No. 20-1004

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 Writ of Certiorari to the
United States Court of Appeals
For the Thirteenth Circuit

BRIEF FOR PETITIONER

TEAM NUMBER 15
Counsel for Petitioner Team 15

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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STATEMENT OF JURISDICTION

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

STATEMENT OF THE CASE

William Tell ("Tell") founded Terrapin Station, LLC (the "Debtor") in 2005. R. 2-3. Debtor was a coffeehouse that was initially successful and recognized as "Independent Coffeehouse of the Year" in 2009 by The Java Digest. *Id.* at 3. Touch of Grey Roasters, Inc. ("Touch of Grey") is an international coffee company and coffeehouse chain headquartered in San Francisco, California. *Id.* In the fall of 2017, Touch of Grey approached Tell to see if he would be interested in turning Terrapin Station into a franchise of Touch of Grey. *Id.* at 4. Tell, eager to partner with a major player in the coffee industry, agreed to the franchise arrangement. *Id*.

The partnership began with Touch of Grey purchasing a recently renovated warehouse space located at 5877 Shakedown Street (the "Premises") and leasing it to the Debtor. *Id.* at 4. The Debtor and Touch of Grey entered into the *Lease Agreement* ("the Lease") for the Premises. *Id.* The Lease was a 20-year lease which required the Debtor to pay $25,000 monthly rent, with such rent being "due in advance on the first day of each month." *Id.* The Shakedown Street location opened on December 1, 2018, and the original Terrapin Station coffeehouse closed on that same date. *Id.* at 5.

Troubles began early, and the Debtor was unable to pay its debts as they became due as early as September 2019. *Id.* The Debtor remained current on the lease, but it owed Touch of Grey over $700,000 for its proprietary Dark Star-branded goods. *Id.* On December 5, 2019, Touch of Grey sent a notice of default threatening to terminate the franchise agreement because of Debtor's breach of the Lease. *Id.* On December 7, 2019, the parties entered into a forbearance agreement where Debtor paid Touch of Grey $250,000, reaffirmed its obligations under the Lease, and released any and all claims it held against Touch of Grey. *Id.* On December 18th, Debtor purchased an additional $200,000 worth of Dark Star products from Touch of Grey on credit, personally guaranteed by Tell. *Id.* at 5-6.

Unfortunately, because of disappointing holiday sales, Debtor's position became untenable. On January 5, 2020, (the "Petition Date") Debtor filed a petition for relief under Chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the District of Moot. *Id.* at 6. On that date, Debtor was current on lease payments, but owed Touch of Grey $650,000 for goods purchased. *Id.* The Debtor had no secured debt, but owed $500,000 to various other unsecured creditors. *Id.*

The Debtor then created a reorganization strategy to turn around the business. *Id.* Debtor would return to its traditional coffeehouse practices prior to its partnership with Touch of Grey, sublet a portion of the Premises to reduce the rent burden, and continue using Dark Star products as the franchise agreement required. *Id.* Two weeks later, Debtor filed a motion requesting permission to pay $200,000 to Touch of Grey, asserting that it was a "critical vendor." *Id.* The Court was skeptical of the "critical vendor" argument, but nonetheless awarded Touch of Grey administrative priority under § 503(b)(9)[1] for the value of the goods sold. *Id.* at 7. The Court also permitted immediate payment of the $200,000 to Touch of Grey, which was shortly thereafter paid by Debtor. *Id.*

The Debtor was forced to close in March 2020 due to the pandemic, and after a brief period of operation in April closed for good on May 5th, 2020. *Id.* On May 6th, Debtor filed a motion to reject the lease and franchise agreement pursuant to section 365(a). *Id.* Two days later,

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

Touch of Grey filed a motion to compel payment of May's rent as under section 365(d)(3), rent came due prior to the date of rejection. *Id.* at 8. Debtor then converted the case from Chapter 11 to a Chapter 7, with no objections. *Id.* A Trustee was appointed, and the Court approved Debtor's motion to reject the Lease and franchise agreement effective as of May 5th, 2020. *Id.*

The Trustee then objected to Touch of Grey's motion to compel payment for the entirety of the May rent pursuant to § 365(d)(3). *Id.* Additionally, the Trustee separately commenced an adversary proceeding seeking to avoid and recover the $250,000 payment that the Debtor had made to Touch of Grey pursuant to the forbearance agreement as a preferential transfer pursuant to §§ 547(b) and 550(a). *Id.*

The bankruptcy court ruled in favor of the Trustee on both issues. *Id.* The court concluded that § 365(d)(3) only required the Debtor to pay rent for the five days prior to rejection. *Id.* In the adversary proceeding, the bankruptcy court granted summary judgment to the Trustee, holding that Touch of Grey could not use the value of the goods reflected on the Invoice as new value to reduce its preference exposure given that the Invoice was paid pursuant to § 503(b)(9). *Id.* at 9.

