffirmed its lease obligations and agreed to release claims against Touch of Grey. R. at 5. That same day, the Debtor paid Touch of Grey the $250,000. R. at 5.

On December 18, 2019, the Debtor purchased an additional $200,000 worth of Dark Star coffee products on credit from Touch of Grey (the "Invoice"). R. at 5. To induce Touch of Grey to sell the goods, the Debtor's principal signed a personal guarantee for the Invoice. R. at 5. The Debtor received the goods identified on the Invoice on December 21, 2019. R. at 5.

C. The Debtor filed for bankruptcy, and the bankruptcy court approved a $200,000 administrative expense to Touch of Grey.

After a disappointing financial performance over 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"). R. at 6. On the Petition Date, the Debtor owed Touch of Grey $650,000 (including the amount due under the Invoice) for Dark Star products. R. at 6. The Debtor also owed over $500,000 to other unsecured creditors. At this point, the Debtor and Touch of Grey engaged in discussions about a path to reorganization. R. at 6.

Two weeks later, the Debtor filed a motion requesting authority to pay $200,000 to Touch of Grey, asserting it was a "critical vendor." R. at 6. The Debtor argued that Touch of Grey was unwilling to sell goods on credit to the Debtor post-petition without this $200,000 payment. R. at 6. It emphasized that the $200,000 would apply to the Invoice, which was entitled a priority expense under section 503(b)(9).[1] R. at 7. The United States Trustee opposed the motion, arguing that the Bankruptcy Code does not authorize critical vendors. R. at 7. After oral argument, the bankruptcy court disapproved of the payment as a critical vendor payment, as it was uncertain whether such payments were permitted. R. at 7. It did, however, approve immediate payment of an administrative expense of $200,000 under section 503(b)(9) as value of goods sold. R. at 7.

D. The Debtor's reorganization failed, and the Trustee sought to avoid preferential payments to Touch of Grey.

Due to the COVID-19 pandemic, the Debtor's reorganization efforts failed, and the coffeehouse permanently closed on May 5, 2020. R. at 7. The Debtor vacated the Premises and

[1] The Bankruptcy Code is set forth in 11 U.S.C. § § 101 *et seq.* (2021). Specific sections of the Bankruptcy Code are identified herein as "section __."

returned the keys to its landlord, Touch of Grey. R. at 7. On May 6, 2020, the Debtor filed a motion to reject the Lease and franchise agreement with Touch of Grey pursuant to section 365(a). R. at 7.

On May 8, 2020, Touch of Grey filed a motion to compel payment of the entire $25,000 payment of the May rent instead of a prorated $4,032.26 payment for the five days of occupancy. R. 7–8. At the outset of the motion to compel hearing, the Debtor announced it was converting its bankruptcy case to a chapter 7. R. at 8. The court granted the conversion and appointed a chapter 7 Trustee. R. at 8. The court also approved the motion to reject the Lease and franchise agreement effective May 6, 2020, but did not rule on the motion to compel. R. at 8.

Once appointed, the Trustee sought to limit Touch of Grey's rent claim and recover preferential payments the Debtor made to Touch of Grey. R. at 8. First, the Trustee objected to Touch of Grey's motion to compel payment for the entirety of May rent under section 365(d)(3), arguing that relief was inequitable to other creditors because the Debtor only occupied the Premises for the first five days of May 2020. R. at 8. Second, the Trustee commenced an adversary proceeding to avoid and recover the $250,000 forbearance agreement payment from the Debtor to Touch of Grey as preferential under sections 547(b) and 550(a). R. at 8. Touch of Grey countered that it was entitled to reduce any preference exposure by the $200,000 in goods it sold to the Debtor (as reflected on the Invoice) under section 547(c)(4). R. at 8. The bankruptcy court held the hearing for the motion to compel together with the cross motions for summary judgment related to the adversary proceeding. R. at 9.

II. PROCEDURAL HISTORY

The bankruptcy court and the District Court for the District of Moot ruled in favor of the Trustee on both issues. R. at 9. The Thirteenth Circuit affirmed the lower courts' opinions,

holding that (1) Touch of Grey could not use the value of goods sold reflected on the Invoice as new value to reduce its preference exposure given that the Invoice was paid pursuant to section 503(b)(9), and (2) section 365(d)(3) only requires the Debtor to pay rent for the five days that it occupied the Premises before rejection. R. at 9.

STANDARD OF REVIEW

The questions presented are strictly questions of law based on statutory interpretation of the Bankruptcy Code. Therefore, the standard of review for this appeal is de novo. *See, e.g., Tex. v. Soileau (In re Soileau)*, 488 F.3d 302, 305 (5th Cir. 2007).

SUMMARY OF THE ARGUMENT

The overarching goal of a chapter 7 liquidation is to maximize value for creditors to make them as whole as possible. Congress drafted the Bankruptcy Code to prevent a creditor race for who can reach as much of a debtor's assets as possible before other creditors find out. The chapter 7 process was designed to be an orderly process where creditors receive their distributions based on priority, and no creditor would be unduly preferred over others. However, the Bankruptcy Code drafters also understood that it is an imperfect world and thus empowered chapter 7 trustees to claw back a debtor's property improperly given to its preferred creditors. A trustee's ability to avoid preferential transfers is pivotal in preserving the bankruptcy estate's value and ensuring creditors receive as much value of their claims as possible.

Petitioner, Touch of Grey Roasters, Inc., attempts to hamstring this fundamental trustee power and prevent fellow creditors from receiving their fair share. By claiming both a section 547(c)(4) new value defense and a section 503(b)(9) administrative expense, the Petitioner would effectively doubly recover by receiving an additional $200,000 worth of protection, obstructing other creditors from receiving the portion of that $200,000 to which they are entitled.

Section 547(c)(4) precludes the Petitioner from asserting a new value defense for goods subject to payment as an administrative expense under section 503(b)(9). Petitioner attempts to shoehorn its own definitions of the Bankruptcy Code to receive protection it is not entitled to when the meaning and spirit of the transaction between the Debtor and Petitioner was clearly preferential. The plain language of section 547(c)(4) unambiguously prevents this maneuvering by the Petitioner. Section 547(c)(4) places no limit on when a transfer that could defeat the new value defense can be made. Therefore, because the Debtor was expressly authorized to pay Petitioner's section 503(b)(9) administrative expense by the bankruptcy court, the payment of Petitioner's administrative expense is an otherwise unavoidable transfer. Petitioner cannot use the same value to assert a new value defense under section 547(c)(4).

Moreover, allowing a defendant to assert a new value defense and receive an administrative expense under section 503(b)(9) would result in a windfall to the Petitioner and frustrate the policies underlying the Bankruptcy Code. Allowing both the $200,000 administrative expense payment and a $200,000 reduction in preference liability in effect allows the Petitioner to receive $400,000 in value—the kind of double counting the Bankruptcy Code drafters strived to avoid.

Furthermore, Petitioner's argument that it is owed the entire $25,000 monthly rent rather than a prorated $4,032.26 for the Debtor's only five days of occupancy is contrary to a sensical reading of an ambiguous statute and in disagreement with underlying bankruptcy policy. Because the plain meaning of section 365(d)(3) is ambiguous on its own, the statute must be interpreted in the context of the larger statutory scheme, the purpose a trustee's rejection power serves, prior practice, and legislative history—all of which support the adoption of the Proration Rule. Requiring the Debtor to pay for an entire period of benefit it has no right to enjoy, while

potentially providing Petitioner another opportunity for double-recovery, is inconsistent with the purpose rejection of an executory contract was created to serve.

In summary, to prevent a windfall to the Petitioner and protect the Bankruptcy Code's policies, this Court should affirm the decision of the Thirteenth Circuit Court of Appeals by holding for the Respondent on both issues.

ARGUMENT

This Court should affirm the Thirteenth Circuit Court of Appeals' decision that section 547(c)(4) precludes Touch of Grey from asserting a new value for goods defense subject to a satisfied administrative expense under 503(b)(9). This Court should further affirm the circuit court's decision that section 365(d)(3) does not require the Trustee to satisfy obligations allocable to the post-rejection period and formally adopt the Proration Rule.

