NO. 20-103

IN THE

Supreme Court of the United States

OCTOBER TERM, 2021

IN RE TERRAPIN STATION, LLC,
DEBTOR,

TOUCH OF GREY ROASTERS, INC.,
PETITIONER

V.

CASEY JONES, CHAPTER 7 TRUSTEE,
RESPONDENT.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE THIRTEENTH CIRCUIT

BRIEF FOR PETITIONER

Team Number 21
COUNSEL FOR PETITIONER

QUESTIONS PRESENTED

I. Does refusing a new value defense inherently conflict with legislative purpose, plain language, and context of 11 U.S.C. § 547(c)(4) and the underlying policy of 11 U.S.C. § 503(b)(9)?

II. Does 11 U.S.C. § 365(d)(3) require a trustee to timely perform the obligations of a debtor by paying rent that becomes due prior to the rejection of an unexpired non-residential real property lease?

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The Thirteenth Circuit Court of Appeals' decision is available at No. 21-0909 and reprinted at Record 2. The Bankruptcy Court for the District of Moot decided in favor of the Trustee. The United States District Court for the District of Moot affirmed the Bankruptcy Court's decision in favor of the Trustee. On appeal, the United States Court of Appeals for the Thirteenth Circuit affirmed.

STATEMENT OF JURISDICTION

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

PERTINENT STATUTORY PROVISIONS

11 U.S.C. § 365 Executory contracts and unexpired leases
(a) Except as provided in sections 765 and 766 of this title and in subsections (b), (c), and (d) of this section, the trustee, subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor.
(b) – (c) omitted.
(d) the satisfaction of any penalty rate or penalty provision relating to a default arising from any failure by the debtor to perform nonmonetary obligations under the executory contract or unexpired lease.

(1) – (2) omitted.

(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. 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).

(e) – (p) omitted**.**

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

(a) [omitted]

(b) After notice and a hearing, there shall be allowed, administrative expenses, other than claims allowed under section 502(f) of this title [11 USCS § 502(f)], including—

(1) – (8) [omitted]

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

11 U.S.C. § 546 Limitations on avoiding powers

(a) An action or proceeding under section 544, 545, 547, 548, or 553 of this title [11 U.S.C.S. § 544, 545, 547, 548, or 553] may not be commenced after the earlier of—

(1) the later of**–**

(A) 2 years after the entry of the order for relief; or

(B) 1 year after the appointment or election of the first trustee under section 702, 1104, 1163, 1202, or 1302 of this title [11 USCS § 702, 1104, 1163, 1202, or 1302] if such appointment or such election occurs before the expiration of the period specified in subparagraph (A); or

(2) the time the case is closed or dismissed.

(b) – (j) [omitted]

11 U.S.C. § 547 Preferences

(a) [omitted]

(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) – (4) [omitted]

(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;

(6) – (9) [omitted]

(d) – (j) [omitted]

STATEMENT OF THE CASE

I. FACTUAL HISTORY

A. The Successful Founding of Terrapin Station

In 2005, William Tell founded the independent coffeehouse Terrapin Station, which rose to local prominence and significant success. R. at 3. By 2017, the Debtor had instead fallen into worse shape. R. at 4. Earnings slowed and the storefront was showing wear and tear. R. at 4. Also in 2017, international coffee company Touch of Grey Roasters began the "neighborhood coffeehouse" program, in which owners of pre-existing, independent coffee houses would enter franchise agreements with Touch of Grey maintaining their external appearances while also selling Touch of Grey coffee products. R. at 4. This would allow Touch of Grey to enter new markets while avoiding the stigma of its "big coffee" reputation. R. at 4.

B. Terrapin Station Seeks New Avenues for Growth with Touch of Grey

In the fall of 2017, Touch of Grey approached Tell, and inquired about bringing the Debtor into the "neighborhood coffeehouse" program. R. at 4. On July 1, 2018, the business agreement between Touch of Grey and Tell was finalized. R. at 4. The Debtor, as tenant, and the Touch of Grey, as landlord, also entered into a twenty-year triple-net Lease Agreement (the "Lease") for a warehouse space purchased and developed by Touch of Grey at 5877 Shakedown Street (the "Premises"). R. at 4. The terms of the lease obligated the Debtor to pay monthly rent of $25,000 "due in advance on the first day of each month." R. at 4. Touch of Grey and the Debtor also entered into a "neighborhood coffeehouse" franchise agreement, requiring the Debtor to exclusively sell Touch of Grey coffee products. R. at 4. Development on the Premises finished in November 2018, and the new "Terrapin Station Coffeehouse" opened the following month. R. at 5.