Touch of Grey then timely appealed both decisions to the United States District Court for the District of Moot. *Id.* The district court affirmed both decisions made by the bankruptcy court, and Touch of Grey again appealed to the Court of Appeals for the Thirteenth Circuit. *Id.* The Thirteenth Circuit affirmed the district court's determination. *Id.* The court first held that § 547(c)(4) precluded Touch of Grey from asserting a new value defense because they had received payment for an administrative expense under § 503(b)(9). *Id.* at 10. The Thirteenth Circuit also held that § 365(d)(3) does not require the Trustee to satisfy obligations allocable to the post-rejection period. *Id.* at 15. Touch of Grey then petitioned this Court for a writ of certiorari, a petition which was granted. *Id.* at 1.

STANDARD OF REVIEW

The facts of the case before us are undisputed, and the only questions before the court are questions of law. Therefore, the standard of review is *de novo. Texas v. Soileau (In re Soileau)*, 488 F.3d 302, 305 (5th Cir. 2007). *De novo* standard of review requires that the court examine the questions of law as if it were the original trial court. *Razavi v. Comm'r of Internal Revenue*, 74 F.3d 125, 127 (6th Cir. 1996).

SUMMARY OF THE ARGUMENT

This Court should reverse the decision of the Thirteenth Circuit Court of Appeals by holding for the Petitioner on both issues presented.

The plain language and statutory context of § 547(c)(4) ends the time period for analyzing a new value defense on the date of the petition. Specifically, § 547(c)(4)(B) uses the term debtor, not trustee or debtor-in-possession. Because transfers of estate property simply cannot be effectuated by the debtor post-petition, the section can only be referring to pre-petition transfers made by the debtor. Additionally, interpreting the statute as allowing post-petition transfers by the debtor-in-possession to reduce a new value defense would mean that any and all payments pursuant to a plan of reorganization would also reduce a creditor's new value defense, a result that is followed by no U.S. court. Moreover, nowhere else in § 547 does the Code examine post-petition activities when analyzing preference liability

Furthermore, even if this Court agrees that post-petition transfers should factor into evaluating a new value defense, the transfer made to Touch of Grey in January 2020 is not an "otherwise unavoidable transfer" under § 547(c)(4)(B) because it is an administrative expense granted via § 503(b)(9). Touch of Grey is entitled to this administrative priority in payment, and the priority claim's immediate payment in January 2020 is immaterial. Had Touch of Grey instead waited until later into Debtor's reorganization for payment, it is unlikely such a priority payment would affect its new value defense. To hold otherwise would hamper the policy of protecting trade suppliers, who would be punished for lending to struggling businesses.

Section 365(d)(3) plainly directs the trustee to perform all obligations that become due under a nonresidential real property lease after the petition is filed and before the lease is either assumed or rejected. The terms of the lease determine when an obligation is due. In the present case, the rental payment came due prior to the first of the month, which was post-petition and pre-rejection, so the trustee must pay May's rent in full. The billing date approach is consistent with the plain language of the statute. In contrast, the approach taken by the court below—the proration approach—relies on legislative history and policy to subvert the plain language. Such reliance, however, is unnecessary because the plain language of § 365(d)(3) is unambiguous.

Even if this Court chose to look past the plain language, the proration approach is still inappropriate. The limited legislative history provides support for either approach, but more clearly reveals a clear legislative intent to apply the billing date approach. Further, the underlying policies of § 365(d)(3) and the Bankruptcy Code are more consistent with the billing date approach.

ARGUMENT

1. Section 547(c)(4) ends the preference analysis period on the date the petition was filed.

Both the plain language of § 547(c)(4) as well as the statutory context in which it sits support reading the "preference period" to end on the petition date. The statute's references to transfers by "the debtor" command that the analysis of such transfers can only be of pre-petition transfers, and the fact that § 547(c)(4)(B) lacks an explicit deadline does not negate the closing of the period on the petition date.

i. The plain language of § 547(c)(4) indicates that post-petition payments to a creditor do not affect such creditor's new value defense.

The plain language of § 547(c)(4) makes clear that window for evaluating preferences closes upon the filing of the petition for bankruptcy relief. Any question of statutory interpretation should begin with an analysis of the language of the statute. *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 241 (1989). If the meaning is plain from the statute's language, the statutory analysis begins and ends with the statute's plain meaning. *Id.* ("where...the statute's language is plain, 'the sole function of the courts is to enforce it according to its terms'" (quoting *Caminetti v. United States*, 242 U.S. 470, 485 (1917))). Section 547(c)(4) provides that to the extent a creditor gives new value to a debtor after a preferential payment, such creditor may reduce their preference exposure as long as "the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor." § 547(c)(4)(B).

