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

BRIEF FOR RESPONDENT

Team 16
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 after 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 nonresidential real property lease but allocable to the period after the effective date of rejection.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

CASES

STATUTES

OTHER AUTHORITIES

OPINIONS BELOW

The decision of the United States Court of Appeals for the Thirteenth Circuit is available at Case No. 20-0803. The United States Bankruptcy Court for the District of Moot ruled in favor of Trustee on both issues, and the United States District Court for the District of Moot affirmed. On appeal, the Thirteenth Circuit likewise affirmed the bankruptcy court on both issues and in favor of Trustee.

STATEMENT OF JURISDICTION

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

STATUTORY PROVISIONS

This case implicates statutory construction of certain provisions of Title 11 of the United States Code. The following provisions are additionally reproduced in Appendix A.

In relevant part, 11 U.S.C. § 547(c)(4) states:

> **(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.

In relevant part, 11 U.S.C. § 503(b)(9) states:

> **(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.

In relevant part, 11 U.S.C. § 365(d)(3) states:

> **(d)(3)(A)** The trustee shall timely perform all the obligations of the debtor, except those specified in section 365(b)(2), arising from and after the order for relief under any unexpired lease of nonresidential real property, until such lease is assumed or rejected, notwithstanding section 503(b)(1) of this title. The court

may extend, for cause, the time for performance of any such obligation that arises within 60 days after the date of the order for relief, but the time for performance shall not be extended beyond such 60-day period, except as provided in subparagraph (B). This subsection shall not be deemed to affect the trustee's obligations under the provisions of subsection (b) or (f) of this section. Acceptance of any such performance does not constitute waiver or relinquishment of the lessor's rights under such lease or under this title.

STATEMENT OF FACTS

I. Factual History

A. Debtor opens coffeehouse as Touch of Grey's tenant and franchisee, and experiences difficulties from the start.

Terrapin Station, LLC (the "Debtor") was founded in 2005 by sole member William Tell ("Tell"), and operated a popular, successful, and award-winning independent coffeehouse in Terrapin, Moot, for over a decade. Record 3. Touch of Grey Roasters, Inc. ("Touch of Grey") is an international coffee company and coffeehouse chain. Record 3.

In the fall of 2017, Touch of Grey approached Tell to inquire into Debtor's interest in franchising a neighborhood coffeehouse, and the parties agreed to proceed. Record 4. To facilitate the opening of the new coffeehouse, Touch of Grey agreed to purchase and lease to Debtor the space located at 5877 Shakedown Street (the "Premises") in the downtown entertainment district of Terrapin. Record 4. On July 1, 2018, Touch of Grey, as landlord, and Debtor, as tenant, entered into a lease agreement (the "Lease") for the Premises. Record 4. The Lease was a twenty-year triple-net lease requiring Debtor to pay monthly rent of $25,000, which was "due in advance on the first day of each month." Record 4. On that same day, Touch of Grey, as franchisor, and Debtor, as franchisee, also entered into a franchise agreement whereby Debtor committed to exclusively sell "Dark Star" -branded products purchased from Touch of Grey. Record 4.

Debtor opened the new coffeehouse on December 1, 2018, and experienced difficulties from the start, including fierce opposition from locals to Debtor's association with Touch of Grey. Record 5. Debtor struggled throughout 2019 with lower than expected sales and above-market rent under the Lease, and became insolvent as early as September 2019. Record 5. Although Debtor remained current on rent obligations under the Lease, by November 1, 2019, Debtor owed Touch of Grey over $700,000 for Dark Star-branded goods purchased on credit. Record 5. Consequently,

on December 5, 2019, Touch of Grey sent Debtor a notice of default threatening to terminate the franchise agreement. Record 5. Touch of Grey and Debtor thereafter entered into a forbearance agreement on December 7, 2019. Record 5. Under the agreement, Touch of Grey agreed to forbear terminating the franchise agreement in exchange for Debtor's payment of $250,000 for outstanding invoices for Dark Star products; reaffirmation of Debtor's obligations under the Lease; and release of any and all claims or causes of action that Debtor had against Touch Grey. Record 5. On that same day, Debtor made the $250,000 payment to Touch of Grey. Record 5.

On December 18, 2019, and as set forth on an invoice of the same date (the "Invoice"), Debtor purchased an additional $200,000 of Dark Star products from Touch of Grey on credit. Record 5. The goods identified on the Invoice were subsequently delivered to Debtor on December 21, 2019. Record 6.

B. After continuous struggling, Debtor files for Chapter 11 bankruptcy and attempts to reorganize.

Debtor filed a chapter 11 petition for relief in the United States Bankruptcy Court for the District of Moot on January 5, 2020 (the "Petition Date"). Record 6. On the Petition Date, Debtor was current on its Lease obligations but owed Touch of Grey $650,000, including the amount due under the Invoice, for goods purchased on credit. Record 6. Debtor had no secured debt but owed over $500,000 to unsecured creditors other than Touch of Grey. Record 6. In a supporting declaration filed on the Petition Date, Tell expressed his intent to reorganize Debtor, find a sub-lessee for a portion of the Premises to reduce Debtor's rent burden, and further, proposed to continue selling Dark Star-branded products, as required under the franchise agreement. Record 6. Counsel for Touch of Grey appeared at the first day hearings and stated that Touch of Grey had concerns with Debtor's reorganization strategy but was nonetheless engaged in ongoing, good faith discussions with Debtor about the future. Record 6.

Two weeks after the Petition Date, Debtor filed a motion requesting authority to pay $200,000 to Touch of Grey for the Invoice value. Record 6. All parties stipulated the requirements for a section 503(b)(9) administrative expense were met, and the bankruptcy court subsequently awarded Touch of Grey an administrative expense for the Invoice value. Record 7 & n.2. Pursuant to the bankruptcy court's authorization, Debtor shortly thereafter made a $200,000 distribution to Touch of Grey for the Invoice, and Touch of Grey resumed selling goods to Debtor on credit. Record 7.

C. Debtor ceases operations, vacates the Premises, and converts case to Chapter 7 with Trustee appointed.

After temporarily closing due to the COVID-19 pandemic and reopening to no customers, Debtor ceased operations on May 5, 2020, vacated the Premises, and returned the keys to Touch of Grey. Record 7. The next day, Debtor filed a motion to reject the Lease and franchise agreement pursuant to section 365(a). Record 7. On May 8, 2020, Touch of Grey filed a motion to compel full payment of May 2020 rent, which became due under the Lease on May 1, 2020. Record 7–8.

At the onset of the hearing for both motions held on May 29, 2020, Debtor announced it was converting its chapter 11 bankruptcy proceeding to chapter 7, pursuant to section 1112(a). Record 8. The bankruptcy court thereafter entered an order converting the case to chapter 7, and appointed Casey Jones (the "Trustee") as chapter 7 trustee for Debtor's estate (the "Estate"). Record 2, 8. The bankruptcy court also granted Debtor's motion to reject the Lease and franchise agreement effective as of May 5, 2020, but requested additional briefing on Touch of Grey's motion to compel. Record 8.

After the hearing, Trustee objected to Touch of Grey's motion to compel, arguing that requiring full payment for May 2020 rent would be inequitable to Debtor's other creditors since Debtor only occupied the Premises for the first five days of May. Record 8. Pursuant to sections

547(b) and 550(a), Trustee further commenced a preference action against Touch of Grey seeking to avoid and recover the $250,000 payment made by Debtor to Touch of Grey under the forbearance agreement for preexisting debts. Record 5, 8. In its answer to the preference action, Touch of Grey asserted an affirmative defense under section 547(c)(4) (the "new value defense") claiming it was entitled to reduce its preference exposure by the Invoice value, despite receiving full payment for the Invoice as a section 503(b)(9) administrative expense. Record 7–8. The parties stipulated that Trustee could establish the elements of a section 547(b) preference, and that none of the section 547(c) defenses to a preference, other than section 547(c)(4), were applicable. Record 9 n.3.