I. SECTION 547(C)(4) PRECLUDES TOUCH OF GREY FROM ASSERTING A NEW VALUE DEFENSE FOR GOODS SUBJECT TO PAYMENT AS AN ADMINISTRATIVE EXPENSE UNDER SECTION 503(B)(9).

The Trustee has a duty to preserve value of the Debtor's estate and ensure that no creditor is given favorable treatment over others. Under section 547(b), enacted with the 1978 Bankruptcy Reform Act, a trustee may avoid, or recover, a transfer of an interest in the debtor's property if the trustee can meet several requirements, including that the transfer was made within ninety days of the debtor filing its bankruptcy petition. *See* 11 U.S.C. § 547(b). Section 547(c) of the Bankruptcy Code provides defenses that a defendant may assert in an action by the trustee to recover a preferential transfer. Section 547(c)(4), in pertinent part, says the debtor may not avoid a transfer that was 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 unavoidable transfer to or for the benefit of such creditor.*

11 U.S.C. § 547(c)(4) (emphasis added).

This defense, commonly referred to as the "new value defense," allows a defendant in a preference action to reduce its liability by the value of the goods it provided to the debtor following the defendant's receipt of the preferential transfer. If the debtor made the payment on account of those goods, however, the defendant cannot assert the new value defense unless that payment was itself an avoidable transfer. 11 U.S.C. § 547(c)(4)(B). If the transfer was not preferential and not avoidable by the Trustee, then the defendant's preference liability is reduced in value by the amount of the payment made by the debtor. *Id.*

Over twenty years after the Bankruptcy Reform Act was passed, Congress amended the Bankruptcy Code to include, inter alia, section 503(b)(9). *See* Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 1227, 119 Stat. 23, (2005). Section 503(b)(9) provides that a creditor is entitled to an administrative expense equal to the value of any goods sold and delivered to the debtor, in the ordinary course of business, within twenty days of the debtor's filing of its bankruptcy petition. 11 U.S.C. § 503(b)(9).

Because both sections 547(c)(4) and 503(b)(9) focus on new value provided by a creditor to a debtor, their intersection has led to some confounding results. Specifically, courts have had to determine whether a creditor can reduce its preference liability by asserting a section 547(c)(4) new value defense, while simultaneously receiving an administrative expense under section 503(b)(9) for the same new value. The Majority Rule, which the Thirteenth Circuit correctly applied, holds that a creditor cannot reduce its preference liability under section 547(c)(4) while

simultaneously getting paid in full for the same value under section 503(b)(9). *See Beaulieu Liquidating Tr. v. Fabric Sources, Inc. (In re Beaulieu Grp.)*, 616 B.R. 857, 878 (Bankr. N.D. Ga. 2020).

A. The plain language of section 547(c)(4) unambiguously precludes the Petitioner from asserting a new value defense for value that was paid in full pursuant to section 503(b)(9).

This Court has repeatedly held that when a statutory scheme is consistent, there "is no need for a court to inquire beyond the plain language of the statute." *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 240–41 (1989). When the plain language of a statute is unambiguous, "the sole function of the courts is to enforce it according to its terms." *Caminetti v. United States*, 242 U.S. 470, 485 (1917). As the Thirteenth Circuit correctly observed, section 547(c)(4) is a complicated statute, but complicated is not the same as ambiguous. R. at 12.

1. Section 547(c)(4) contains no temporal limit on when an otherwise unavoidable transfer that depletes the new value defense can be made.

In drafting the Bankruptcy Code, Congress broadly defined the word "transfer" to include any method of parting with the debtor's property. 11 U.S.C. § 101(54)(D); *Beaulieu Liquidating Tr. v. Fabric Sources, Inc. (In re Beaulieu Grp.)*, 616 B.R. 857, 871 (Bankr. N.D. Ga. 2020). Section 547(b) specifically limits preference liability to transfers made by the debtor within ninety days of filing the petition. 11 U.S.C. § 547(b)(4)(A). The plain language of 547(c)(4), however, does not include such a temporal limitation. 11 U.S.C. § 547(c)(4). Moreover, an otherwise unavoidable transfer made by the debtor that depletes the new value defense does not itself need to be a preference. *See id*. As such, Congress did not intend to limit otherwise unavoidable transfers which could deplete the new value defense to transfers made ninety days prepetition. *See id*.; *see also Siegel v. Sony Elecs., Inc. (In re Cir. City Stores, Inc.)*, 515 B.R.

302, 314 (Bankr. E.D. Va. 2014). Therefore, a post-petition transfer, such as payment of a section 503(b)(9) administrative expense, can deplete the new value defense.

Petitioner argues, despite the unambiguous language to the contrary, that section 547(c)(4) includes a temporal limitation. It cites cases that encourage taking section 547 into context as a whole rather than focusing on the specific language in each provision. *See, e.g., Friedman's Liquidating Tr. v. Roth Staffing Cos., (In re Friedman's)*, 738 F.3d 547, 554–56 (3d Cir. 2013). This line of reasoning is not only contrary to the plain language of section 547(c)(4) but also illogical because it forces courts to read an additional restriction into the statute when there is no indication that was Congress's intent.

Petitioner mischaracterizes the Third Circuit's holding of *Friedman's Liquidating Trust* to apply to administrative claims and relies on a holding that ignores the fundamental tenet of statutory interpretation—plain meaning. The *Friedman's* court found section 547(c)(4) to apply a temporal limitation to otherwise unavoidable transfers that could deplete the new value defense. *Id.* at 557. The court examined the context of section 547(c)(4), noting that the new value defense is located in the section titled "preferences." *Id.* at 555. The court reasoned this suggested that section 547 is concerned only with transactions occurring during the ninety days preceding the bankruptcy petition filing. *Id.* The court pointed to provisions within section 547 that are expressly involved with transactions during the preference period, as well as the statute of limitations for a preference action. *Id.* at 556. According to the *Friedman's* court, because these tangentially related sections are concerned only with prepetition transactions, so too must section 547(c)(4). *Id.*

Any reliance Petitioner places on the *Friedman's* opinion is misplaced for several reasons. First, the court in *Friedman's* was concerned with payments made according to a wage

order, and the court itself indicated that it did not intend for its decision to apply to administrative expenses under section 503(b)(9). *Id.* at 561 n.9 ("Here, we need not resolve the question of whether assertion of a reclamation claim should reduce a new value defense, as we are only considering the effect of payments made pursuant to a Wage Order.").

Moreover, the Third Circuit's statutory interpretation is flawed, as section 547(c)(4) contains no ambiguity. As the court in *Beaulieu Liquidating Trust* emphasized, the court may consider the title of a statute when resolving ambiguity in that statute, but the title "cannot trump the plain meaning of its text." *Beaulieu Liquidating Tr.*, 616 B.R. at 873 (quoting *United Mine Works of Am. Combined Benefit Fund v. Toffel (In re Walter Energy, Inc.)*, 911 F.3d 1121, 1154 n.38 (11th Cir. 2019)). Here, the text of 547(c)(4) includes no temporal limitation, and the language is "plain and ambiguous." *Id.* As such, the title of "preferences," under which section 547 is placed, should add no additional temporal interpretation to section 547(c)(4).

Additionally, as the court in *Friedman's* noted, section 547 itself contains numerous temporal limitations on transfers. *See e.g.*, 11 U.S.C. § § 547(b)(4)(A); 547(b)(4)(B); 547(c)(3)(B); 547(c)(5)(A)(i); 547(c)(5)(A)(ii). Given that Congress chose to include temporal limitations in multiple parts of section 547, surely it is no mistake that Congress excluded a similar temporal limitation in section 547(c)(4).