To begin, the plain language explicitly notes that the otherwise unavoidable transfer must be made by *the debtor*, not the trustee or debtor-in-possession. When a debtor files a petition, virtually all the debtor's non-exempt interests in property become property of the estate. § 541(a). The property of the estate may only be used or sold according to the provisions contained in § 363, which details the methods by which a *trustee* may use, sell, or lease property of the estate. For example, in § 363(c)(1), the Code clearly makes a distinction between debtor and trustee, allowing that "if the business of the debtor is authorized to be operated...the *trustee* may enter into transactions, including the sale or lease of property of the estate." § 363(c)(1) (emphasis added). In fact, nowhere in § 363 does the Bankruptcy Code permit a "debtor" to use (or transfer) property of the estate, only the trustee is given this privilege.

In a Chapter 11 case, the debtor becomes the "debtor-in-possession" when the petition is filed, and is given the same rights as a trustee. § 1107(a). While the debtor and the debtor-in-possession are often the same entity, the two are considered legally distinct from each other. *In re Gordon Sel-Way, Inc.*, 270 F.3d 280, 290 (6th Cir. 2001). In *Sel-Way*, the Sixth Circuit made clear this distinction between debtor and debtor-in-possession in order to preclude the right of setoff, holding that "there is no mutuality between a creditor's pre-petition claim against a debtor and a debtor-in-possession's post-petition claim against a creditor." *Id*. Whenever the Code references "the debtor," it references an entity separate from the trustee or debtor-in-possession, even if practically they are the same. Transfers of estate property cannot be effectuated by the debtor—only a trustee (or via § 1107, a debtor-in-possession endowed with the rights of a trustee) may transfer or use estate property.

Therefore, when § 547(c)(4)(B) states that the new value defense is negated by an otherwise unavoidable transfer by the *debtor*, it explicitly refers to the pre-petition debtor. A post-petition debtor cannot make such transfers, so when the section refers to "the debtor," the section can *only* refer to the pre-petition debtor. Therefore, the period for analyzing the new value defense ends upon the filing of the petition. Any argument that Congress simply conflated the term "debtor" with "trustee" or "debtor-in-possession" in § 547 ignores both Congress' ability to specify the difference elsewhere in the Code (as it did in § 363) and the plain meaning of the statute. The plain meaning of § 547(c)(4)(B) closes the new value analysis when the petition is filed.

One could argue that the plain language of § 547(c)(4)(B) could additionally be referring to post-petition transfers by the debtor of *debtor's* property (i.e. exempt assets that are not part of the estate). This argument would then posit that the "window" of preference analysis is therefore not completely shut on the petition date. However, this argument would miss one of the two major purposes of § 547's avoidance powers—to protect the property of the estate for the benefit of equality of distribution among creditors. *Union Bank v. Wolas*, 502 U.S. 151, 161 (1991). Section 547(c)(4)(B) should instead be read to solely refer to pre-petition transfers, and cannot include post-petition transfers made by the debtor of non-estate property. If a post-petition transfer by a debtor was permitted to reduce a creditor's new value defense against the estate, the result would do nothing to preserve the assets of the estate for distribution. Preference actions are initiated with the goal of bringing property back into the estate which would have been in the estate but for a debtor's preferential transfer to a creditor on the eve of bankruptcy. A debtor's transfer of non-estate property after the filing of the petition does not affect the availability of estate property for distribution to creditors, and thus should also not fall under the ambit of § 547(c)(4)(B) to negate a new value defense. Therefore, the window for examining a new value defense definitively ends on the date of the petition.

One could also assert that because the statute lacks a deadline for the otherwise unavoidable transfer, the statute's plain meaning indicates that there is no such deadline, and that any payments from the debtor (or the estate) at any time after new value is given must therefore figure into the preference analysis. *In re Login Bros. Book Co., Inc.*, 294 B.R. 297, 300-301

(Bankr. N.D. Ill. 2003). Of course, this argument already ignores the distinction made above between the debtor and the debtor-in-possession. Regardless, this reading, while a possible interpretation the statute's plain meaning, contradicts the purpose of the statute. This interpretation leaves a completely boundless approach to preference analysis, catching made by the estate post-petition and using them to reduce a rightfully asserted new value defense. As the Third Circuit put it, "[d]id Congress really intend there to be no limit to when a payment defeating a new value defense could be made in determining whether a preference has occurred? We think not." *Friedman's Liquidating Trust v. Roth Staffing Companies (In re Friedman's Inc.)*, 738 F.3d 547, 554 (3rd Cir. 2013). If the reading proposed by Respondent were embraced by this Court, then all transfers made by a debtor-in-possession (even those in the ordinary course of business) must be considered a reduction in the new value defense. This reading would discourage vendors from conducting ordinary business with a debtor who has entered Chapter 11, reducing the likelihood of a successful reorganization and sliding the debtor into a Chapter 7 liquidation.