II. Procedural History

The bankruptcy court ruled in favor of Trustee on both issues and the district court affirmed. Record 9. On appeal, a three-judge panel from the Thirteenth Circuit Court of Appeals likewise affirmed in favor of Trustee, holding that: (1) section 547(c)(4) precludes a defendant in a preference action from asserting new value for goods subject to a satisfied section 503(b)(9) administrative expense; and (2) section 365(d)(3) does not require a trustee to satisfy unexpired nonresidential lease obligations allocable to the post-rejection period. Record 9.

STANDARD OF REVIEW

The questions presented involve statutory interpretation of the Bankruptcy Code,[1] and as such, are questions of law that this Court reviews de novo. *See Pollitzer v. Gebhardt*, 860 F.3d 1334, 1338 (11th Cir. 2017).

[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 __."

SUMMARY OF THE ARGUMENT

Under 11 U.S.C. § 547(c)(4), an "otherwise unavoidable transfer," which cannot be used to reduce a creditor's preference exposure, is not limited to pre-petition transfers and may include distributions made in full satisfaction of 11 U.S.C. § 503(b)(9) administrative expense claims. Further, 11 U.S.C. § 365(d)(3) does not require a trustee to satisfy unexpired nonresidential lease obligations that are allocable to the period after rejection of the lease. Accordingly, the Thirteenth Circuit Court of Appeals correctly interpreted sections 547(c)(4) and 365(d)(3), and its decision in favor of Trustee should be affirmed.

In regard to the first issue, creditors cannot reduce their preference exposure under section 547(c)(4) according to new value that has previously been paid in full as a section 503(b)(9) administrative expense. First, the unambiguous statutory language of section 547(c)(4) and its statutory context strongly support that what constitutes an otherwise unavoidable transfer is not limited to pre-petition transfers. Second, Trustee's interpretation best promotes the Code's overarching policy of facilitating equality of distribution among similarly situated creditors, as well as balances the dual-purposes of sections 547 and 503(b)(9).

Nothing in the unambiguous plain language of section 547(c)(4) limits otherwise unavoidable transfers that are excluded from assertion as new value to pre-petition transfers. Rather, under the unambiguous plain language of section 547(c)(4), a court-authorized distribution made in full satisfaction of a section 503(b)(9) claim is precisely such an otherwise unavoidable transfer. The statutory context also affirms that it is inappropriate to read a pre-petition temporal limitation into section 547(c)(4), insofar as Congress did not intend for the statute to have such a restriction. Congress's explicit provision of a temporal limitation in the comparable affirmative defense to preference actions provided in section 547(c)(5) exemplifies that Congress did not intend for otherwise unavoidable transfers under section 547(c)(4) to be limited to pre-petition

transfers. Rather, the presence of an explicit temporal limitation in section 547(c)(5) reinforces that Congress would have explicitly limited otherwise unavoidable transfers under section 547(c)(4) to pre-petition transfers if it so desired to impose such a restriction.

Trustee's interpretation of section 547(c)(4) also best promotes the Code's policy of equality of distribution among similarly situated creditors. Touch of Grey's interpretation would allow certain unsecured creditors to receive compensation beyond the benefit they provided to the estate, and as such, reduce the amount ultimately available to repay other unsecured creditors. By contrast, Trustee's interpretation ensures unsecured creditors only receive compensation proportionate to the benefit they provide to the estate during the relevant preference period, and anything beyond that may be made available to repay all the unsecured creditors pro rata.

Further, Trustee's interpretation balances the dual-purposes of sections 547 and 503(b)(9). Even if creditors have to choose between using the same new value to receive an administrative expensive or to reduce their preference exposure, they are nonetheless encouraged to continue doing business with financially troubled debtors by being fully compensated for the new value provided. Requiring creditors to choose between the two also discourages creditors from racing to the courthouse with claims against the debtor because it minimizes the threat of disparate treatment based on whether or not some unsecured creditors' claims happen to fall within the section 503(b)(9) window.

In regard to the second issue, section 365(d)(3) does not require a trustee to satisfy unexpired nonresidential lease obligations that are allocable to the period after rejection of the lease. First, although the statutory language of section 365(d)(3) is ambiguous, it is nonetheless consistent with prorating lease obligations according to the rejection date, and consideration of section 365(d)(3) in the context of its relation to sections 365(g) and 502(g) supports that a trustee

is not required to satisfy lease obligations allocable to the post-rejection period. Second, it was common practice prior to the enactment of section 365(d)(3) to prorate lease obligations according to the rejection date, and nothing in the legislative history suggests that Congress intended for section 365(d)(3) to abrogate this prior practice. Third, it is most consistent with the Code's policies and purposes to interpret section 365(d)(3) as requiring proration of lease obligations according to the rejection date.

In section 365(d)(3), the statutory terms "obligations" and "arises," as well as the statutory phrase "until such lease is assumed or rejected," create ambiguity as to when a trustee's obligations arise and their extent. Despite this ambiguity, it is consistent with the common meaning of the statutory language to interpret section 365(d)(3) as prorating a trustee's obligations under an unexpired nonresidential lease to not extend beyond the rejection date. Furthermore, consideration of section 365(d)(3) in relation to sections 365(g) and 502(g) evidences that it is necessary to interpret section 365(d)(3) as prorating lease obligations, in order to give all three statutes full effect.

Given the ambiguity of the statute, it is appropriate to consider prior practice and the legislative history of section 365(d)(3). The prior practice of prorating lease obligations and limited legislative history of section 365(d)(3), which says nothing about abrogating said prior practice, both reinforce that Trustee's interpretation of the statute is correct. Section 365(d)(3) was enacted to ensure current payment by tenants for current services provided by landlords, during the post-petition, pre-assumption or -rejection period. The legislative history makes no mention of congressional intent to abrogate the prior practice of prorating lease obligations according to the rejection date because the prior practice is consistent with ensuring current payment for current services, and Congress therefore did not intend to abrogate it.

Further, whereas Touch of Grey's interpretation of section 365(d)(3) can lend to uncertain and inequitable results, Trustee's interpretation is entirely consistent with the policies and purposes of the Code. Interpreting section 365(d)(3) as prorating lease obligations according to the date of rejection best facilitates the prime Code policy of equality of distribution among similarly situated creditors and balances it against the Code's purpose of granting creditors preferential treatment in order to maximize debtors' hopes of reorganization. Whereas Touch of Grey's interpretation offers landlords a windfall at the expense of the debtor's estate and other unsecured creditors, prorating lease obligations consistently limits landlords' ability to claim an administrative expense to services actually provided during the post-petition, pre-rejection period.

Finally, Trustee's interpretation of section 365(d)(3) also best promotes fairness to landlords and protects them from potential prejudice in certain scenarios where Touch of Grey's interpretation would cause them harm. Under Touch of Grey's interpretation, landlords would receive no administrative expense claim when the lease requires payment in advance of the petition filing date for post-petition services, or requires payment during the post-rejection period for post-petition, pre-rejection services. By contrast, Trustee's interpretation ensures landlords consistently receive an administrative expense claim on a prorated basis, according to services rendered during the post-petition, pre-rejection period.

In conclusion, the Thirteenth Circuit Court of Appeals correctly interpreted sections 547(c)(4) and 365(d)(3), and this Court should affirm its decision in favor of Trustee.

ARGUMENT

This Court should affirm the decision of the Thirteenth Circuit Court of Appeals interpreting 11 U.S.C. § 547(c)(4) as prohibiting a creditor from asserting new value to reduce its preference exposure when the creditor has already been fully compensated for the same value pursuant to 11 U.S.C. § 503(b)(9). This Court should further affirm the Thirteenth Circuit's decision interpreting 11 U.S.C. § 365(d)(3) as prorating unexpired nonresidential lease obligations to not extend beyond the effective date of rejection of the lease.

I. Section 547(c)(4) does not limit what constitutes an "otherwise unavoidable transfer" to pre-petition transfers.

One of the prime policies of the Code is equality of distribution among similarly situated creditors. *Union Bank v. Wolas*, 502 U.S. 151, 161 (1991). In furtherance of such policy, section 547(b) authorizes a trustee to claw back certain preferential transfers made by a debtor to its creditors during the ninety days prior to the debtor's filing for bankruptcy. 11 U.S.C. § 547(b). Nevertheless, through the different means provided in sections 547(c)(4) and 503(b)(9), the Code also recognizes the need to balance equal treatment with compensating creditors to the extent they continue doing business with and replenish financially troubled debtors during the period prior to the debtor filing for bankruptcy. *See* 11 U.S.C. §§ 503(b)(9), 547(c)(4).