Adopting the interpretation of section 547(c)(4) proposed by the Third Circuit in *Friedman's* would rewrite section 547(c)(4). In doing so, this Court would be "trespassing on a function reserved for the legislative branch." *Sigmon Coal Co. v. Apfel*, 226 F.3d 291, 308 (4th Cir. 2000). The plain language of section 547(c)(4) unambiguously places no temporal limitation on when an otherwise unavoidable transfer that depletes the new value defense can be made. As such, this Court should enforce section 547 (c)(4) according to that plain language. *See*

Caminetti, 242 U.S. at 485. Therefore, this Court should follow the Thirteenth Circuit's holding that post-petition transfers can deplete the new value defense.

2. Applying the Petitioner's reading of the words "transfer" and "debtor" in section 547(c)(4) would lead to absurd results contrary to the statute's plain meaning.

To identify preferential treatment of a creditor, Congress broadly defined the word "transfer" to include any change in ownership of the Debtor's property. However, Petitioner contends that because the Debtor made a "distribution" and not a "transfer" when it paid Petitioner's section 503(b)(9) administrative expense, the payment cannot qualify as a transfer under section 547(c)(4)(B). Petitioner also argues that because section 547(c)(4) uses the term "debtor" instead of "trustee," the text limits otherwise avoidable transfers that could deplete the new value defense to transfers made by the debtor prepetition, as opposed to post-petition transfers made by the trustee or debtor in possession.

The Thirteenth Circuit was correct in dismissing Petitioner's incongruous reading of 547(c)(4). In *Beaulieu Liquidating Trust*, the court disposed of the "distribution" argument by pointing out that Congress defined the word "transfer" broadly and that nothing in the definition of "transfer" excludes distributions. 616 B.R. at 870. To be sure, "while not all transfers are distributions, all distributions . . . are transfers." *Id*. Any reading otherwise would lead to the absurd result where a Debtor could simply give a preferential payment to a creditor the title of "distribution" to evade preference exposure, even though the underlying nature of the payment is an avoidable transfer.

The Petitioner makes an equally absurd argument about the meaning of the word "debtor," which the *Beaulieu Liquidating Trust* court outright rejected. *Id*. The court explained that a trust or bankruptcy estate functions only as a pass-through between the debtor and

creditors. *Id*. As such, any payment of a section 503(b)(9) administrative expense "is either a transfer from the Debtor to the Trust for the benefit of creditors or a deemed transfer directly to the Defendant." *Id*. Thus, Petitioner's argument is inapposite because the bankruptcy estate functions as a pass-through between the debtor and creditors—any payment made by the bankruptcy estate ultimately comes from the debtor. This Court should reject Petitioner's arguments because such a reading of section 547(c)(4) would be contrary to its plain meaning.

3. An administrative expense pursuant to section 503(b)(9) is an otherwise unavoidable transfer for the purposes of section 547(c)(4).

A transfer by the debtor on account of new value can only deplete the new value defense if that transfer is not subject to the trustee's avoiding powers. Section 549 of the Bankruptcy Code provides the only conditions under which a post-petition transfer may be avoided. 11 U.S.C. § 549. Section 549(a)(2) states that the trustee may avoid any post-petition transfer:

> (A) that is authorized only under section 303(f) or 542(c) of this title; or
>
> (B) *that is not authorized under this title or by the court.*

11 U.S.C. § 549(a)(2) (emphasis added).

Here, the Debtor was expressly authorized to pay Petitioner's section 503(b)(9) administrative expense by the bankruptcy court. Thus, the payment of Petitioner's administrative expense under section 503(b)(9) is not avoidable under section 549 and can be used to deplete the new value defense. As such, Petitioner cannot use the value that was paid back as a 503(b)(9) administrative expense to assert a new value defense under section 547(c)(4). *See Cir. City Stores, Inc. v. Mitsubishi Digital Elecs. Am., Inc. (In re Cir. City Stores, Inc.)*, 2010 WL 4956022, 8 (Bankr. E.D. Va. 2010) (holding "As a matter of law, the Transfer for the [the creditor] on account of its 503(b)(9) Claim precludes [the creditor] from utilizing the value of the same goods … a second time as the basis for asserting a New Value Defense …"); *see, e.g., Beaulieu Liquidating Tr.*, 616 B.R. at 869; *Siegel* 515 B.R. at 614.

The plain language of section 547(c)(4) precludes Petitioner from both asserting a new value defense under section 547(c)(4) and receiving an administrative expense pursuant to section 503(b)(9). Section 547(c)(4) places no temporal limit on when an otherwise unavoidable transfer that could deplete the new value defense must be made. Additionally, a section 503(b)(9) administrative expense is an otherwise unavoidable transfer. As such, this Court should affirm the Thirteenth Circuit's decision and hold that a defendant cannot assert a new value defense under section 547(c)(4) when it received payment of a section 503(b)(9) administrative expense for the same value.

B. Administrative expenses under section 503(b)(9) are analogous to reclamation claims and should be treated similarly in the subsequent new value context.

The Petitioner's 503(b)(9) administrative expense has already been paid in full, and as such, has no risk of non-payment by an insolvent estate. Thus, Petitioner's section 503(b)(9) administrative expense is analogous to a reclamation claim. *See TI Acquisition, LLC v. S. Polymer, Inc. (In re TI Acquisition)*, 429 B.R. 377, 381 (Bankr. N.D. Ga. 2010) (holding that a section 503(b)(9) administrative expense which is not vulnerable to non-payment by an insolvent estate is analogous to a reclamation claim). The holder of a reclamation claim is entitled to either reclaim the goods it shipped or have its claim for the value of those goods enhanced in priority over other creditors. *See Phx. Rest. Grp. v. Proficient Food (In re Phx. Rest. Grp., Inc.)*, 373 B.R. 541, 547–48 (Bankr. M.D. Tenn. 2007). Because a reclamation creditor keeps "strings" attached to the goods it shipped, those goods do not enhance the debtor or constitute new value under Section 547(a). *Id.*

Similarly, for a debtor to benefit from goods shipped within the twenty-day prepetition window, it must provide the creditor with an administrative claim under section 503(b)(9). *TI Acquisition,* 429 B.R. at 381. In this way, a section 503(b)(9) creditor keeps "strings" attached to the goods it shipped by way of its administrative claim that does not enhance the debtor or add

new value, just like a reclamation creditor does. *See id.* Moreover, like a reclamation creditor, a section 503(b)(9) creditor receives priority over other creditors. *See id.* Finally, both reclamation creditors and section 503(b)(9) creditors are paid in full. *Id.* at 385. Thus, administrative expenses under section 503(b)(9) are analogous to reclamation claims.

Courts have generally held that the holder of a reclamation claim cannot use the goods subject to the reclamation claim to assert a new value defense under section 547(c)(4). *See, e.g., Phoenix Restaurant Grp.,* 373 B.R. at 548; *Ringel Valuation Servs. Inc. v. Shamrock Foods Co. (In re Ariz. Fast Foods, LLC)*, 299 B.R. 589, 596 (Bankr. D. Ariz. 2003). Because the Petitioner here has a 503(b)(9) administrative claim comparable to a reclamation claim, disallowing its use of the value of the payment to assert a section 547(c)(4) new value defense is in-line with the treatment afforded to holders of reclamation claims. *See TI Acquisition*, 429 B.R. at 385. Because section 503(b)(9) administrative expenses and reclamation claims are analogous, this Court should adopt the Majority Rule interpretation of section 547(c)(4), which results in the disallowance of a new value defense.

Petitioner's proposed interpretation of section 547(c)(4) would result in precisely the opposite outcome. If this Court were to adopt Petitioner's interpretation and hold that section 547(c)(4) allows a creditor to both assert a new value defense and receive payment of an administrative expense pursuant to section 503(b)(9) for the same value, section 503(b)(9) administrative expenses would be afforded the exact opposite treatment from reclamation claims despite having the exact same characteristics. Such disparate outcomes must be avoided. Thus, this Court should reject Petitioner's proposed interpretation of section 547(c)(4) in favor of the Majority Rule interpretation because the Majority Rule interpretation results in the similar treatment of analogous claims.