In addition, if § 547(c)(4)(B) were read to lack any sort of temporal limitation because it lacks an explicit deadline, it should follow then that the entirety of § 547(c)(4) should be read similarly. This would allow creditors to assert new value defenses by simply transferring property to the debtor *after* the debtor files the petition. But a majority of courts at the very least disagree with this approach, and do not allow post-petition extensions of credit to qualify as "new value." *See, e.g.*, *Bergquist v. Anderson-Greenwood Aviation Corp. (In re Bellanca Corp.)*, 850 F.1d 1275, 1284 (8th Cir. 1988) (holding that, similar to arguments made above, transfers made to debtor post-petition are not made to the debtor, but to the debtor's estate); *Frield v. Maryland Motor Truck Ass'n Workers Comp. Self-Insurance Group (In re George Transfer,* *Inc.)*, 259 B.R. 89, 96 (Bankr. D. Md. 2001) ([t]his court has found no case decided under § 547(c)(4) that permitted a transferee to successfully defend an action for the recovery of a preference based on a subsequent advance that was made post-petition"). If this Court affirmed the lower court's decision that post-petition transfers from debtor to creditor should figure into the new value defense analysis, it would be inequitable to continue to prohibit creditors from using post-petition transfers to the debtor to bolster a new value defense.

Furthermore, such a reading could destabilize the finality of a preference action judgment. Imagine Terrapin had instead pursued a preference action early in the case (once they entered Chapter 11), received a judgment, and recovered. Then, if Terrapin later converted to Chapter 7 as they did in the facts of the case, and Touch of Grey was further able to secure administrative priority, would not such payments undermine the new value determination made earlier in the case? Respondent may counter this assertion by claiming that the window to evaluate the new value defense extends only up to a judgment on a preference action, but such an argument strays from any sort of plain meaning of the section and reads a more fluid and arbitrary deadline into the statute, as opposed to the more reasonable deadline of the petition date.

ii. The statutory context around § 547(c)(4) indicates that the preference analysis window closes upon filing the petition.

If the plain meaning of § 547(c)(4) was not enough, one could additionally look to the surrounding provisions in § 547 and the rest of the Bankruptcy Code to show that any preference analysis must not include post-petition transfers or activities.

To begin, the rest of § 547 is only concerned with transfers and activities within the "preference period," and not post-petition actions. Preferences under § 547 are evaluated in the "preference period," or 90 days before filing the petition (or one year before filing the petition for transfers to insiders). § 547(b)(4). Nowhere in § 547 are any post-petition activities considered in analyzing whether a preference has occurred. The section is instead concerned with the powers to avoid transfers previously made by the debtor, who again cannot make transfers after the petition has been filed. Section 547(c)(4) would be thoroughly inconsistent with the rest of preferences section if it was the only sub-section which contemplated post-petition activities in its analysis. While such inconsistencies are of course permitted, Congress would likely have noted this inconsistency by stating that the otherwise unavoidable transfer can be a post-petition transfer. Congress, as this Court has stated, does not "hide elephants in mouseholes." *Whitman v. American Trucking Ass'ns*, 531 U.S. 457, 468 (2001).

Nowhere is this more apparent than when considering the hypothetical Chapter 7 liquidation analysis under § 547(b)(5). Under the liquidation analysis, if a creditor who received a preferential payment would fare no better had the transfer not been made and the case were being liquidated under Chapter 7, then the payment is not avoidable. § 547(b)(5). The classic example is an oversecured creditor who receives a transfer within 90 days of bankruptcy—because the creditor is oversecured, the payment would not increase their recovery had the collateral been liquidated under Chapter 7. *In re Teligent, Inc.*, 337 B.R. 39, 45 (Bankr. S.D.N.Y. 2005). This determination is made, however, on the petition date, as the statute contemplates a situation where the case were *originally* a Chapter 7 liquidation. If a creditor is oversecured at the time of petition, but becomes undersecured during the case (i.e. a creditor with a security interest in a debtor's inventory that decreases during the case), the hypothetical Chapter 7 liquidation analysis would still consider such a creditor oversecured for the preference analysis. If the new value defense in § 547(c)(4) were read to include post-petition transfers to the creditor, it would conflict with the hypothetical Chapter 7 liquidation test within the same section.