C. The Debtor's Faltering Business and Failures to Make Timely Payments

The Debtor struggled to get the new venture off the ground when a group of local independent coffee houses mounted a local campaign to negatively portray the Debtor as "big coffee in disguise." R. at 5. The Debtor attempted to turn things around through all of 2019 but struggled to meet the initial sales expectations and to fulfill its obligations under the Lease. R. at 5. The Debtor first failed to timely pay its debts in September 2019. R. at 5. By November 2019, the Debtor owed Touch of Grey $700,000 for goods it purchased. R. at 5.

On December 7, 2019, Touch of Grey was concerned by the Debtor's poor performance and entered into a forbearance agreement where the Creditor agreed to forbear terminating the franchise agreement in exchange for receiving: (1) a $250,000 payment on outstanding invoices for Touch of Grey products; (2) reaffirmation to Touch of Grey that the Debtor understands its Lease obligations; and (3) releasing all claims and causes of action against Touch of Grey. R. at 5. That day, Touch of Grey paid the $250,000 invoice amount. R. at 5.

To convince Touch of Grey to sell the Debtor more coffee products despite inadequate sales and payment performance, Tell signed a personal guarantee on December 18, 2019, and the Debtor subsequently purchased $200,000 on credit shown in an invoice (the "Invoice"). R. at 5. On December 31, 2019, the goods were delivered to the Debtor. R. at 6. However, the Debtor once again faced poor sales numbers. R. at 6.

D. The Debtor and Touch of Grey's Mutual Attempt to Restructure

On January 5, 2020, the Debtor filed a petition for relief under chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the District of Moot. R. at 6. Tell stated along with his "first day" motions that he intended to reorganize the Debtor by returning to traditional coffeehouse hours and operation and finding a sub-lessee for part of the Premises to

reduce rent. R. at 6. Touch of Grey's counsel appeared at the first day hearings and expressed some serious concerns about the reorganization strategy, but reaffirmed Touch of Grey's commitment to cooperate with the Debtor to plan for the future. R. at 6.

Two weeks after the first day hearings, the Debtor sought authority from the bankruptcy court to immediately pay $200,000 to Touch of Grey for the credit extended via the Invoice. R. at 6. The Debtor argued, opposed by the Trustee, that Touch of Grey was a "critical vendor" that was crucial in the reorganizational plans, and the payment would allow the business relationship to survive. R. at 6-7. Touch of Grey's necessity was intensified by the Debtor's other creditors, to whom the Debtor owed over $500,000 in unsecured debt. R. at 6. Many of these creditors refused to continue to provide goods and services to the Debtor on credit, leaving Touch of Grey as one of the only remaining cooperative suppliers. R. at 6. The bankruptcy court rejected the classification of Touch of Grey as a "critical vendor" – noting uncertainty as to whether "critical vendor" status is accepted under the Bankruptcy Code – but nevertheless granted the immediate $200,000 payment to Touch of Grey as an administrative expense under § 503(b)(9) for the value of goods sold on credit. R. at 7. As a result, the Debtor was able to purchase more goods on credit from Touch of Grey and maintain its business operations for several more months. R. at 7.

E. The Failure of Reorganization Efforts and the Trustee's Aggressive Strategy

The Debtor's attempt to reorganize under chapter 11 was unsuccessful. R. at 7. The pandemic served as the final nail in the reorganizational coffin; the Debtor temporarily ceased operations in March 2020, and its patrons did not return after the April 2020 reopening. R. at 7. The Debtor closed permanently on May 5, 2020 and abandoned the Premises. R. at 7. The Debtor returned the keys to Touch of Grey, and filed a motion on May 6, 2020 to reject the

Lease and franchise agreement under § 365(a). R. at 7. Touch of Grey asserted that it was owed the entirety of the rent due under the pre-rejection lease, pursuant to § 365(d)(3). R. at 8.

At the May 29, 2020 hearing regarding the lease-rejection motion, the Debtor announced that it was converting its case from chapter 11 to chapter 7, and faced no objection from any party. R. at 8. The bankruptcy court then granted the motion to reject the Lease and terminate the franchise agreement, effective May 5, 2020. R. at 8. Touch of Grey's request for payment in full of the rent due for May was not ruled on, but an order appointing the Trustee as the chapter 7 trustee for the Debtor's estate was entered. R. at 8.