While some courts have held a section 503(b)(9) administrative expense is more analogous to a critical vendor rather than a reclamation claim, these courts ignore essential differences between section 503(b)(9) administrative expenses and critical vendors. *See, e.g., Commissary Operations, Inc. v. Dot Foods, Inc. (In re Commissary Operations, Inc.)*, 421 B.R. 873, 878 (M.D. Tenn. 2010). First, an order designating a creditor as a critical vendor gives the debtor significant leverage in negotiating the terms of the creditor's critical vendor status. *TI Acquisition,* 429 B.R. at 382. A prepetition debtor, however, cannot use the protection of the bankruptcy court to negotiate terms on goods provided within the twenty-day prepetition period. *Id.* Second, to be designated as a critical vendor, a creditor must provide post-petition credit to the debtor. No such requirement exists for a creditor to receive payment of an administrative expense pursuant to section 503(b)(9). *Id.* Finally, a bankruptcy court has discretion to not approve payment of prepetition obligations to critical vendors; however, 503(b)(9) does not allow such discretion. *Id.* For these reasons, administrative expenses under section 503(b)(9) are substantially different from critical vendor claims and should instead be analyzed identically to reclamation claims, which disallow the use of the new value defense.

C. Allowing defendants to both assert a new value defense and receive an administrative expense under section 503(b)(9) would result in a windfall to the Petitioner and frustrate the policies underlying the Bankruptcy Code.

If this Court agrees with Petitioner's proposed interpretation of the intersection between sections 547(c)(4) and 503(b)(9), the resulting windfall to creditors would frustrate not only the policies behind section 547(c)(4), but policies underlying the Bankruptcy Code as a whole.

1. Congress drafted the Bankruptcy Code to avoid the exact kind of double credit that Petitioner argues it is owed.

The Bankruptcy Code was drafted to avoid inequity and ensure that creditors like Petitioner did not receive more than their fair share. Petitioner's proposed statutory interpretation

would result in Petitioner receiving payment in full for the $200,000 of value it advanced to the Debtor in the form of a section 503(b)(9) administrative expense and a reduction in its liability for preferential transfers under section 547(c)(4) by an additional $200,000. This would effectively result in Petitioner receiving $400,000 from the bankruptcy estate on account of only $200,000 worth of goods that it advanced. *See Circuit City Stores, Inc.*, 2010 WL 4956022 at 9 ("The supplier would be receiving, in essence, a double payment.").

Congress has previously expressed concern for the type of double recovery Petitioner demands. *See, e.g.,* H.R. Rep. No. 95-595, at 280 (1977) (explaining that section 346(b)(3) of the Bankruptcy Code solved problems of "abuse with respect to double deductions," and "prevents the double deduction of nonbusiness expenses under IRC section 212."); *id.* at 327–28 (discussing that double counting by a trustee is "detrimental to the interests of creditors, and needlessly increases the cost of administering bankruptcy estates."); *id.* at 353 (explaining that section 502 of the Bankruptcy Code disallows "a claim to the extent that the creditor may offset a debt owing to the debtor. This will prevent double recovery…."). Congress drafted the Bankruptcy Code with the unmistakable intent to avoid the possibility of double counting. Congress would disapprove of using section 503(b)(9) as a backdoor for creditors to receive double credit for the same value. Thus, this Court should not allow Petitioner to receive a windfall of $200,000 over the value it provided the Debtor.

2. <u>The policies underlying the Bankruptcy Code would be frustrated if Petitioner were allowed to receive a section 503(b)(9) administrative expense for the same value as its new value defense liability shield.</u>

The purpose of section 547(c)(4) is to give credit against liability for preferences to the extent that creditors have repaid that preference. *MMR Holding Corp. v. C & C Consultants, Inc.*, 203 B.R. 605, 609 (M.D. La. 1996). If a transfer made by the debtor on account of the new

value is unavoidable, then the estate has not received the full value of what the creditor has provided because the creditor has been paid back on account of that value. *Id.* The new value defense is specifically limited to "the extent to which the bankruptcy estate has been enhanced by the creditor's actions." *TI Acquisition, LLC*, 429 B.R. at 384. Allowing Petitioner to double count the value it provided the Debtor conflicts with the policy objective of giving creditors credit against liability for preferences they have repaid. Because Petitioner already received payment in full under section 503(b)(9), Petitioner has not repaid the preferential transfers it received, and the Debtor's estate is no longer enhanced.

Additionally, one of the primary purposes of bankruptcy law, and section 547(c)(4), is to provide equal treatment to creditors. *See Union Bank v. Wolas*, 502 U.S. 151, 161 (1991); *TI Acquisition, LLC,* 429 B.R. at 384. Allowing Petitioner to double count the value it provided to the Debtor frustrates this purpose because Petitioner will be receiving not just more than the value it gave, but double the value it gave. This will result in $200,000 less in property of the estate—a significant portion of the $500,000 owed to the Debtor's other unsecured creditors—that could be used to make those creditors whole.

The Majority Rule as adopted by the Thirteenth Circuit is supported by the plain language of section 547(c)(4) and by practical concerns and the policies underlying section 547(c)(4) and the Bankruptcy Code as a whole. Petitioner cannot, as the Thirteenth Circuit described, "double dip" by asserting a new value defense while simultaneously receiving payment in full under section 503(b)(9). R. at 15. Therefore, this Court should affirm the decision of the Thirteenth Circuit.

II. THE PRORATION RULE APPROACH TO SECTION 365(D)(3) CLAIMS IS MOST APPROPRIATE UNDER A PLAIN-MEANING INTERPRETATION AND WHEN READ IN CONTEXT WITH THE STATUTORY SCHEME, POLICY, AND LEGISLATIVE HISTORY.

The Court should affirm the Thirteenth Circuit Court of Appeals' decision to apply the Proration Rule in cases depending on section § 365(d)(3). Here, Petitioner argues that despite the Debtor only occupying the Premises for five days and timely rejecting the Lease, it is owed $25,000 for the entire month rather than a prorated $4,032.26. This would result in a windfall to the Petitioner and the imprudent requirement of the Debtor paying for vacant space.

Following an order for relief or conversion to Chapter 7, a trustee has a limited period to assume or reject an unexpired lease. 11 U.S.C. § 365. Section 365(d)(3), enacted with the Bankruptcy Amendments of 1984, provides that the trustee must timely perform the debtor-lessee's obligations that arise from an unexpired nonresidential real property lease until assumption or rejection. 11 U.S.C. § 365(d)(3). This presents an issue concerning when the performance obligation arises. Courts are split on whether a trustee must fulfill its obligations that accrued until the point of rejection or whether the trustee must pay the entire amount of lease obligations due for the entire billing period. Courts apply either the Proration Rule or the performance date rule. The Proration Rule is supported by contextual statutory language, prior practice, legislative history, and bankruptcy policy, and thus this Court should affirm the Thirteenth Circuit's Proration Rule application.

A. The plain meaning of section 365(d)(3), read in context, supports the Proration Rule.

The first stage of inquiry is the statute's plain meaning. Courts are split on whether the plain meaning of Section 365(d)(3) is ambiguous. *Compare In re Ames Dep't Stores, Inc.*, 306 B.R. 43, 66-67 (Bankr. S.D.N.Y. 2004), *El Paso Props. Corp. v. Gonzales (In re Furr's Supermarkets, Inc.)*, 283 B.R. 60, 66 n.8 (B.A.P. 10th Cir. 2002) (citation omitted) ("The

existence of a split in the circuits in the interpretation of § 365(d)(3) is, in itself, evidence of the ambiguity in the language."), *and* 3 Collier on Bankruptcy P 365.04 ("Although the language may seem clear, it has generated controversy."), *with Centerpoint Props. v. Montgomery Ward Holding Corp. (In re Montgomery Ward Holding Corp.)*, 268 F.3d 205, 209 (3d Cir. 2001).

The relevant portion of section 365(d)(3) reads:

> 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).

Courts disagree on the meanings and application of "obligation" and "arising." Most significantly, the statute is unclear as to the time when the obligation arises. The obligation may accrue over time, supporting the Proration Rule, or may be read in absolutist terms, as coming due in full at a fixed time.