Other sections of the Bankruptcy Code also point towards the finality of the date the petition is filed. Section 546(a), for example, sets forth a statute of limitations for preference actions, limiting such actions to two years beyond the date of the petition. § 546(a)(1)(A). If actions after the petition could be considered in evaluating a preference, why would § 546(a) start the clock on the petition date? Typically, a statute of limitations only begins to run when a claim has accrued, or when a plaintiff has a "complete and present cause of action." *Wallace v. Kato*, 549 U.S. 384, 388 (2007). If events after the bankruptcy petition could be considered in evaluating a preference plaintiff's claim, then such a plaintiff would theoretically lack a complete cause of action on the petition date. And while Congress has the power to set statutes of limitation that begin running separate from the full accrual of a claim, it is unlikely they were trying to do so in § 546(a).

2. A payment made to a creditor via § 503(b)(9) is not an "otherwise unavoidable transfer" but instead resembles a typical bankruptcy outcome.

A creditor who receives administrative priority via § 503(b)(9) is not given a transfer of property, but is only given priority in payment. Section 503(b)(9) is a boon for trade suppliers who do business with distressed debtors who have not entered bankruptcy—the provision allows the value of any goods received by the debtor in the ordinary course of business within 20 days of the petition to be an administrative expense, payable to the creditor who transferred the goods. Administrative expenses are then given priority in payment, a priority which increases the likelihood the claim will be paid. § 507(a)(2). However, a creditor who receives administrative priority is not guaranteed payment of their claim, especially if the estate is "administratively insolvent." *In re Unitcast, Inc.*, 219 B.R. 741, 744 (B.A.P. 6th Cir. 1989). To the contrary, a creditor with an administrative expense claim remains a creditor who holds an unsecured claim.

Here, Touch of Grey only received the $200,000 transfer because the court assigned their claim administrative priority via § 503(b)(9), and allowed immediate payment. R.7. However, the immediacy of the payment does not negate Touch of Grey's entitlement to the payment, and should not qualify as an "otherwise unavoidable transfer" under § 547(c)(4)(B). Even if the premise that post-petition transfers fall under the ambit of § 547(c)(4)(B) is accepted by this court, a transfer to a trade supplier via § 503(b)(9) should not count against such a trade supplier's new value defense. If Touch of Grey had instead been paid under a Chapter 11 plan with its priority granted under § 503(b)(9), the payment would not have decreased its new value defense, and Respondent would not be asserting that Touch of Grey has "double-dipped." Such treatment tracks with other payments to unsecured creditors—non-priority payments under a plan or following a liquidation do not typically affect a new value defense. So, the question becomes: if post-petition transfers figure into a new value defense analysis, when does a post-petition payment to a creditor transform from an "otherwise avoidable transfer" into just a traditional payment on a claim? Instead of setting an arbitrary date for this transformation, this Court could instead follow the plain meaning of the statute, and prevent post-petition transfers from affecting a new value defense.

3. The policy behind § 547(c)(4) and § 503(b)(9) encouraging trade suppliers like Petitioner to continue dealings with distressed debtors is undermined by the lower court's decision.

The Bankruptcy Code recognizes the importance of creditors who continue to do business with an insolvent debtor. Across the Code, Congress attempts to strike a delicate balance between the need to give debtors a "fresh start" via discharge and the need to prevent debtors from racking up unsecured debt on the eve of bankruptcy, knowing a discharge is incoming. Trade suppliers like Petitioner are often key to a debtor's reorganization. If trade suppliers are not given protection in a bankruptcy, they are discouraged from continuing business with debtors who approach the brink of bankruptcy, more debtors will be pushed into bankruptcy who might have otherwise avoided filing.

The new value defense in § 547(c)(4) is proof of Congress' intent to protect such creditors. By allowing creditors to offset potential preference liability with pre-petition extensions of new value, the Code encourages such creditors to continue helping the debtor avoid filing bankruptcy by keeping the business afloat. Section 503(b)(9), enacted nearly thirty years after § 547 in the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA), furthers this purpose by protecting creditors who deliver goods to a debtor whose bankruptcy petition is imminent. Although legislative history on § 506(b)(9) is virtually non-existent, the House Judiciary Committee report includes the section under the heading "Reclamation," referencing the common law right to reclamation held by suppliers. H.R. Rep. No. 109-31, at 146 (2005). By referring to a right typically held by suppliers, one could theorize that the intended benefactor of § 503(b)(9) was to be these suppliers.

However, if the Circuit Court's interpretation of a payment pursuant to § 503(b)(9) is affirmed by this Court, Congress' protection of trade suppliers is hindered. Instead of receiving the benefit of priority in exchange for their willingness to deal with a distressed debtor, the supplier instead is punished by receiving a reduction in a new value defense. This is contrary to an overarching policy of the Bankruptcy Code that encourages creditors to continue dealing with a debtor all the way up until a bankruptcy petition is filed, in order to maximize the likelihood of a successful reorganization or better yet, the likelihood a debtor avoids bankruptcy altogether. Should this Court affirm, trade suppliers may instead choose to cut ties with failing debtors, hastening the slide into bankruptcy and further burdening the bankruptcy system with debtors who otherwise might have escaped the process.