The Trustee took an "aggressive" posture and immediately objected to Touch of Grey's motion to compel the May rent pursuant to § 365(d)(3) and commenced an adversary proceeding to recover the $250,000 paid as a condition of the forbearance agreement on December 7, 2019. R. at 8. Regarding the rent, the Trustee argued that it was inequitable to grant the entirety of the May rent due because the Debtor only occupied the Premises for five days of the month. R. at 8. Regarding the $250,000 payment, the Trustee argued that the payment was a preferential transfer subject to recovery under §§ 547(b) and 550(a). R. at 8. In response, Touch of Grey filed affirmative defenses, including a new value defense under § 547(c)(4) to reduce its preference exposure by $200,000, the value of goods sold to the Debtor. R. at 8. In an effort to avoid costly litigation, all parties agreed to a stay of proceedings until attempts at mediation were exhausted. R. at 8. Unfortunately, the mediation was ultimately unsuccessful. R. at 8-9.

II. PROCEDURAL HISTORY

The Debtor filed a petition for relief under chapter 11 bankruptcy in the United States Bankruptcy Court for the District of Moot on January 5, 2020. R. at 6. On May 29, 2020, the Debtor requested to convert its bankruptcy case from chapter 11 to chapter 7. R. at 8. The

bankruptcy court ordered the conversion and appointed the Trustee as the chapter 7 trustee. R. at 8. The Trustee objected to Touch of Grey's motion to collect the entire May rent and commenced an adversary proceeding requesting to avoid and recover as a preferential transfer the $250,000 payment the Debtor made to Touch of Grey under the forbearance agreement on December 7, 2019, pursuant to §§ 547(b) and 550(a). R. at 8. On July 23, 2020, the parties filed cross-motions for summary judgment on the new value issue. R. at 9.

The bankruptcy court ruled in favor of the Trustee on both issues and granted Touch of Grey an administrative expense of $4,032.26 for the five-day portion of the pre-rejection May rent. R. at 9. In the hearing on the cross-motions on summary judgment, the bankruptcy granted summary judgment to the Trustee and entered a judgment of $250,000 against Touch of Grey. R. at 9. Touch of Grey appealed both decisions to the United States District Court for the District of Moot, which affirmed on both issues. R. at 9. Touch of Grey then filed a notice of appeal with the United States Court of Appeals for the Thirteenth District. R. at 9. The court affirmed the decisions of the bankruptcy court. R. at 9.

STATEMENT OF THE STANDARD OF REVIEW

This case concerns only issues of law because the parties do not dispute the facts. R. at 9. Under Federal Rule of Civil Procedure 56(c), made applicable to adversary proceedings and contested bankruptcy matters under Federal Rules of Bankruptcy Procedure 7056 and 9014, summary judgment is proper if "there is no genuine issue of material fact and that the moving party is entitled to judgment as a matter of law." *See Celotex Corp. v. Catrett*, 477 U.S. 317, 322 (1986). Fed. R. Civ. P. 56(d). In bankruptcy matters, an appellate court reviews questions of law de novo. *See, e.g., U.S. Bank Nat. Ass'n ex rel. CWCapital Asset Management LLC v. Village at*

Lakeridge, 138 S. Ct. 960, 965 (2018). When reviewing a question of law *de novo*, the Court reviews legal conclusions "without the slightest deference." *Id.* at 965.

SUMMARY OF THE ARGUMENT

This Court should reverse the decision of the Court of Appeals for the Thirteenth Circuit on both issues presented and grant both Touch of Grey's motion for summary judgment requesting to reduce its preference exposure and its motion to compel payment for the full month of May rent. The Bankruptcy Code operates to give struggling debtors an opportunity to recover financially while providing for equitable distribution of the debtor's assets to its creditors. To accomplish these goals, creditors must be encouraged to extend new value on credit to debtors and protected for doing so. The Code seeks to balance equity and rehabilitation, and while proration was the pre-Code amendment practice, Congress amended the Code to further balance the equities between the parties by advancing the billing date approach.

Two sections of the Bankruptcy Code meet to form the first issue discussed in this brief – § 503, permitting administrative payments to creditors, and § 547, providing for avoidance of preferences by trustees and defenses from avoidance for creditors. Both the language and the broader statutory context signal that the preference window is meant to close on the date the bankruptcy petition is filed. Therefore, calculations of preference liability should remain the same after the petition date, regardless of subsequent advancements of new value to the debtor or transfers to the creditor. Permitting otherwise would result in preference calculations fluctuating significantly based simply on the date the preference avoidance action is filed, which is untenable.