This Court has explained that when interpreting ambiguous sections of the Bankruptcy Code, courts must analyze the statute in the context of "the provisions of the whole law, and to its object and policy . . . ." *Kelly v. Robinson*, 479 U.S. 36, 43 (1986) (quoting *Offshore Logistics, Inc. v. Tallentire*, 477 U.S. 207, 221 (1986)). In understanding a statute, courts "must not be guided by a single sentence or [part] of a sentence." *Id*. Ambiguous statutes must be read in the context of other statutes and the "real-world situation" pertaining to the language. *In re Handy Andy Home Improvement Ctrs.*, 144 F.3d 1125, 1128 (7th Cir. 1998) ("When context is disregarded, silliness results."). Legislative history can "appropriately be considered" when a statute is ambiguous. *Ames,* 306 at 68 (stating when legislative history is considered, section 365(d)(3)'s "proper construction is straightforward.")

Because section 365(d)(3)'s language is ambiguous, especially when considering the real-world context of the statute, this Court must analyze the section in the context of relevant Code provisions, the objectives and policies underlying the Bankruptcy Code, and the legislative history. Analyzed in context, it is clear that section 365(d)(3) supports the Proration Rule, and the Debtor only owes Petitioner for the five days of occupancy.

1. The term "obligations" in section 365(d)(3) is ambiguous.

Courts are split on the meaning of the phrase "obligations of the debtor . . . arising from and after the order for relief." 11 U.S.C. § 365(d)(3). The term "obligation" gives courts trouble, as it is not defined in the Bankruptcy Code. There are two potential definitions for the term "obligation." First, an obligation can be defined as a claim, which the Bankruptcy Code defines as an unmatured right to payment. *Child World v. Campbell/Mass. Tr. (In re Child World)*, 161 B.R. 571, 574 (S.D.N.Y. 1993); 11 U.S.C. § 101(1). Second, some courts reason that because Congress specifically used "obligation" and not "claim," the statute may not be interpreted with the definition of claim. *See, e.g.*, *In re R.H. Macy & Co*., 152 B.R. 869, 872–73 (Bankr. S.D.N.Y. 1993). These courts adopt the Black Law Dictionary definition of obligation—"that which a person is bound to do or forebear; any duty imposed by law … [or] contract." *Obligation*, *Black's Law Dictionary* (11th ed. 2019). Under the second interpretation, courts define obligation as something a tenant is legally required to perform under the lease terms. *Montgomery*, 268 F.3d at 209. However, under either meaning of the term, "obligation" is ambiguous as to *when* the obligation arises. *See, e.g.*, *Child World*, 161 B.R. at 574.

2. The daily accrual approach to the term "arises" in section 365(d)(3) is in-line with the benefits the Debtor and Petitioner actually received.

The ambiguity in section 365(d)(3) primarily exists because of the interaction between the terms "arises" when considered with the term "obligations." *See, e.g.*, *In re GCP CT Sch.*

Acquisition, LLC, 443 B.R. 243, 254 (Bankr. D. Mass. 2010). The statute does not instruct the interpreter on determining when the obligation arises. *See, e.g.*, *Montgomery*, 268 F.3d at 213 (Judge Mansmann, dissenting). So, courts have struggled with whether the obligation arises as an absolute occurrence on the performance date—the performance date approach—or the obligation arises as it accrues over time—the daily accrual approach. *See, e.g.*, *GCP*, 443 B.R. at 254 n.70; *Montgomery*, 268 F.3d at 213 (Judge Mansmann, dissenting) ("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.").

Courts that adopt the Proration Rule interpret "arising" as an obligation that accrues each day—the daily accrual approach. *Handy Andy*, 144 F.3d at 1127; *In re NETtel Corp.*, 289 B.R. 486, 490 (Bankr. D.D.C. 2002) (emphasis in original) (stating "a rental obligation arises *under the lease* based on the corresponding period of occupancy *under the lease.*"). In *Handy Andy*, the court found that because the debtor's lease obligation to pay taxes was clear, "the obligation could realistically be said to have arisen piecemeal every day." *Handy Andy*, 144 F.3d at 1127. In *NETtel*, the Court recognized that the *Handy Andy* court's observation would be equally true concerning a base rent obligation. *NETtel Corp.*, 289 B.R. at 490. The court in *NETtel* held that a landlord's entitlement to compensation for occupancy corresponds to the actual days the tenant was entitled to occupancy; in a practical sense, the obligation can be said to arise on each occupancy day. *Id.*

Courts adopting the performance date approach argue that the obligation arises at the time it is due under the lease and thus must be paid in full for the entire period. *Id.* Under this approach, the trustee must perform obligations in full as they become due on the lease, even if the debtor does not realize the benefits because the debtor rejects and surrenders the property.

See id. at 491. This interpretation treats "arising" as synonymous with "payable"—an obligation arises when payable under the lease. However, while the lease terms may provide that compensation is *payable* prerejection, fundamentally, the obligation may *arise* post-rejection.

Additional problems with the performance date approach arise that contradict the purpose of section 365(d)(3). Section 365(d)(3) requires the performance of obligations arising "*after* the order of relief." 11 U.S.C. § 365(d)(3) (emphasis added). Under the performance date approach, an advance rent payment due *prior* to the order of relief would not be subject to payment under section 365(d)(3) because the obligation did not arise "after the order of relief." *NETtel Corp.*, 289 B.R. at 490. Instead, a landlord would be required to seek payment under Section 503(b)(1).[2] However, Congress enacted section 365(d)(3) precisely to remove landlords from the burden of proving entitlement to payment under 503(b)(1). *NETtel Corp.*, 289 B.R. at 490–91 (stating that section 365(d)(3) "was intended to avoid" precisely this result). Requiring a landlord to seek payment under section 503(b)(1), simply because of the rigidity of the performance date approach, reinvents the exact problem that section 365(d)(3) was enacted to solve.

The interplay between the terms "obligation" and "arises" has created significant ambiguity and a split of approaches. *Newman v. McCrory Corp. (In re McCrory Corp.)*, 210 B.R. 934, 939 (S.D.N.Y. 1997). Because the performance date approach leads to results contrary to section 365(d)(3)'s purpose, whereas the daily accrual approach supports the benefits the landlord and debtor actually receive, this Court should affirm the Thirteenth Circuit's interpretation that the daily accrual approach is the most sensical reading of the statute.

These various multiple readings and approaches make clear that the statute is ambiguous. Because the statutory language of 365(d)(3) is ambiguous, analysis of the context and policy of

[2] Section 503(b)(1) requires a creditor to prove, through notice and hearing, that the use of its property was an actual and necessary cost of preserving the debtor's estate. 11 U.S.C. § 503(b)(1).

the statute within the Code, as well as the legislative history, is necessary to construing section 365(d)(3). *See, e.g.*, *McCrory*, 210 B.R. at 939.

B. Alternatively, because the statutory language of 365(d)(3) is ambiguous, analysis of the context and policy of the statute within the Code is necessary to construe section 365(d)(3).

Statutory language must be read in the context of the policy and objectives of the Bankruptcy Code and the "real-world situation to which the language pertains." *In re Handy Andy Home Improvement Ctrs.*, 144 F.3d 1125, 1128 (7th Cir. 1998); *see also El Paso Props. Corp. v. Gonzales (In re Furr's Supermarkets, Inc.)*, 283 B.R. 60, 69 (B.A.P. 10th Cir. 2002). The Proration Rule is in line with the goal of rejection by allowing a trustee to reject a lease and not be subject to obligations that do not benefit the estate. Proration best supports the bankruptcy policy of ensuring maximum value to creditors and is necessary to protect the interests of debtors, creditors, and landlords. Thus, this Court should apply the Proration Rule to section 365(d)(3) and find that the Debtor only owed Petitioner rent for its five days of occupancy.

1. Section 365(d)(3) must be read and interpreted in the context of other pertinent Bankruptcy Code statutes to avoid negating other sections of the Code.