Section 547(c)(4) provides creditors an affirmative defense against preference actions by permitting creditors to reduce their preference liability according to the new value they provided to the debtor's benefit during the preference period. 11 U.S.C. § 547(c)(4). However, there are exceptions to what a creditor may claim as new value, the relevant one in this case being a prohibition against creditors using value for which the debtor has made an "otherwise unavoidable transfer to or for the benefit of such creditors," to reduce their preference exposure. 11 U.S.C. § 547(c)(4)(B). On the other hand, section 503(b)(9) was added to the Code after section

547(c)(4), and authorizes payment of administrative expenses to creditors for 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. § 503(b)(9). Section 503(b)(9) was enacted to shield trade creditors from being burned in bankruptcy by debtors who purchase goods when they may know bankruptcy is imminent and that payment for such goods will therefore not have to be tendered. *See GFI Wisconsin, Inc. v. Reedsburg Util. Comm'n*, 440 B.R. 791, 797 (W.D. Wis. 2010). Because section 503(b)(9) claims involve value received by the debtor within the twenty days prior to filing for bankruptcy and are subject to notice and hearing before the bankruptcy court, payments for such administrative expenses are necessarily made post-petition. *See* 11 U.S.C. § 503(b)(9).

Despite its unambiguous statutory language, context, and the Code's policies and purposes, courts are split on whether section 547(c)(4) should be interpreted as limiting what constitutes an "otherwise unavoidable transfer" to those made pre-petition, and as thereby allowing creditors to be doubly compensated for the same value under sections 547(c)(4) and 503(b)(9). The majority of courts having considered the issue have found that section 547(c)(4) does not contain a pre-petition temporal limitation, and therefore, full payment of a section 503(b)(9) administrative expense may constitute an otherwise unavoidable transfer. *See e.g., PMCM 2, LLC v. Fabric Sources, Inc. (In re Beaulieu Grp., LLC)*, 616 B.R. 857, 878 (Bankr. N.D. Ga. 2020), *appeal docketed sub nom Auriga Polymers Inc. v. PMCM2, LLC*, No. 20-14647 (11th Cir. Dec. 11, 2020). By contrast, Touch of Grey relies on the minority approach and argues that section 547(c)(4) only contemplates transfers made pre-petition, and therefore, post-petition satisfaction of a section 503(b)(9) administrative expense cannot constitute an otherwise unavoidable transfer. Record 12;

see e.g., *Friedman's Liquidating Tr. V. Roth Staffing Cos. LP (In re Friedman's Inc.)*, 738 F.3d 547, 554–55 (3d Cir. 2013).

Section 547(c)(4) is not limited to pre-petition transfers because first, the plain meaning of section 547(c)(4) is unambiguous and imposes no temporal limitation requiring that an otherwise unavoidable transfer be made pre-petition in order to preclude creditors from claiming the underlying value as new value to reduce their preference exposure. Second, it is consistent with the Code's policies and purposes to interpret section 547(c)(4) as prohibiting creditors from being doubly compensated by asserting new value for goods for which they have already been paid in full under section 503(b)(9). Accordingly, the Thirteenth Circuit's interpretation of section 547(c)(4) and its decision should be affirmed.

A. The plain meaning of section 547(c)(4) unambiguously establishes that what constitutes an "otherwise unavoidable transfer" is not limited to pre-petition transfers.

Nothing in the unambiguous plain language of section 547(c)(4) limits what constitutes an "otherwise unavoidable transfer" to those made pre-petition, and the statutory context affirms that it is inappropriate to read such a temporal limitation into the statute.

As this Court has "stated time and again . . . 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). Where a statute's language is plain and a non-absurd meaning is in view, as it is in section 547(c)(4), it is to be enforced according to its terms. *See Lamie v. U.S. Tr.*, 540 U.S. 526, 534 (2004). However, a statute cannot be read in isolation. *King v. St. Vincent's Hosp.*, 502 U.S. 215, 221 (1991). Rather, statutes must "be read as a whole, . . . since the meaning of statutory language, plain or not, depends on context." *Id.* And interpreting section 547(c)(4) according to its statutory context affirms that Congress did not include a temporal limitation in the statutory language, because it did not intend for section 547(c)(4) to have one. *See Whitman v. Am.*

Trucking Ass'ns, Inc., 531 U.S. 457, 468 (2001) ("Congress . . . does not, one might say, hide elephants in mouseholes."); *see also Russello v. U.S.*, 464 U.S. 16, 23 (1983) ("[W]here Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion.").

1. Nothing in the unambiguous plain language of section 547(c)(4) limits an "otherwise unavoidable transfer" to pre-petition transfers.

The plain language of section 547(c)(4) unambiguously contains no temporal limitation restricting what constitutes an otherwise unavoidable transfer to transfers made pre-petition.

Although section 547(c)(4) may seem a complicated statute given the use of double negatives, it is nonetheless unambiguous. *Boyd v. The Water Doctor (In re Check Reporting Servs., Inc.)*, 140 B.R. 425, 434 (Bankr. W.D. Mich. 1992). The statute, in relevant part, 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.

11 U.S.C. § 547(c)(4). Because Touch of Grey's claim is unsecured, the only limitation provided by the plain statutory language of section 547(c)(4) relevant in the present case is that "an otherwise unavoidable transfer" cannot have been made on account of the asserted new value. 11 U.S.C. § 547(c)(4)(B). A distribution made pursuant to section 503(b)(9) is precisely such an otherwise unavoidable transfer. Therefore, the value on account of which such an otherwise unavoidable transfer was made is precluded from subsequent assertion as new value under section 547(c)(4).

The term "new value" is defined in section 547(a), and the parties have stipulated that new value does not need to remain unpaid in order to establish a new value defense. Record 10 n.5. "Transfer" is broadly defined in section 101(54)(D) as "each mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with . . . property" or "an interest in property," and may therefore include a distribution made pursuant to section 503(b)(9). 11 U.S.C. § 101(54)(D). In accordance with its plain meaning, the term "otherwise" in the phrase "otherwise unavoidable transfer," means a transfer unavoidable for reasons other than section 547(c)(4). *Phoenix Rest. Grp., Inc. v. Ajilon Prof'l Staffing LLC (In re Phoenix Rest. Grp., Inc.)*, 317 B.R. 491, 499 (Bankr. M.D. Tenn. 2004). And pursuant to section 549(a), a post-petition distribution made in satisfaction of a section 503(b)(9) administrative expense constitutes an otherwise unavoidable transfer if it is authorized by the Code or bankruptcy court. 11 U.S.C. § 549(a). Therefore, the court-authorized distribution made to Touch of Grey pursuant to section 503(b)(9) and in full satisfaction of the Invoice constitutes an otherwise unavoidable transfer under section 547(c)(4). As such, the value underlying the satisfied Invoice may not also be used to reduce Touch of Grey's preference liability.

In support of their contrary interpretation, Touch of Grey mistakenly asserts that use of the term "debtor" in section 547(c)(4) signifies that a transfer must be made pre-petition in order to constitute an otherwise unavoidable transfer. Record 13. However, Touch of Grey's argument is without merit and does not even find unanimous support among those courts adopting the minority interpretation of section 547(c)(4). *See e.g., In re Friedman's Inc.*, 738 F.3d at 555. As the Third Circuit noted, the term "debtor" as defined in section 101(13), is not restricted to the pre- nor post-petition context, and "many other provisions in the Code refer to 'debtors' in the post-petition context." *Id.* at 555; *see e.g.*, 11 U.S.C. § 1101(1) (defining "debtor in possession" in chapter 11

cases as synonymous with debtor). Furthermore, in analyzing other provisions of the Code, this Court has declined to find use of the term "debtor" as restricted to the pre-petition context. *See NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 528 (1984).