4. Section 365(d)(3) requires the trustee to pay May's rent in its entirety because it became due prior to the rejection of the Lease.

Section 365(a) vests the Trustee with the power to assume or reject any unexpired leases, subject to the court's approval. 11 U.S.C § 365(a). Notably, section 365(d)(3) applies to nonresidential real property leases, as is the case here. But the decision to assume or reject a lease can be complicated, and as such takes time. This creates the awkward "twilight zone" period between the commencement of the bankruptcy case and the assumption or rejection of the lease. *See* Glenn R. Schmitt, *The Bankruptcy Code Requirement of Compliance with Lease Obligations - Does ""All"' Mean Everything?*, 10 N. Ill. U. L. Rev. 225, 234 (1990).

Section 365(d)(3) provides that the trustee must "timely perform all the obligations of the debtor . . . arising from [,] and after the order for relief [,] under any unexpired lease of nonresidential real property. . ." § 365(d)(3). [2] Courts have generally agreed about what § 365(d)(3) requires the trustee to do, but have diverged into two distinct approaches as to when the trustee must perform. R. at 16.

The "proration" approach has been adopted by a slight majority of courts. Under this approach, the obligations are only required to be performed until the assumption or rejection. The practical significance of this approach, in the context of rental obligations, is to prorate the monthly rent to only cover the period up until the rejection. *In re Ames Dep't Stores, Inc.*, 306 B.R. 43, 65 (Bankr. S.D.N.Y. 2004). In contrast, a slight minority of courts have adopted the

[2] As a threshold matter, it is important to note what "from" modifies— "order of relief" or "lease." As the Third Circuit explained, "from" is best understood to modify "lease" rather than "order for relief." *In re Montgomery Ward Holding Corp.*, 268 F.3d 205, 208 (3d Cir. 2001). Requiring the trustee to perform all obligations "arising from. . . the order of relief" would not only make little sense but also would be inconsistent with the legislative history. *Id.* The inserted commas represent this clarification.

"billing date" approach which requires the trustee to pay the rental obligations as they become due under the lease, despite the fact that the rental period may extend past the date of rejection.

Based on principles of statutory construction, the "billing date" approach is the proper interpretation of § 365(d)(3). Despite the position taken by the lower courts, the language of the statute is unambiguous and plainly directs the trustee to perform obligations as they become due under the lease. Accordingly, it is not necessary to look to legislative history or policy concerns. But, if this Court were to find the language ambiguous, a look at the legislative history and policy provides additional support for the adoption of the "billing date" approach.

i. The plain language of § 365(d)(3) directs the trustee to pay May's rent in full.

The proper starting point in discerning the meaning of § 365(d)(3) is the language of the statute. *Ron Pair Enterprises, Inc.*, 489 U.S. at 241. If the statutory language is plain, that is "where the inquiry should end" and the court should enforce the statute according to such terms. *Id.* The plain language of § 365(d)(3) expressly requires the trustee to perform "all the obligations of the debtor . . . arising from and after" the petition date under an unexpired lease until the date the lease either is assumed or rejected.

Proper interpretation of § 365(d)(3) turns on two key, yet undefined, terms— "obligations" and "arising." Ordinarily, an obligation is "[t]hat which a person is bound to do" or "any duty imposed by law, promise, [or] contract." *Obligation, Black's Law Dictionary* (5th ed. 1979). To "arise" ordinarily means "to come into existence." To "arise" ordinarily means "to come into existence." *Arise, Compact Edition of the Oxford English Dictionary* (1st ed. 1971); *see also Arise, Webster's Ninth New Collegiate Dictionary* (9th ed. 1983) (defining "arise" as "to come into being"). Taken together, then, § 365(d)(3) plainly—and unambiguously—requires the trustee to perform all duties, if such duties come into existence during the period after the petition is filed and before the lease is assumed or rejected, as required under the lease.

In *Montgomery Ward*, the Third Circuit noted, "[i]n the context of a lease contract, . . . the most straightforward understanding of an obligation is something that one is legally required to perform under the terms of the lease." *In re Montgomery Ward Holding Corp.*, 268 F.3d at 209. The court further explained that "such an obligation arises when one becomes legally required to perform." *Id.*

However, other courts have reached a different conclusion by disputing the proper understanding of "arising" as used in § 365(d)(3). In *Ames Dep't Stores*, the court noted that "arising" as used in § 365(d)(3) has two possible interpretations. *In re Ames Dep't Stores, Inc.*, 306 B.R. at 67. First, it may be understood in "absolutist terms," which as mentioned above would render a rental payment obligation to arise when such payment becomes due under the terms of the lease. *Id.* Second, consistent with the proration approach, arising may also be interpreted in an accrual sense such that the obligations arise anew each day of occupancy. *Id.*

On its face, the accrual understanding of arising seems to be a plausible approach. But "[t]he definition of words in isolation, however, is not necessarily controlling in statutory construction." *Dolan v. U.S. Postal Serv.*, 546 U.S. 481, 486 (2006). Statutory language must be construed "in light of the terms surrounding it." *FCC v. AT&T Inc.*, 562 U.S. 397, 405 (2011). As such, in construing the term "arising" as used in § 365(d)(3), it is necessary to look to the surrounding words. The statute specifically refers to "obligations arising. . . under any unexpired lease," which sets the terms of the lease as the measuring stick for when an obligation arises.