Statutory language "cannot be construed in a vacuum." *Roberts v. Sea-Land Servs., Inc*., 566 U.S. 93, 101 (2012). Instead, the words of a statute must be read in context and within their place in the overall statutory scheme when ambiguous. *Id*.; *see Handy Andy*, 144 F.3d at 1128 (as explained by Judge Posner, "When context is disregarded, silliness results."). Bankruptcy Code provisions must be considered in the context of other relevant provisions, along with the overall objective and policy of the Code. *See, e.g.*, *In re Ames Dep't Stores, Inc.*, 306 B.R. 43, 66 (Bankr. S.D.N.Y. 2004). Because the statutory scheme and other provisions of the Code support the Proration Rule, this Court should affirm the finding that Petitioner is only entitled to a lease payment for the five days of occupancy.

To understand the intent of section 365(d)(3), other statutory provisions must be examined to decode the section's ambiguity. *Id.* at 66. Under sections 365(g) and 502(g), a post-rejection breach of a lease obligation is treated as a prepetition claim. *Id.* at 70. Section 502(g) provides that "all claims associated with the rejection of the lease are deemed prepetition claims." 11 U.S.C. § 502(g). Under these sections, post-rejection, unperformed obligations—including future rent—are treated as general unsecured claims. *In re NETtel Corp.*, 289 B.R. 486, 491–92 (Bankr. D.D.C. 2002). Yet, under the performance date approach, rent corresponding to the post-rejection period would be treated as an administrative expense, leaving sections 365(g) and 502(g) "nugatory." *Ames*, 306 B.R. at 70. Because the performance date approach negates the effect of sections 365(g) and 502(g), it cannot be the proper interpretation of section 365(d)(3). *See id.*

Moreover, the performance date approach vitiates the Code's priority scheme. Section 365(g) provides the means for determining priority for claims following rejection. *Med. Malpractice Ins. Ass'n v. Hirsch (In re Lavigne)*, 114 F.3d 379, 389 (2d Cir. 1997). Yet, under the performance date approach, a landlord's claim for the post-rejection period is elevated over the claims of other creditors—a result that is contrary to the plain meaning and purpose of sections 365(g) and 502(g). *Ames*, 306 B.R. at 70. In effect, this reading "unravels the priority scheme of the Bankruptcy Code." *El Paso*, 283 B.R. at 69. Because the performance date approach would render sections 365(g) and 502(g) pointless and infringe on the Code's priority scheme, the performance date approach cannot be the proper interpretation of section 365(d)(3). *NETtel*, 289 B.R. at 492–93 (citing *Pa. Dept. of Pub. Welfare v. Davenport,* 495 U.S. 552, 563 (1990)) ("Congress did not likely intend to upset these settled principles and priorities when it enacted section 365(d)(3)."). Therefore, this Court should apply the Proration Rule.

2. The Proration Rule follows the Bankruptcy Code policy underlying rejection and assumption.

The Proration Rule is consistent with the Code's policy surrounding rejection because it enables a trustee to determine which contracts are beneficial for the debtor and reject burdensome obligations. Conversely, the performance approach is inconsistent with these aims. The Bankruptcy Code provides an avenue for a trustee to reject a lease that is not a "good deal" for the estate. *Mission Prod. Holdings v. Tempnology, LLC*, 139 S. Ct. 1652, 1658 (2019). The purpose of rejection is to end the liability associated with the future right of occupancy. *NETtel*, 289 B.R. at 491. Following rejection, a debtor loses the right to occupy the premises under the lease. *Id.* at 489. Under the policy aims of rejection, a debtor should not be required to pay for obligations allocable to the post-rejection period, particularly when the debtor no longer occupies the property and, moreover, when the debtor is barred from a right to occupy the property. Yet, under the performance date approach, a debtor would be required to pay obligations for the post-rejection period as administrative claims. This absurd interpretation essentially renders the debtor's rejection pointless. Requiring the debtor to pay obligations associated with the post-rejection period, especially as burdensome administrative claims, contravenes the very purpose of rejection. *Id.* at 491–92 (stating this result will leave the estate "saddled with a burden that rejection is designed to avoid.").

The incongruity of the performance date approach is especially apparent when a lease is rejected under section 365(d)(4). Section 365(d)(4) provides that when a trustee fails to assume or reject a lease within the proscribed time period, the lease is deemed rejected. The statute requires the trustee to surrender the leased premises to the landlord immediately. 11 U.S.C. § 365(d)(4); *See NETtel*, 289 B.R. at 489–90 n.6. Under the performance date approach, after surrendering the premises as required by section 365(d)(4), a trustee would still be required to

pay for the unoccupied and unused property. The trustee should not be obligated to pay for property statutorily required to be surrendered to the landlord.

On the other hand, under the Proration Rule, a debtor would not be required to pay for property returned to the landlord in compliance with section 365(d)(4). It is unlikely that Congress demanded immediate surrender while simultaneously requiring the debtor to pay for the surrendered property. Thus, Congress's simultaneous enactment of section 365(d)(4) reinforces the Proration Rule.

The Bankruptcy Code provides an avenue for the debtor to reject a burdensome lease and be freed from its onerous obligations. Yet, under the performance date approach, the trustee may be unable to rid itself of the burdens under the lease. Conversely, under the Proration Rule, the trustee can fully utilize the Code's rejection tools as contemplated by the Code. Because the Proration Rule best achieves the aims of rejection under the Code, this Court should adopt the Proration Rule and affirm the Thirteenth Circuit's holding.

3. The Proration Rule ensures fair distribution and supports the policy of maximum value to creditors.

A critical policy underlying the Bankruptcy Code is the objective of promoting equal distribution and maximum economic value to creditors. *See, e.g., Howard Delivery Serv., Inc. v. Zurich Am. Ins. Co.*, 547 U.S. 651, 667 (2006) (citing *Kothe v. R. C. Taylor Tr.*, 280 U.S. 224, 227 (1930)). To support this aim, preferential treatment toward a creditor should only occur when "clearly authorized by Congress." *Howard Delivery Serv.* 547 U.S. at 655. Allowing landlords to recover rent allocable to the post-rejection period would grant landlords a "windfall payment" to the detriment of debtors and other creditors without Congress's authorization. *Child World v. Campbell/Mass. Tr. (In re Child World)*, 161 B.R. 571, 576 (S.D.N.Y. 1993); *Ames*, 306 B.R. at 71 (stating this could provide landlords "a double recovery.").

A claim that is granted priority status reduces the funds available to other creditors. *Howard Delivery Serv.,* 547 U.S. at 667. Granting priority to a claimant that is not clearly entitled to such priority is inconsistent with the Bankruptcy Code policy of equality of distribution and dilutes the value of the other creditors. *Id.*

There is no indication that Congress passed section 365(d)(3) to give landlords "favored treatment." *Handy Andy*, 144 F.3d at 1128. Congress enacted section 365(d)(3) to put landlords on an "equal footing" with other creditors, not to "grant them a windfall at the expense of other creditors." *Newman v. McCrory Corp. (In re McCrory Corp.)*, 210 B.R. 934, 939–40 (S.D.N.Y. 1997) (quoting *Santa Ana Best Plaza v. Best Prods. Co. (In re Best Prods. Co.)*, 206 B.R. 404, 406–07 (Bankr. E.D. Va. 1997).

In *McCrory*, the court noted that the landlord would gain a windfall if the debtor were required to pay advance taxes for the entire year rather than prorating the amount owed because the landlord could relet the property and recover double for those tax bills. *Id.* at 940. Furthermore, the debtor would be required to pay an entire year's worth of taxes even though it possessed the property for only one month before rejection. *Id.* Strict reliance on the performance date approach would harm creditors by leaving less money to pay those creditors' claims and potentially lead to double recovery by the landlord. *See id.*

Alternatively, the performance date approach could result in a windfall to the debtor-tenant to the landlord's detriment. *See McCrory*, 210 B.R. at 940. In *McCrory*, the court illustrated an alternative outcome of the debtor-tenant's obligation to pay annual taxes for the coming year. *See id.* Under the performance date approach, if the annual taxes were due one day before the petition was filed, the obligation would be treated as an unsecured, prepetition claim. *Id.*; *see* 11 U.S.C. § 502(g). In this scenario, the landlord's claim for the taxes for that period (or

rent, if the rent was due before the petition's filing date) would depend on allowance of the claim as an administrative expense under the usual requirements of section 503(b)(1).