Therefore, the only reasonable interpretation of the unambiguous plain language of section 547(c)(4) is that it lacks a temporal restriction requiring otherwise unavoidable transfers be made pre-petition. Accordingly, a distribution made in full satisfaction of a section 503(b)(9) administrative expense qualifies as an otherwise unavoidable transfer under section 547(c)(4), and the underlying value may not be claimed by a creditor, such as Touch of Grey, as new value.

2. The statutory context reinforces that what constitutes an "otherwise unavoidable transfer" under section 547(c)(4) is not limited to pre-petition transfers.

Consideration of the statutory context affirms that it would run contrary to congressional intent to interpret section 547(c)(4) as imposing a pre-petition temporal limitation on what constitutes an otherwise unavoidable transfer. Where Congress desires to impose temporal limitations upon sections of the Code, it has made such intention clear by explicitly providing temporal limitations in the statutory language. *See e.g.*, 11 U.S.C. §§ 502(d), 542(c), 547(c)(5), 550, 551. By contrast, the lack of an explicit temporal limitation in the statutory language of section 547(c)(4) supports that Congress did not intend to restrict what constitutes an otherwise unavoidable transfer under the statute to pre-petition transfers.

Comparing sections 547(c)(4) and (c)(5) is particularly illuminative of congressional intent that what constitutes an otherwise unavoidable transfer under section 547(c)(4) not be restricted to pre-petition transfers. Both sections 547(c)(4) and (c)(5) provide creditors affirmative defenses against preference actions and identify limitations to the defenses for what can be used to reduce preference liability. Whereas the statutory language of section 547(c)(4) does not impose a pre-petition temporal limit on otherwise unavoidable transfers that are excluded from the new value

defense, section 547(c)(5) explicitly limits preference analysis to certain transfers made "as of the date of the filing of the petition . . . ." *Compare* 11 U.S.C. § 547(c)(4), *with* 11 U.S.C. § 547(c)(5). This limitation in section 547(c)(5) exhibits that when Congress desires to impose a temporal limitation in the specific context of affirmative defenses to preference, it expressly provides for such in the statutory language. Accordingly, the lack of comparable language in section 547(c)(4) reinforces that the new value defense does not contain a temporal limitation restricting what constitutes an otherwise unavoidable transfer to pre-petition transfers.

In support of its flawed interpretation, Touch of Grey urges this Court to interpret use of the term "transfer" in section 547(c)(4) as limiting otherwise unavoidable transfers to those made pre-petition, based on the term's usage in section 547(b). Record 14. Although preference analysis under section 547(b) is indeed limited to transfers made "within 90 days before the date of the filing of the date of petition," it is inappropriate to assume this limit translates to section 547(c)(4). *See* 11 U.S.C. § 547(b). Rather, this Court has recognized that section 547(c) provides exceptions to the general rules of section 547(b), and therefore, the sections may properly be subject to different temporal limits. *Barnhill v. Johnson*, 503 U.S. 393, 402 (1992). Consequently, consideration of the language of 547(c)(4) according to its statutory context demonstrates that Congress did not intend to impose a pre-petition temporal limitation on the statute. It would run contrary to principles of statutory interpretation as well as this Court's own prior decisions to interpret section 547(c)(4) as providing otherwise.

For these reasons, consideration of section 547(c)(4) according to its statutory context requires that it be interpreted as not limiting otherwise unavoidable transfers to pre-petition transfers. And as such, a distribution made in full satisfaction of a section 503(b)(9) administrative expense may constitute an otherwise unavoidable transfer under section 547(c)(4).

B. It is consistent with the Code's policies and purposes to interpret section 547(c)(4) as not limiting what constitutes an "otherwise unavoidable transfer" to pre-petition transfers.

Interpreting section 547(c)(4) as not limiting what constitutes an otherwise unavoidable transfer to pre-petition transfers is not only consistent with the statute's unambiguous plain meaning, but also best promotes the Code's policies and purposes. In particular, Trustee's interpretation of section 547(c)(4) best promotes the Code's overarching policy of facilitating equality of distribution among similarly situated creditors. *See Union Bank,* 502 U.S. at 161. Furthermore, Trustee's interpretation balances the dual-purposes of sections 547 and 503(b)(9) insofar as it encourages creditors to continue extending credit to financially distressed debtors during the pre-petition period while simultaneously discouraging unsecured creditors from racing to the courthouse with claims. *See id.* (identifying purposes of the preference section); *see also TI Acquisition, LLC v. Southern Polymer, Inc. (In re TI Acquisition, LLC)*, 429 B.R. 377, 384–85 (Bank. N.D. Ga. 2010) (citing *Commissary Operations, Inc. v. Dot Foods, Inc. (In re Commissary Operations, Inc.)*, 421 B.R. 873, 877–879 (Bankr. M.D. Tenn. 2010) (discussing overlapping purposes of sections 547 and 503(b)(9))).

1. Interpreting section 547(c)(4) preference analysis as not limited to pre-petition transfers promotes the Code's policy of equality of distribution among similarly situated creditors.

Interpreting section 547(c)(4) to permit Touch of Grey to assert new value for underlying value for which it has already been paid in full as an administrative expense would grant Touch of Grey a windfall at the expense of Debtor's other unsecured creditors, and thereby contradict the Code's policy of equality of distribution among similarly situated creditors. By contrast, Trustee's interpretation of section 547(c)(4) promotes the Code's policy of equality of distribution among similarly situated creditors and lends to more equitable results.

Through its interpretation of section 547(c)(4), Touch of Grey seeks what one bankruptcy court has described as "payment plus treatment." *See In re Beaulieu Grp., LLC*, 616 B.R. at 875–77. That is, Touch of Grey urges this Court to interpret section 547(c)(4) as enabling creditors to receive full payment for a section 503(b)(9) administrative expense claim, plus subsequently use the same fully satisfied underlying value to reduce the amount of preference liability owed to the debtor's estate. However, such payment plus treatment undercuts the Code's policy of equality of distribution among unsecured creditors insofar as it reduces the amount of estate funds available to repay the debtor's other unsecured creditors disproportionate to the benefit bestowed upon the estate.

Although by the very nature of bankruptcy unsecured creditors often receive less than their full claim, payment plus treatment exacerbates this by permitting payment plus creditors to receive more than they gave to the estate at the expense of the debtor's other unsecured creditors. To illustrate this point in terms of the present case, Debtor's $200,000 distribution to Touch of Grey, as payment for the administrative expense reflected on the Invoice, cannot be clawed back, and therefore, reduced the total amount available to repay Debtor's other creditors by $200,000. However, it alone did not result in a net reduction to the Estate insofar as the distribution was proportionate to the $200,000 in goods sold to Debtor on credit. But, if Touch of Grey were subsequently permitted to reduce its preference exposure for the $250,000 forbearance agreement payment by the amount of the Invoice, it would receive compensation disproportionate to the value it provided to Debtor during the twenty days prior to the Petition Date. Whereas the additional $200,000 could otherwise be clawed back by the Estate to repay priority creditors and the remainder distributed pro rata among all of Debtor's unsecured creditors, Touch of Grey would be permitted to keep the $200,000 administrative expense and $200,000 of preferential payment.

See 11 U.S.C. § 726(a). Such a result runs entirely contrary to the Code's overarching policy of equality of distribution among similarly situated creditors, and as such, Touch of Grey's interpretation of section 547(c)(4) must be rejected to the extent it permits this outcome.

To the contrary, the Third Circuit suggests that unequal treatment of creditors is permitted by the Code given its provisions granting certain claims priority over others. *In re Friedman's Inc.*, 738 F.3d at 560. But although section 503(b)(9) indeed grants priority status to administrative expenses, it does not follow that the statute should be read as granting preferential status to transfers made outside of the twenty-day window preceding petition filing. *See Howard Delivery Serv., Inc. v. Zurich Am. Ins. Co.*, 547 U.S. 651, 655 (2006) ("[P]referential treatment of a class of creditors is in order only when clearly authorized by Congress."). This is especially true in the present case, where Touch of Grey has already been fully compensated for the administrative expense reflected on the Invoice. And Touch of Grey is in no way denied such full compensation by being unable to additionally assert the Invoice value to reduce its preference exposure for the forbearance agreement payment, which was in turn made for goods provided outside of the section 503(b)(9) window. While the Code might explicitly provide for certain exceptions to its overarching policy of equality of distribution among similarly situated creditors, it would be unreasonable to read the Code's exceptions as completely undercutting said policy. Rather, as in the case of administrative expenses, the Code explicitly notes where it intends to favor one creditor over others, and therefore, preferential treatment should not be read into statutes like sections 547(c)(4) and 503(b)(9) beyond what Congress has explicitly authorized. *See id.*

Accordingly, section 547(c)(4) should not be interpreted as limiting otherwise unavoidable transfers to pre-petition transfers because the consequences of such an interpretation would subvert the Code's overarching policy of equality of distribution among similarly situated creditors.