Further, such an interpretation runs counter to the traditional rules of statutory interpretation. If Congress intended for "arise" to mean "accrue," they could have, and likely would have, chosen to use that word instead. After all, as the Supreme Court has explained, "courts must presume that a legislature says in a statute what it means and means in a statute what it says there." *Conn. Nat'l Bank v. Germain*, 503 U.S. 249, 253–54 (1992). It is inappropriate to substitute one term for another, especially when doing so creates unwarranted ambiguity.

This Court should abide by the plain language of § 365(d)(3) and require the payment of May's rent in full because the rental payment obligation became due after the petition and prior to Terrapin rejecting the lease.

ii. The statutory context of § 365(d)(3) removes any ambiguity.

Even if this Court finds the plain language to be ambiguous, a closer examination of § 365(d)(3) removes such ambiguity. Indeed, a statute that could seem "ambiguous in isolation is often clarified by the remainder of the statutory scheme . . . because only one of the permissible meanings produces a substantive effect that is compatible with the rest of the law." *United Sav. Ass'n of Tex. v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 371 (1988).

Section 365(d)(3) expressly requires the trustee to perform all obligations under the lease "notwithstanding section 503(b)(1)." Section 503(b)(1) limits, after notice and hearing, the amount of an allowed administrative expense claim to the "actual, necessary costs and expenses of preserving the estate." Thus, a trustee is required to make rental payments under an unexpired lease "irrespective of whether payments required under the lease meet the usual requirements for. . . reasonableness and benefit to the estate, they are unconditionally due." *In re Wingspread Corp.*, 116 B.R. 915, 925 (Bankr. S.D.N.Y. 1990). But applying the proration approach does exactly what Congress expressly counseled against—assess the payments based on the actual use and benefit standard. *See* Joshua Fruchter, *To Bind or Not to Bind - Bankruptcy Code § 365(d)(3): Statutory Minefield*, 68 Am. Bankr. L.J. 437, 455 (1994).

The Thirteenth Circuit attempts to reconcile this inconsistency by limiting the exemption from § 503(b)(1) to the period that the trustee occupied the premises. R. at 19. But this limitation is unpersuasive. The clause "notwithstanding section 503(b)(1)" removes the actual and necessary requirements from any payment made under § 365(d)(3) and is not limited to only payments made during the actual occupancy.

Therefore, considering the express language removing the requirements of § 503(b)(1), the term "arising" cannot be construed as "accruing." As such, this Court should require the payment of May's rent in full, in accordance with the terms of the lease.

iii. The legislative history of § 365(d)(3) does not support the proration approach.

The language of § 365(d)(3) is unambiguous and thus it is unnecessary to consult the legislative history. *In re Koenig Sporting Goods, Inc.*, 203 F.3d 986, 988 (6th Cir. 2000) ("When a statute is unambiguous, resort to legislative history and policy considerations is improper.") But even if the statute is ambiguous, the scant legislative history[3] better aligns with the billing date approach.

Section 365(d)(3) was enacted in 1984 as a part of the Bankruptcy Amendments and Federal Judgeship Act of 1984. *In re Montgomery Ward Holding Corp.,* 268 F.3d at 210. Floor statements by Senator Orin Hatch explained the enactment of § 365(d)(3) as follows:

> 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 [or debtor-in-possession] 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. In addition, the other tenants often must increase their common area charge payments to compensate for the trustee's failure to make the required payments for the debtor.
>
> This bill would lessen these problems *by requiring the trustee to perform all the obligations of the debtor under a lease of nonresidential real property at the time required in the lease.* This timely performance requirement will insure that debtor-

[3] There was "no Senate report or House report submitted with the legislation, nor did the House conference report contain a joint explanatory statement." *In re Child World, Inc.*, 161 B.R. 571, 575 n.6 (S.D.N.Y. 1993). The Congressional Record contains statements of legislators with Senator Hatch being the only legislator to address § 365(d)(3). *Id.*

> tenants pay their rent, common area, and other charges on time pending the trustee's assumption or rejection of the lease.