This result is contrary to Congress's intent in enacting section 365(d)(3) and the plain language of the statute. Congress enacted section 365(d)(3) to remove landlords from the burdensome requirements of section 503(b)(1). The statute's language, "notwithstanding section 503(b)(1)," clearly demonstrates that Congress did not intend for lease obligations to be subject to the burdens of section 503(b)(1). *In re Stone Barn Manhattan LLC*, 398 B.R. 359, 367 (Bankr. S.D.N.Y. 2008). Yet, under the Petitioner's performance date approach, these lease obligations would only be payable through section 503(b)(1), contravening the plain language of the statute and Congress's intent. *See id*. Under the Proration Rule, however, the debtor would be liable for the portion of the taxes that accrued during its occupancy until rejection. *See McCrory*, 210 B.R. at 940 (stating the performance date outcome cannot be "what Congress had in mind.").

Similarly, the court in *Ames* demonstrated that a failure to apply post-rejection proration could prejudice landlords when obligations are billed in arrears. *Ames*, 306 B.R. at 70. This is particularly common when lease obligations provide for percentage rent, which may only be ascertainable after the rental period. *Id.* (noting the absence of congressional intent to bring about such a result). It would be unfair to deprive landlords of this payment simply because the payment amount could not be determined and billed before rejection. *Id.* at 71; *see also NETtel*, 289 B.R. at 493 (stating proration is necessary to protect the landlord when the billing date for advance rent precedes the order for relief or when the billing date for rent allocable to the prior period is after the rejection of the lease).

Courts adopting the performance date approach argue there is no detriment to the debtor because the debtor controls the rejection date. *See, e.g.*, *Koenig Sporting Goods, Inc. v. Morse*

Rd. Co. (In re Koenig Sporting Goods, Inc.), 203 F.3d 986, 989 (6th Cir. 2000), *contra Stone Barn Manhattan*, 398 at 367–68. These courts argue the debtor controls the rejection date, and thus the debtor is not harmed by failing to choose the dates most beneficial to the debtor. *Koenig*, 203 F.3d at 989–90.

This approach assumes that lease obligations and debtors' decisions fit neatly into the scenarios contemplated by these courts. However, the debtor does not always have control over the date of the rejection of the lease because rejection requires a court order. *NETtel*, 289 B.R. at 495 n.15 (stating "There are often cases in which the trustee, despite valiant efforts, is unable to obtain entry of the order of rejection prior to a payment for future occupancy being due under the lease."). In *Stone Barn Manhattan*, the debtor sought a court order for the sale of assets, including leases, before the end of the month to "avoid the accrual of another full month's rent." *Stone Barn Manhattan LLC*, 398 B.R. at 368. The court could not schedule a hearing on the "shortened notice that would have been required." *Id.* Under the rigid performance date approach, if the rejection were approved in the following month, the debtor would have been liable for the entire month's obligation, despite its efforts to avoid that result. *See id.*

Moreover, a debtor's circumstances may change suddenly, requiring the debtor to reject a lease after the billing period has already commenced. Furthermore, when a lease provides for quarterly or yearly billing periods, it is unreasonable to burden a trustee with foreseeing a need for rejection before the billing period begins. "It is undesirable to interpret section 365(d)(3) as operating in a manner … that depends on the fortuity of the time of the month of the order for relief or the rejection of the lease." *NETtel*, 289 B.R. at 490. Under the Proration Rule, the debtor is not forced to pay lease obligations corresponding to the entire billing period, preserving more

value to distribute among creditors. Thus, because proration promotes maximum value to creditors, this Court should adopt the Proration Rule.

4. Adopting Petitioner's performance date approach would lead to absurd results contrary to bankruptcy policy.

Interpreting a statute within the context of the larger statutory scheme requires analysis of the "real-world situation" relevant to the statute. *Handy Andy*, 144 F.3d at 1128 (stating the context "consists … also of the real-world situation to which the language pertains."); *see also Lamie v. U.S. Tr.*, 540 U.S. 526, 536 (2004) (citations omitted) (stating if the plain meaning of a statute leads to absurd results, the text must be treated as if it were ambiguous). Under the performance date approach, if a trustee were to reject a lease that provides for large sums of advance rent, such as on a quarterly or yearly basis, the trustee would be required to pay the entire sum of advance rent—even if the payment reached millions of dollars. Put aptly by the Thirteenth Circuit—"this cannot possibly be what Congress had in mind when it enacted section 365(d)(3)." R. at 21.; *see Ames*, 306 B.R. at 71, ("[This] leads to near-absurdity when obligations billable to the tenant are allocable to periods going far in advance.").

While the performance date approach hurts debtors, landlords, and creditors, the Proration Rule balances the rights of these groups. Under the Proration Rule, landlords would receive fair consideration for the benefits provided to an estate. *Id.* Moreover, this approach equitably serves debtors, who would not be required to pay for post-rejection, post-surrender occupancy of the premises. The Proration Rule ensures that neither the landlord nor the debtor receives a windfall to the detriment of the landlord, debtor, or other creditors. This conclusion is reinforced by the Bankruptcy Code policy of "narrowly construing statutory priorities to treat creditors as equally as possible." *Child World*, 161 B.R. at 576. Thus, because the Proration Rule is most consistent with the Bankruptcy Code policies underlying rejection and promoting

maximum value and ensuring equality among creditors, this Court should adopt the Proration Rule.

C. The legislative history of section 365(d)(3) and pre-1984 Bankruptcy Code common practice supports adopting the Proration Rule.

To understand the context of section 365(d)(3), an analysis of its legislative history is required. Congress enacted section 365(d)(3) to protect landlords and enable a debtor's estate to receive the benefits from rejection of unfavorable leases. The Proration Rule supports both aims. Moreover, prior practice before section 365(d)(3)'s enactment was proration. Therefore, this Court must interpret that Congress intended to maintain this valuation method because there is no evidence of intent to the contrary.

1. Section 365(d)(3)'s legislative history supports the Proration Rule's application.

Because the language of section 365(d)(3) is ambiguous, legislative history must also be considered. (*In re Ames Dep't Stores, Inc.*, 306 B.R. 43, 68 (Bankr. S.D.N.Y. 2004); *Child World v. Campbell/Mass. Tr. (In re Child World)*, 161 B.R. 571, 574 (S.D.N.Y. 1993). Congress enacted section 365(d)(3) to ensure that landlords are not disadvantaged for providing services between a tenant's bankruptcy petition and assumption or rejection of a lease. *See, e.g.*, *Newman v. McCrory Corp. (In re McCrory Corp.)*, 210 B.R. 934, 939–40 (S.D.N.Y. 1997). Before the section's passage, a debtor had until plan confirmation to decide whether to assume or reject an unexpired lease. Under section 503(b), landlords were forced to prove the property was necessary for the estate either by filing a motion to compel payment or by waiting until the plan's confirmation. Often, courts held the estate's benefit from usage of the property was less than the bargained-for rent and reduced the landlord's full benefit of the lease bargains, even for post-petition, prerejection claims. *Ames*, 306 B.R. at 68.

More onerously, landlords were required to continue to provide property and services to a debtor's estate but required to wait until confirmation to recover post-petition rent. *Id.* (citing H.R. Conf. Rep. No. 98-882 (1984), *reprinted in* 1984 U.S.C.C.A.N. 576, 598–99). To compound this burden, these administrative claims were only paid to the extent the estate was administratively solvent. *Handy Andy Home Improvement Ctrs.*, 144 F.3d 1125, 1128 (7th Cir. 1998).

With the 1984 Bankruptcy Code Amendments, Congress addressed the purgatory landlords faced waiting until plan confirmation to learn if the debtor would assume or reject the lease. Congress passed section 365(d)(4) to impose a time limit on debtors' assumption or rejection. R. at 32. Senator Orrin Hatch, a conferee to the Amendments, stated that section 365(d)(3) was enacted to remedy the problem of landlords not receiving timely payment from debtor-tenants. H.R. Conf. Rep. No. 882, *reprinted in* 1984 U.S.C.C.A.N. at 598–99 ("This timely performance requirement will [e]nsure that debtor-tenants pay their rent, common area, and other charges on time pending the trustee's assumption or rejection of the lease.").