2. Interpreting section 547(c)(4) as not limiting an "otherwise unavoidable transfer" to pre-petition transfers encourages creditors to continue doing business with financially troubled debtors while also discouraging a race to the courthouse.

Trustee's interpretation balances the dual-purposes of sections 547 and 503(b)(9) by encouraging creditors to continue extending credit to financially distressed debtors during the pre-petition period while simultaneously discouraging creditors from racing to the courthouse with claims against debtors. Trustee's interpretation is consistent with encouraging creditors to continue extending credit because despite having to choose between claiming value provided during the twenty days prior to filing for bankruptcy as either an administrative expense or new value, the creditor is nonetheless compensated proportionate to the benefit bestowed upon the debtor. On the other hand, Trustee's interpretation also discourages creditors from racing to the courthouse by ensuring preferential payments for preexisting debts can be clawed back and shared among unsecured creditors notwithstanding some creditors having administrative expense claims.

For example, and as illustrated in Table A, Touch of Grey received a preferential payment of $250,000 pursuant to the forbearance agreement. The Estate was depleted a proportionate amount insofar as the Estate did not receive any additional value but was instead paying a preexisting debt. Within the twenty days prior to the Petition Date, Touch of Grey subsequently replenished the Estate by $200,000 by providing Debtor with products on credit, and thereby brought the Estate's net reduction to negative $50,000. However, the benefit of the Invoice value was negated by Debtor's payment of $200,000 to Touch of Grey as an administrative expense that cannot be clawed back. The Invoice payment therefore brought the Estate back to a net reduction of negative $250,000. Accordingly, the Estate's resultant net reduction of negative $250,000 is proportionate to, and representative of, the $250,000 preferential payment made to Touch of Grey pursuant to the forbearance agreement. At such point, Touch of Grey has been equitably

compensated for the value of the Invoice, and Touch of Grey's preference liability is proportionate to the $250,000 preferential payment it received. However, to go further and permit Touch of Grey to reduce its preference liability by $200,000 would inequitably result in Touch of Grey both receiving full payment for its administrative expense claim and having $200,000 of its preferential payment under the forbearance agreement sheltered from section 547(b). In turn, the Estate would have $200,000 less available for distribution among Debtor's other unsecured creditors.

Estate relative to Touch of Grey's preference exposure (Table A)

	$(250,000)	Preferential payment pursuant to forbearance agreement
+	$ 200,000	Invoice value replenished to Estate
	$ (50,000)	
–	$ 200,000	Administrative expense payment for Invoice value
	$(250,000)	**Preference exposure (Trustee's interpretation)**
+	$ 200,000	Preference exposure reduced by Invoice new value
	$ (50,000)	**Preference exposure (Touch of Grey's interpretation)**

Some courts adopting the minority interpretation of section 547(c)(4) have suggested that restricting creditors from claiming the same underlying value as both an administrative expense and new value might chill creditor's willingness to do business with troubled debtors. *See e.g., In re Commissary Operations, Inc.*, 421 B.R. at 879. However, this assertion is mistaken because it relies on the unsupported assumption that creditors know when a debtor is within twenty days of filing for bankruptcy and will treat the debtor differently as a result, which is typically not the case. Instead, "paying creditors in full for their claims is the ultimate method of encouraging them to continue trade with the debtor," and is precisely what is achieved through full satisfaction of a section 503(b)(9) claim regardless of whether a creditor is permitted to use the same value to also reduce its preference liability for a separate preferential transfer. *In re TI Acquisition, LLC,* 429 B.R. at 385. In that regard, the difference between the interpretations advocated for by Trustee and Touch of Grey is the potential harm to Debtor's other unsecured creditors that would result from

permitting payment plus treatment. If anything, allowing payment plus treatment might encourage creditors to race to the courthouse with claims against financially troubled debtors, insofar as it creates the threat of unsanctioned disparate treatment according to whether creditors' trade with the debtor happens to fall within or outside the twenty days prior to the debtor's filing for bankruptcy.

For the foregoing reasons, it is consistent with the Code's purposes of encouraging creditors to continue doing business with financially troubled debtors and discouraging creditors from racing to the courthouse, to interpret section 547(c)(4) preference analysis as not limited to pre-petition transfers. As such, this Court should affirm the Thirteenth Circuit's decision.

II. Section 365(d)(3) does not require a trustee to satisfy obligations under an unexpired nonresidential lease that are allocable to the post-rejection period.

As in the present case, unduly burdensome executory contracts and unexpired leases are likely to play a role in a debtor's descent into insolvency. In recognition of such, section 365(a) permits a trustee to assume or reject an executory contract or unexpired lease upon the trustee's determination of whether the agreement is a "good deal" for the estate.[2] *Mission Prod. Holdings, Inc. v. Tempnology, LLC*, 139 S. Ct. 1652, 1658 (2019); *see also NLRB*, 465 U.S. at 513 ("[T]he authority to reject an executory contract is vital to the basic purpose to a Chapter 11 reorganization, because rejection can release the debtor's estate from burdensome obligations that can impede a successful reorganization."). As in the present case, when a trustee finds the agreement is not a good deal but unduly burdensome to the estate and therefore rejects it, the trustee thereby repudiates any further performance of its duties under the agreement, subject to limited exceptions. *See Mission Prod. Holdings, Inc.*, 139 S. Ct. at 1658. Section 365(d)(3) pertains to unexpired leases

[2] Debtor, as debtor in possession, moved to reject the Lease while the present case was pending under chapter 11. Record 7. In general, a debtor in possession in a case pending under chapter 11 has all of the rights and powers of a trustee. 11 U.S.C. § 1107(a).

for nonresidential real property in particular, and provides in relevant part: "The trustee shall timely perform all the obligations of the debtor, except those specified in section 365(b)(2), arising from and after the order for relief under any unexpired lease of nonresidential real property, until such lease is assumed or rejected, notwithstanding section 503(b)(1) of this title." 11 U.S.C. § 365(d)(3)(A).

While courts that have interpreted section 365(d)(3) commonly recognize that the statute requires a trustee to perform lease obligations pending assumption or rejection of the lease, courts are in sharp disagreement over when the obligation to perform arises and its extent. *In re GCP CT School Acquisition, LLC*, 443 B.R. 243, 254 n.70 (Bankr. D. Mass. 2010) (collecting cases). A slight majority of courts who have addressed the issue have interpreted section 365(d)(3) as adopting the "proration approach," which limits a trustee's obligations during the post-petition period to not extend beyond the rejection date.[3] *See e.g.*, *El Paso Props. Corp. v. Gonzales (In re Furr's Supermarkets, Inc.)*, 283 B.R. 60, 69–70 (B.A.P. 10th Cir. 2012). Under the proration approach, a trustee's duty to perform lease obligations during the post-petition period is prorated according to the date of rejection of the lease. *Id.* at 62. Contrastingly, Touch of Grey advocates for the minority interpretation of section 365(d)(3), which adopts the less flexible "billing date approach" and requires a trustee to perform lease obligations according to when they are due under the terms of the lease, regardless of whether rejection of the lease intervenes. *See e.g., Koenig Sporting Goods, Inc. v. Morse Road Co. (In re Koenig Sporting Goods, Inc.)*, 203 F.3d 986, 989 (6th Cir. 2000).

[3] Despite the fact that the date of the order of relief is not always the same as the petition filing date, courts analyzing section 365(d)(3) commonly refer to obligations that arise after an order for relief as arising "post-petition," *HA-LO Indus. v. CenterPoint Props. Tr.*, 342 F.3d 794, 798 & n.2 (7th Cir. 2003). In the present case, the date of the order of relief is the same as the petition filing date, and therefore, for the purposes of this argument, references to the post-petition period are synonymous with the post-order of relief period. *See* 11 U.S.C. § 301 (stating that a voluntary chapter 11 case is commenced by filing a petition and constitutes an order for relief).