H.R. Rep. No. 882, 95th Cong., 2d Sess., *reprinted in* 1984 U.S.C.C.A.N. 576 (emphasis added).

These statements by Senator Hatch indicate that Congress intended for payments under a nonresidential real property lease to be paid as they become due under the terms of the lease.

The lower courts' reliance on the "current payment" for "current services" language is misplaced. This statement was made in describing one of the problems meant to be addressed by § 365(d)(3). In contrast, the statement made regarding the obligations being paid "at the time required in the lease" describes how § 365(d)(3) is intended to operate to lessen the problems described above. So, the later statement about when the obligations must be performed by the trustee is more determinative of Congressional intent than the statement merely describing a hypothetical problem.

5. The policy behind § 365(d)(3) favors the payment of May's rent in full.

The plain meaning of the statute controls and should be conclusive, except in the "'rare cases [in which] the literal application of a statute will produce a result demonstrably at odds with the intentions of its drafters.'" *Ron Pair Enterprises, Inc.*, 489 U.S. at 242. (quoting *Griffin v. Oceanic Contractors, Inc.*, 458 U.S. 564, 571 (1982)). But this is not one of the "rare cases" that require a deviation from the plain language. Indeed, the plain language interpretation is consistent with the underlying policies of § 365(d)(3) and the Bankruptcy Code as a whole.

i. The favorable treatment of landlords is consistent with the policies underlying § 365(d)(3) and the Bankruptcy Code.

A fundamental tenant of bankruptcy law is equal treatment of creditors of the same or similar classes. Based on this, the proration approach proponents argue that application of the billing date approach impermissibly favors the landlord over other creditors. But this argument suffers a fatal flaw—it assumes that landlords are equal to other general unsecured creditors. This cannot be the case.

Landlords are best described as "involuntary creditors." Other creditors providing services post-petition can withhold future services. Landlords, in contrast, do not have this option. They are "forced to deal with bankrupt tenants on whatever terms the bankruptcy court imposes" because automatic stay prevents the landlord from evicting the debtor-tenant. *Robinson v. Chicago Hous. Auth.*, 54 F.3d 316, 317-18 (7th Cir. 1995). Indeed, the legislative history of § 365(d)(3) reveals a greater concern by Congress "for easing the burden on landlords than for protecting assets for the benefit of all creditors." *In re ABC Books & Sch. Supplies*, 121 B.R. 329, 332 (Bankr. S.D. Oh. 1990). Thus, the favorable treatment of landlords is not only consistent with the policies underlying § 365(d)(3) but is required.

ii. Rental obligations are fundamentally different than tax obligations.

The obligation to make monthly rental payments is inherently different than the obligations to pay taxes. As the Seventh Circuit acknowledged in distinguishing the case from a prior decision of the court, "[p]ostpetition rent covering a period of time that extends into the postrejection period is 'not a sunk cost that relates to a time before the bankruptcy case, but a charge for the consumption of a resource during the administration of the case . . . and costs of administration must be paid.'" *HA-LO Indus., Inc. v. CenterPoint Properties Tr.*, 342 F.3d 794, 799 (7th Cir. 2003) (quoting *In re Comdisco, Inc.*, 272 B.R. 671, 674–75 (Bankr. N.D. Ill. 2002). Thus, the lower court's reliance on precedent interpreting § 365(d)(3) is misplaced.

CONCLUSION

For the reasons stated, this Court should reverse the decision of the Thirteenth Circuit on both issues.

The plain language of § 547(c)(4) and the surrounding context of the statute indicate that any evaluation of preferences should temporally end its analysis on the date of the petition, and post-petition activities by the debtor-in-possession should not figure in to an examination of a § 547(c)(4) new value defense. Additionally, the transfer from the Debtor to Touch of Grey was not an "otherwise avoidable transfer" as contemplated by § 547(c)(4)(B) but is instead a typical bankruptcy outcome that does not reduce a new value defense. Furthermore, if the benefits given to trade suppliers in § 503(b)(9) could be used to reduce a new value defense, trade suppliers would be discouraged from doing business with struggling debtors, pushing more debtors into the bankruptcy system who might otherwise might have avoided it.

In its plain language, § 365(d)(3) directs the trustee to perform all obligations that become due under a nonresidential real property lease as they become due, consistent with the "billing date" approach. The rental payment under the Lease with Touch of Grey came due prior to the first of the month, which was post-petition and pre-rejection, so the trustee must pay May's rent in full. The court below erred in taking the proration approach, and unnecessarily relied on legislative history and policy. But even if this Court were to instead rely on legislative history and policy, the billing date approach is still more appropriate. The limited legislative history more clearly reveals a clear legislative intent to apply the billing date approach. Furthermore, the underlying policies of § 365(d)(3) and the Bankruptcy Code are more consistent with the billing date approach.