Additionally, section 365(d)(3) was intended to remove the bankruptcy court's power to review the amount paid under lease obligations and quash the unfairness of the pre-1984 practice of requiring landlords to prove the unpaid rent was necessary under 503(b)(1). *Ames*, 306 B.R. at 69. Similarly, the court in *Handy Andy* stated that Congress passed section 365(d)(3) to give "relief to landlords" by removing landlords "from under the 'actual, necessary' provision of 503(b)(1)" and allowing landlords to collect rent during the "awkward postpetition prerejection period." *Handy Andy*, 144 F.3d at 1128 ("There is no indication that Congress meant to go any further than to provide a landlord exception to 503(b)(1)."). Thus, the legislative history

demonstrates that section 365(d)(3) was enacted to alleviate the burden imposed on landlords by section 503(b)(1).

Furthermore, Senator Hatch's statements surrounding the enactment of section 365(d)(3) support the Proration Rule. Senator Hatch said the section was intended to remedy the problem of landlords being required to provide "current services" without "current payment." H.R. Conf. Rep. No. 98-882, *reprinted in* 1984 U.S.C.C.A.N. at 598–99. The logic of passing section 365(d)(3) to change the status quo and require debtor-tenants to pay for "current services" indicates that tenants should only be required to pay for the services they actually receive. *Child World*, 161 B.R. at 576. Following rejection, a landlord no longer provides "current services" because the debtor loses the right of occupancy and thus should no longer receive "current payment" for that period. *Ames*, 306 B.R. at 71.

2. Because there is no evidence of Congress's intent to upend the prior proration practice, statutory interpretation requires maintaining the Proration Rule.

On numerous occasions, this Court stated that absent specific indication otherwise, Congress's presumed intent is to preserve pre-Bankruptcy Code practice. *See, e.g.*, *In re NETtel Corp.*, 289 B.R. 486, 493 (Bankr. D.D.C. 2002) (citing *Pa. Dept. of Pub. Welfare v. Davenport,* 495 U.S. 552, 563 (1990)); *Centerpoint Props. v. Montgomery Ward Holding Corp. (In re Montgomery Ward Holding Corp.)*, 268 F.3d 205, 211 (3d Cir. 2001). Before the passage of 365(d)(3), debtor-tenants paid obligations arising from the period of occupancy on a pro-rata basis. *See, e.g.*, *Child World*, 161 B.R. at 574–75.

The legislative history of section 365(d)(3) does not indicate Congressional intent to overturn the long-standing practice of prorating debtor-tenants' rent to cover only the post-petition, prerejection period. *Id.* at 575–76; *McCrory*, 210 B.R. at 937 ("Congress did not explicitly address whether obligations owed under a lease should be prorated, consistent with

pre-amendment practice."). As the Thirteenth Circuit noted, "when Congress enacted section 365(d)(3) in 1984, the Proration Rule was in no way abrogated." R. at 19 (citing *Child World*, 161 B.R. at 575–76). Because Congress did not indicate any change to the pre-1984 Amendments proration practice, Congress's presumed intent was to preserve the Proration Rule.

For the reasons stated, this Court should adopt the Proration Rule. The plain meaning of section 365(d)(3) and the absurd outcomes the statute produces when read according to the performance date approach demonstrate the statute's ambiguity. While the plain meaning of section 365(d)(3) is ambiguous, the statute does not preclude the proration approach. Proration is consistent with other provisions of the Bankruptcy Code, as well as the priority scheme contemplated by the Code. Proration serves the Code policies underlying rejection and ensures that landlords and debtor-tenants receive current service for current payment at the rate agreed to in the lease. This approach best serves landlords, debtors, and other creditors. The legislative history does not preclude, and, in fact, supports, the proration approach. Finally, proration is consistent with the pre-1984 practice of prorating lease obligations pending the debtor's rejection. The legislative history does not expressly indicate an intention to change the long-standing proration approach. Therefore, this Court should affirm the decision of the Thirteenth Circuit and formally adopt the Proration Rule in 365(d)(3) analyses.

CONCLUSION

It is the fundamental role of a trustee to preserve value of the estate and ensure that no creditor receives more than their fair share. The Trustee here found, and all the trial and appeal courts agreed, that Petitioner's maneuvering here would result in double-recovery and over-payment, obstructing fellow unsecured creditors from proper recovery. For the foregoing reasons, this Court should affirm the decision of the Thirteenth Circuit Court of Appeals.

APPENDIX A

11 U.S.C. § 101. Definitions

…

(54) The term "transfer" means—

…

(D) each mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with—

(i) property; or

(ii) an interest in property.

---

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

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

…

(d)(3)(A) The trustee shall timely perform all the obligations of the debtor . . . 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.

…

(d)(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 unexpired 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 a plan.

…

(g) Except as provided in subsections (h)(2) and (i)(2) of this section, the rejection of an executory contract or unexpired lease of the debtor constitutes a breach of such contract or lease—

(1) if such contract or lease has not been assumed under this section or under a plan confirmed under chapter 9, 11, 12, or 13 of this title, immediately before the date of the filing of the petition; or

(2) if such contract or lease has been assumed under this section or under a plan confirmed under chapter 9, 11, 12, or 13 of this title-—

(A) if before such rejection the case has not been converted under section 1112, 1208, or 1307 of this title, at the time of such rejection; or

(B) if before such rejection the case has been converted under section 1112, 1208, or 1307 of this title—

(i) immediately before the date of such conversion, if such contract or lease was assumed before such conversion; or

(ii) at the time of such rejection, if such contract or lease was assumed after such conversion.

11 U.S.C. § 502. Allowance of claims or interests

…

(g)(1) A claim arising from the rejection, under section 365 of this title or under a plan under chapter 9, 11, 12, or 13 of this title, of an executory contract or unexpired lease of the debtor that has not been assumed shall be determined, and shall be allowed under subsection (a), (b), or (c) of this section or disallowed under subsection (d) or (e) of this section, the same as if such claim had arisen before the date of the filing of the petition.

---

11 U.S.C. § 503. Allowance of administrative expenses

…

(b) After notice and a hearing, there shall be allowed administrative expenses, other than claims allowed under section 502(f) of this title, including—

(1) (A) the actual, necessary costs and expenses of preserving the estate

…

(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.

---

11 U.S.C. § 547. Preferences

…

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

…

(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

…

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

…

(3) that creates a security interest in property acquired by the debtor—

(A) to the extent such security interest secures new value that was--

(i) given at or after the signing of a security agreement that contains a description of such property as collateral;

(ii) given by or on behalf of the secured party under such agreement;

(iii) given to enable the debtor to acquire such property; and

(iv) in fact used by the debtor to acquire such property; and

(B) that is perfected on or before 30 days after the debtor receives possession of such property

(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.

(5) that creates a perfected security interest in inventory or a receivable or the proceeds of either, except to the extent that the aggregate of all such transfers to the transferee caused a reduction, as of the date of the filing of the petition and to the prejudice of other creditors holding unsecured claims, of any amount by which the debt secured by such security interest exceeded the value of all security interests for such debt on the later of—

(A)(i) with respect to a transfer to which subsection (b)(4)(A) of this section applies, 90 days before the date of the filing of the petition; or

(A)(ii) with respect to a transfer to which subsection (b)(4)(B) of this section applies, one year before the date of the filing of the petition; or

(B) the date on which new value was first given under the security agreement creating such security interest;

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11 U.S.C. § 549. Postpetition transactions

(a) Except as provided in subsection (b) or (c) of this section, the trustee may avoid a transfer of property of the estate—

(1) that occurs after the commencement of the case; and

(2)(A) that is authorized only under section 303(f) or 542(c) of this title; or

(2)(B) that is not authorized under this title or by the court.