The statutory language, context, legislative history, and policy considerations all support interpreting section 365(d)(3) as adopting the proration approach. First, although the statutory language of section 365(d)(3) is ambiguous, constructing section 365(d)(3) in relation to sections 365(g) and 502(g) indicates that a trustee's obligation to perform arises on a prorated basis and terminates upon rejection of the lease. Second, the legislative history of section 365(d)(3) demonstrates that Congress did not intend for the statute to abrogate the prior practice of prorating lease obligations according to the date of rejection, but rather, reinforce the prior practice. Finally, interpreting section 365(d)(3) as adopting the proration approach best serves and protects the Code's policies and purposes. Accordingly, the Thirteenth Circuit's interpretation of section 365(d)(3) and its decision should be affirmed.

A. Although the plain language of section 365(d)(3) is ambiguous, the statutory context confirms that a trustee's obligation to perform arises on a prorated basis and terminates upon rejection of the lease.

The statutory language of section 365(d)(3) is ambiguous insofar as it does not define when a trustee's obligation to perform arises, and by itself, may be read as consistent with either the proration or billing date approach. However, consideration of the statutory language in relation to sections 365(g) and 502(g) demonstrates that it is necessary to interpret the statute as adopting the proration approach.

Interpretation of section 365(d)(3) must first begin with the language of the statute itself. *See U.S. v. Ron Pair Enters., Inc.*, 489 U.S. 235, 241 (1989). If the language is plain, this Court's inquiry ends, and the statute is enforced "according to its terms." *Id.* (citation omitted). Further, traditional principles of statutory construction require that words in the statute be accorded their "ordinary, contemporary, common meaning." *Pioneer Inv. Servs. Co. v. Brunswick Assocs. Ltd. P'ship*, 507 U.S. 380, 388 (1993) (citation omitted). However, the statute must also be read as a whole, "since the meaning of statutory language, plain or not, depends on context." *King*, 502 U.S.

at 221 (1991). Although the statutory language of section 365(d)(3) is susceptible to interpretation as adopting either the billing date or proration approach, "[s]tatutory language . . . cannot be construed in a vacuum." *Roberts v. Sea-Land Servs., Inc.*, 566 U.S. 93, 101 (2012) (citation omitted). Rather, as this Court has recognized, "[i]t is a fundamental canon of statutory construction that the words of a statute must be read in their context and with a view to their place in the overall statutory scheme." *Id.* And furthermore, this Court has a "duty to interpret Congress's statutes as a harmonious whole rather than at war with one another." *Epic Sys. Corp. v. Lewis*, 138 S. Ct. 1612, 1619 (2018).

1. The plain language of section 365(d)(3) is ambiguous but nonetheless consistent with the proration approach.

The statutory terms "obligations" and "arises," as well as the statutory phrase "until such lease is assumed or rejected," create ambiguity as to when a trustee's obligation to perform under section 365(d)(3) arises and the extent of the obligation. However, it is reasonable and consistent with the statutory language's common meaning to interpret section 365(d)(3) as prorating a trustee's obligation to perform under an unexpired nonresidential lease to not extend beyond the lease rejection date.

The Code does not define the statutory terms "obligations" and "arises." When the terms are read together according to their common meanings, section 365(d)(3) is susceptible to more than one interpretation regarding when a trustee's obligation to perform arises. The common meaning of the term "obligation" is a legal duty to do something. *Obligation*, BLACK'S LAW DICTIONARY (11th ed. 2019). The common meaning of "arise" is, most relevantly, to originate or result from. *Arise*, BLACK'S LAW DICTIONARY (11th ed. 2019). Thus, assigning the terms their common meaning, a trustee's obligation to perform under section 365(d)(3) may arise according to an absolute occurrence fixed in the terms of the lease (e.g., a billing date), or continuously accrue

until the lease is assumed or rejected. Accordingly, use of the statutory terms "obligations" and "arises" render section 365(d)(3) ambiguous, but the common meaning of the statutory language is nonetheless consistent with the proration approach.

The temporal limitations provided in the statutory language further evidence that section 365(d)(3) is ambiguous as to when a trustee's obligation to perform arises. Although the phrases "after the order for relief" and "until such lease is assumed or rejected" limit section 365(d)(3) to the post-petition, pre-assumption or -rejection period, they do not otherwise clarify exactly when a trustee's obligations arise nor identify the extent of a trustee's obligations once the lease is rejected. Rather, the statutory phrase "until such lease is assumed or rejected" reinforces the ambiguity of the statutory language insofar as it may be construed as modifying "perform" or "obligations." *In re Ames Dep't Stores, Inc.*, 306 B.R. 43, 67 (Bankr. S.D.N.Y. 2004). If the phrase modifies "perform," the statute might be interpreted as favoring the billing date approach. But it is equally if not more plausible that the phrase modifies "obligations," which would make the proration approach necessary and appropriate. *Id.*

By contrast, a minority of courts have interpreted the statutory language of section 365(d)(3) as unambiguously requiring adoption of the billing date approach by fixating on the common meaning of "obligations" alone. *E.g., Centerpoint Props. v. Montgomery Ward Holding Corp. (In re Montgomery Ward Holding Corp.)*, 268 F.3d 205, 209 (3d Cir. 2001). However, such an interpretation runs contrary to principles of statutory construction insofar as it does not interpret "obligations" with due consideration to the rest of the statutory language. *See Hibbs v. Winn*, 542 U.S. 88, 101 (2004) (emphasizing that words in the statutory language are not to be read in isolation, but rather, "must be read in context [since] a phrase gathers meaning from the words around it"). The ordinary meaning of "obligations" does not by itself identify when a trustee's

obligation to perform arises under section 365(d)(3). Rather, considering the term in relation to the rest of the statutory language, particularly the phrase "until such lease is assumed or rejected," highlights the ambiguity of the statute and further, that adoption of the proration approach is the more reasonable interpretation of the statutory language.

Therefore, the statutory language of section 365(d)(3) is ambiguous but nonetheless consistent with prorating a trustee's obligation to perform under an unexpired nonresidential lease according to the lease rejection date.

2. The statutory context supports that section 365(d)(3) does not require a trustee to satisfy obligations allocable to the post-rejection period.

Consideration of section 365(d)(3) in relation to sections 365(g) and 502(g) in particular, supports that a trustee is not required to satisfy lease obligations allocable to the post-rejection period, and that as such, it is necessary to interpret section 365(d)(3) as adopting the proration approach. Similar to section 365(d)(3), sections 365(g) and 502(g) address obligations after rejection of an unexpired lease. *Compare* 11 U.S.C. § 365(d)(3) *with* 11 U.S.C. §§ 365(g), 502(g). Section 365(g) relevantly states that rejection of an unassumed unexpired lease constitutes a breach, and the breach is deemed to have occurred "immediately before the date of the filing of the petition." 11 U.S.C. § 365(g)(1). Section 502(g) relevantly states that a claim arising from rejection of an unassumed unexpired lease is to be analyzed "the same as if such claim had arisen before the date of the filing of the petition. 11 U.S.C. § 502(g)(1). Accordingly, once an unexpired lease is rejected pursuant to section 365, sections 365(g) and 502(g) direct courts to treat claims for breaches of unexpired lease obligations as pre-petition claims. 11 U.S.C. §§ 365(g)(1), 502(g)(1). And because the estate is only liable for post-rejection lease obligations as pre-petition claims, the landlord to the rejected unexpired lease shares pro rata with other unsecured creditors in whatever is left after payment of administrative expenses and other priority claims. 11 U.S.C.

§ 726(a). By contrast, if the unexpired lease is not rejected, then the landlord may claim the lease obligations as administrative expenses and be entitled to payment for such before other unsecured creditors. *See* 11 U.S.C. § 365(d)(3).

Section 365(d)(3) should not be interpreted as converting claims for breaches of unexpired lease obligations during the post-rejection period from pre-petition claims to administrative expense claims, insofar as such an interpretation would subvert sections 365(g) and 502(g). Whereas the billing date approach would enable such a conversion in cases such as the present and thereby do violence to sections 365(g) and 502(g), the proration approach may be applied consistent with both sections. For example, awarding Touch of Grey rent for the entire month of May 2020 based on the billing date would render Debtor's rejection of the lease and relinquishment of the premises on May 5th without effect because the Estate would still be burdened with the post-rejection rent obligation for May as an administrative expense. But, if May rent is prorated according to the date of Debtor's rejection and relinquishment, Touch of Grey gets an administrative expense for rent proportionate to the pre-rejection period and Debtor's rejection is given proper effect insofar as rent for the post-rejection period is treated as a pre-petition claim.

Many of the courts that have adopted the billing date approach have done so without duly considering section 365(d)(3) in relation to sections 365(g) or 502(g). *E.g., In re Koenig Sporting Goods, Inc.*, 203 F.3d at 990 (limiting analysis of the statutory context of section 365(d)(3) to its relation to section 502(b)(6)). Even if the statutory language were unambiguous, which it is not, the broader statutory context and scheme of section 365(d)(3) must nonetheless be considered "since the meaning of statutory language, plain or not, depends on context." *King*, 502 U.S. at 221. Constructing the plain language of section 365(d)(3) in relation to sections 365(g) and 502(g) establishes that the Estate is not liable for post-rejection lease obligations as administrative

expenses, and it is instead necessary to adopt the proration approach to give all three statutes proper effect.

For the aforementioned reasons, the statutory context of section 365(d)(3) exemplifies that the Thirteenth Circuit correctly interpreted the statute as adopting the proration approach. As such, this Court should affirm the Thirteenth Circuit's decision.

B. The legislative history demonstrates that in enacting section 365(d)(3), Congress did not intend to abrogate the prior practice of prorating lease obligations according to the date of rejection.

Given the ambiguity of the statutory language, it is appropriate to consider prior practice and the limited legislative history of section 365(d)(3), which both affirm it is correct to interpret the statute as adopting the proration approach. Prior to enactment of section 365(d)(3), courts widely applied the proration approach and prorated a trustee's obligations under an unexpired lease for nonresidential real property according to the date of rejection. *See Child World, Inc. v. Campbell/Massachusetts Tr. (In re Child World, Inc.)*, 161 B.R. 571, 574–75 (S.D.N.Y. 1993) (collecting cases). The legislative history of section 365(d)(3) does not suggest that Congress intended to abrogate this prior practice, but contrarily suggests that Congress sought to reinforce the proration approach.

As this Court has emphasized, the Code should not be "read . . . to erode past bankruptcy practice absent a clear indication that Congress intended such a departure . . . ." *Cohen v. De La Cruz*, 523 U.S. 213, 221 (1998) (citation omitted). Rather, the "normal rule of statutory construction is that if Congress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific," especially in the context of bankruptcy codifications. *Midlantic Nat'l Bank v. New Jersey Dep't of Envtl. Prot.*, 474 U.S. 494, 501 (1986).

Prior to the enactment of section 365(d)(3), lease obligations during the post-petition, pre-rejection period were handled as administrative expenses, and landlords seeking payment of

current post-petition rent were subject to the hurdles of section 503(b)(1). *In re Handy Andy Home Improvement Ctrs., Inc.*, 144 F.3d 1125, 1128 (7th Cir. 1998). This resulted in a great deal of uncertainty for landlords during the post-petition period, pending lease assumption or rejection, as it created the potential that debtors could stay in the premises indefinitely without paying rent if the landlord failed to establish rent as an "actual, necessary cost[] . . . of preserving the estate." *See* 11 U.S.C. § 503(b)(1)(A). As evidenced in the legislative history, Congress therefore sought to address this problem of landlords being "forced to provide current services—the use of [landlords'] property, utilities, security, and other service—without current payment" by enacting section 365(d)(3) as part of the 1984 amendments to the Code. 130 CONG. REC. (1984), *as reprinted in* 1984 U.S.C.C.A.N. 576, 599 (statement of Sen. Hatch).

Noticeably absent from the legislative history is any indication of congressional intent to abrogate the prior practice of applying the proration approach to calculate lease obligations. And there is no mention of abrogating the proration approach in the legislative history of section 365(d)(3) precisely because Congress did not intend for the statute to affect the existing practice. Rather, Congress's intent in enacting section 365(d)(3) was to free landlords from the restraints of section 503(b)(1) and ensure landlords receive current payment for current service. *Id.* That the legislative history omits reference to the proration approach, despite its widespread adoption at the time of the 1984 amendments, suggests that Congress did not view its application as inconsistent with ensuring landlords receive current payment for current services.

In support of its position, Touch of Grey urges this Court to elevate a portion of its post-rejection rent claim to the status of an administrative expense, based merely on the billing date set forth in the Lease. Record 20. In making such a request, Touch of Grey asks this Court to rebuke principles of statutory construction and read into the legislative history of section 365(d)(3) a

congressional intent that is simply not present. Congress enacted section 365(d)(3) in order to ensure landlords receive current payment for current services; there is no indication Congress intended to go beyond that. Applying the proration approach, Touch of Grey receives current payment for current services: an administrative expense for five days of rent corresponding to the five days during May 2020 that Debtor occupied the Premises prior to rejecting the Lease. By contrast, application of the billing date approach would entitle Touch of Grey to payment beyond the services provided during the post-petition, pre-rejection period, insofar as Touch of Grey would receive an administrative expense for the entirety of May rent despite rejection of the Lease and reclamation of the Premises on May 5, 2020.

Therefore, the legislative history of section 365(d)(3) demonstrates that Congress did not intend for the statute to abrogate the existing practice of prorating lease obligations according to the date of rejection, but rather, reinforce it.

C. It is consistent with the Code's policies and purposes to interpret section 365(d)(3) as adopting the proration approach.

Whereas the billing date approach can lend to uncertain and inequitable results, the proration approach is entirely consistent with the policies and purposes of the Code. In particular, interpreting section 365(d)(3) as adopting the proration approach best facilitates the prime Code policy of equality of distribution among similarly situated creditors, and balances it against the Code's purpose in granting creditors preferential treatment, of enabling debtors to keep going as long as possible. *See Howard Delivery Serv.*, 547 U.S. at 655 ("[T]he Bankruptcy Code aims, in the main, to secure equal distribution among creditors . . . . We take into account, as well, the complementary principle that preferential treatment of a class of creditors is in order only when clearly authorized by Congress."); *see also In re Handy Andy Home Improvement Ctrs.*, 144 F.3d at 1127 ("[T]he purpose of giving postpetition creditors a high priority in the distribution of the

debtor's estate . . . is to enable the debtor to keep going for as long as its current revenues cover its current costs, so that it does not collapse prematurely because of the weight of its existing debt."). Further, the proration approach also promotes fairness to landlords and protects them from potential prejudice, insofar as it provides more consistent and equitable results.

1. The proration approach best balances the policy of equality of distribution among similarly situated creditors with the purpose behind granting creditors preferential treatment.

Interpreting section 365(d)(3) as prorating lease obligations according to the rejection date best balances the Code policy of equality of distribution among similarly situated creditors with the purpose behind granting creditors preferential treatment, of maximizing debtors' hopes of reorganization. Under the billing date approach, landlords may receive a windfall at the expense of other creditors in two scenarios: first, when the lease obligates retroactive payment during the post-petition, pre-rejection period for services provided pre-petition; and second, when the lease obligates advanced payment prior to the rejection date, but the landlord is able to relet the premises to a replacement tenant. *Koenig Sporting Goods, Inc. v. Morse Road Co. (In re Koenig Sporting Goods, Inc.)*, 229 B.R. 388, 394 (B.A.P. 6th Cir. 1999) (Rhodes, J., dissenting). In both instances, granting landlords full administrative expenses for such lease obligations undermines the purpose behind granting them preferential treatment insofar as pre-petition and post-rejection services do not support debtors' efforts to continue doing business during the post-petition, pre-rejection period.

First, although retroactive payment for lease obligations is not at issue in the present case, it further exemplifies the inequity of the billing date approach and why policy considerations favor adoption of the proration approach. Under the billing date approach, a landlord could seek administrative expense status for lease obligations that arise during the post-petition, pre-rejection period, despite the corresponding service being provided pre-petition. In such a scenario, the

landlord has not contributed to the debtor's ability to continue doing business during the post-petition, pre-rejection period, as would otherwise justify the landlord's preferential treatment. But whereas the landlord would otherwise only be entitled to an unsecured claim for pre-petition lease obligations, the billing date approach nonetheless enables landlords to claim them as administrative expenses based on the fortuitous event of their billing date falling within the post-petition, pre-rejection period. Accordingly, in contradiction of the Code's prime policy and the purpose motivating preferential treatment, the billing date approach creates the potential for landlords to hinder debtors' ability to reorganize and deplete the estate at the expense of other unsecured creditors. By contrast, the proration approach is entirely consistent with the Code's prime policy and the purpose behind granting preferential treatment, because it limits the landlord's claim for an administrative expense to services actually provided during the post-petition, pre-rejection period.

Second, the billing date approach creates the potential for landlords to receive a windfall in situations like the present, where the lease obligates advanced payment prior to the rejection date, because the landlord receives payment from the debtor and additionally has the opportunity to relet the premises to a new tenant. For example, if Touch of Grey had been able to relet the Premises at any point in May 2020 after Debtor vacated, the billing date approach would entitle Touch of Grey to an administrative expense claim for all of May 2020 rent, and Touch of Grey would additionally be able to collect May 2020 rent from its new tenant. That Touch of Grey did not find a new tenant in May 2020 is irrelevant to the fact that it had the opportunity to do so.

Furthermore, although in the present case the Lease required monthly advanced payment of rent, such may not always be the case. To illustrate the inequity permitted by the billing date approach, consider a hypothetical lease requiring yearly advanced payment of rent with rejection

of the lease occurring two days after the billing date. In such a hypothetical situation, the consequences for the debtor's estate and other unsecured creditors are likely to be more severe, and if the landlord finds a new tenant within the next year, they will be doubly compensated. Accordingly, the billing date approach must be rejected as inconsistent with the Code's prime policy and the purpose behind granting preferential treatment, insofar as it creates the potential for a landlord to deplete the debtor's estate beyond the services provided and at the expense of other unsecured creditors, while also returning to the landlord the benefit of the premises.

To the contrary, some courts adopting the billing date approach argue that it does not result in a windfall to the landlord because the debtor controls the date of rejection. *E.g.*, *In re Koenig Sporting Goods, Inc.)*, 203 F.3d at 989–90. However, such an assertion ignores that debtors must take into consideration numerous factors in timing their rejection, and lease obligations are merely one of them. Furthermore, it would undermine the purpose of preferential treatment to force debtors to base the date of rejection of a lease primarily on when lease obligations are billed, rather than on whether debtors' current revenues cover their current costs.

In conclusion, the proration approach best facilitates the Code's prime policy of equality of distribution among similarly situated creditors and balances it against the purpose of granting preferential treatment in order to enable debtors to keep going as long as possible. Accordingly, this Court should affirm the Thirteenth Circuit's decision.

2. The proration approach also promotes fairness to landlords and protects them from potential prejudice.

The proration approach also better promotes fairness to landlords and protects them from potential prejudice in situations where the billing date approach would otherwise cause landlords harm. The proration approach protects landlords in at least two scenarios: first, when the lease requires payment in advance of the petition filing date for post-petition services; and second, when

the lease requires payment during the post-rejection period for post-petition, pre-rejection services. *In re NETtel Corp., Inc.*, 289 B.R. 486, 493 (Bankr. D.D.C. 2002). As the legislative history states, the purpose of section 365(d) in general is to "prevent parties in contractual or lease relationships with the debtor from being left in doubt concerning their status vis-a-vis the estate." H.R. REP. No. 95–595, at 348 (1978), *as reprinted in* 1978 U.S.C.C.A.N. 5963, 6304. The billing date approach undermines this purpose by creating inequitable, even absurd results in the aforementioned situations. Contrastingly, the proration approach is relatively simple to apply and consistently equitable.

When the lease requires payment in advance of the petition filing date for post-petition services, or requires payment during the post-rejection period for post-petition, pre-rejection services, adoption of the billing date approach would result in the landlord being entirely denied an administrative expense for the corresponding lease obligation. *E.g., In re Oreck Corp.*, 506 B.R. 500, 504 (Bankr. M.D. Tenn. 2014). Such a result undercuts the purpose of section 365(d) generally, insofar as it creates the very type of uncertainty for landlords that Congress intended the statute to remedy. Furthermore, application of the billing date approach in such scenarios highlights its potential for unfairness to landlords because it would require landlords to provide services during the post-petition, pre-rejection period, but not grant them a corresponding administrative expense claim merely because the billing date fell prior to filing of the petition, or after the date of rejection. But this outcome is avoided by application of the proration approach, under which the landlord consistently receives a prorated administrative expense for services rendered during the post-petition, pre-rejection period. *E.g., In re Stone Barn Manhattan LLC*, 398 B.R. 359, 368 (Bankr. S.D.N.Y. 2008).

Contrastingly, the Third Circuit has recognized the aforementioned potential for abuse under the billing date approach, but nonetheless accepted the allegedly unambiguous statutory language of section 365(d)(3) as necessitating its adoption. *In re Montgomery Ward Holding Corp.*, 268 F.3d at 211–12. Even if the statutory language of section 365(d)(3) were unambiguous, which it is not, this Court has directed that statutes need not be interpreted literally when the results would be absurd. *See Lamie*, 540 U.S. at 534. Absurd and inequitable results are precisely what may occur under adoption of the billing date approach, and this Court should therefore reject it and interpret section 365(d)(3) as adopting the proration approach.

In conclusion, the proration approach better promotes fairness to landlords and protects them in situations where the billing date approach would otherwise cause them prejudice. This Court should therefore affirm the Thirteenth Circuit's decision interpreting section 365(d)(3) as adopting the proration approach.

CONCLUSION

For the foregoing reasons, the Thirteenth Circuit Court of Appeals correctly interpreted sections 547(c)(4) and 365(d)(3), and this Court should affirm its decision in favor of Trustee.

APPENDIX A

11 U.S.C. § 365

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

. . .

(d)(3)(A) The trustee shall timely perform all the obligations of the debtor, except those specified in section 365(b)(2), arising from and after the order for relief under any unexpired lease of nonresidential real property, until such lease is assumed or rejected, notwithstanding section 503(b)(1) of this title. The court may extend, for cause, the time for performance of any such obligation that arises within 60 days after the date of the order for relief, but the time for performance shall not be extended beyond such 60-day period, except as provided in subparagraph (B). This subsection shall not be deemed to affect the trustee's obligations under the provisions of subsection (b) or (f) of this section. Acceptance of any such performance does not constitute waiver or relinquishment of the lessor's rights under such lease or under this title.

(B) In a case under subchapter V of chapter 11, the time for performance of an obligation described in subparagraph (A) arising under any unexpired lease of nonresidential real property may be extended by the court if the debtor is experiencing or has experienced a material financial hardship due, directly or indirectly, to the coronavirus disease 2019 (COVID-19) pandemic until the earlier of—

(i) the date that is 60 days after the date of the order for relief, which may be extended by the court for an additional period of 60 days if the court determines that the debtor is continuing to experience a material financial hardship due, directly or indirectly, to the coronavirus disease 2019 (COVID-19) pandemic; or
(ii) the date on which the lease is assumed or rejected under this section.

(C) An obligation described in subparagraph (A) for which an extension is granted under subparagraph (B) shall be treated as an administrative expense described in section 507(a)(2) for the purpose of section 1191(e).

. . .

(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.

. . .

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11 U.S.C. § 503

. . .

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

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

. . .

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11 U.S.C. § 547

. . .

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

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

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

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

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

(A) the case were a case under chapter 7 of this title;
(B) the transfer had not been made; and
(C) such creditor received payment of such debt to the extent provided by the provisions of this title.

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

. . .

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

(A) not secured by an otherwise unavoidable security interest; and
(B) on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor.

(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
(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;

. . .