Creditors who continue to extend value on credit replenish the debtor's estate when other vendors may refuse. Advancements of new value to a floundering debtor enable the debtor to

continue serving its customers, collecting profit on goods sold, and maintaining a positive reputation with its customers. This benefit is lasting, even if the debtor or trustee later compensates the creditor for all or part of the value. Section 547(c)(4) was created to reward such creditors by permitting them to later reduce their preference exposure by the value of the goods sold. Administering the section otherwise would nullify Congress' efforts to encourage the generosity of vendors.

The Bankruptcy Code reflects a delicate balance of Congress's many policy goals. The court's role is to give effect to these policies, rather than to take a policymaking position itself. The policies underlying § 503 and § 547 interact in this case. Congress enacted § 503(b)(9) specifically to give priority treatment to vendors of goods, with the goal to encourage these vendors to continue providing a struggling business with value. Section 547(c)(4) acts to protect these creditors from preference exposure after they have extended new value to the debtor's estate. The Bankruptcy Code seeks to treat similarly situated creditors equitably but does not purport to offer equal distribution to all creditors. Because Touch of Grey has advanced new value to Terrapin, it should be shielded from preference liability and should not be treated the same as creditors who have not extended the same value to the estate. This Court should reverse the holding of the Thirteenth Circuit and grant summary judgement for Touch of Grey.

The second issue surrounds whether the proration approach or the billing date approach is most strongly supported under the statute's plain language, Congress's intentions in enacting the statute, and policy considerations to best protect the parties. Courts differ regarding whether the trustee's rent obligation to pay the debtor's rent to the landlord "arises" either each day that the tenant occupies the property (the "proration approach") or the day set under the lease for rent to

be due (the "billing-date approach"). Billing date approach courts typically find the plain language unambiguous, while proration courts find the language ambiguous.

The Bankruptcy Court for the District of Moot and the Court of Appeals for the Thirteenth Circuit incorrectly interpreted the plain language of § 365(d)(3) as ambiguous. The proration approach is scantily supportable under the text, rendering parts of the statute superfluous and at other times, incorrectly conflating terms between which Congress certainly knew how to distinguish. While the proration approach may reasonably narrow opportunities for debtor abuse, these policy considerations are for Congress to debate and not the courts. The judiciary must apply the plain language of the statute as it is written, regardless of equitable and policy considerations the court may find compelling. Here, because Terrapin rejected the lease on May 4 instead of April 31, the Trustee is obligated to pay May's rent to Touch of Grey. The statute's plain language ensures that the analysis does not reach farther than this simple arithmetic, just as Congress intended.

The plain language of § 365(d)(3) is explicit in stating that the trustee shall perform "all the obligations of the debtor … arising from and after the order for relief under any unexpired leaves of nonresidential real property." The statute addresses the trustee's timing requirement, and because adhering to the plain meaning of the statute would not create a result demonstrably at odds with Congress's intent, this Court should adhere to the plain meaning.

However, even if the Court found the statute ambiguous on its face, the legislative purpose nonetheless indicates substantial support for the billing date approach. Section 365(d)(3) was specifically enacted to ameliorate lessor financial burden and balance the burden normally borne exclusively on the lessor, to be placed temporarily on the shoulders of the lessee. Congress

further intended to eliminate doubt as to where the parties in a lease relationship stood regarding the estate, and clarify when and how the trustee must make payments.

The statute's meaning and purpose promote a balancing of equities amongst debtors and creditors. If a debtor foresees the need to file bankruptcy, the debtor will be more thoughtful in managing its affairs and timing its filing otherwise be caught paying a full month's rent. Creditors, because they have security in knowing they will receive current payment for current services, are more likely to extend goodwill to debtors in distress. Further, debtors are not harmed by the plain reading of § 365(d)(3) because they are able to decide for themselves when to file and have the power in the scenario, as opposed to the creditor who is left to the debtor's whims. Thus, this Court should reverse the decision of the Thirteenth Circuit and grant Touch of Grey's motion to compel payment for the full rent for the month of May. This Court should reverse the decision by the Thirteenth Circuit and rule in favor of Touch of Grey on both issues.

ARGUMENT

I. THE THIRTEENTH CIRCUIT ERRED IN HOLDING THAT AN ADMINISTRATIVE EXPENSE PAYMENT UNDER 11 U.S.C § 503(B)(9) PRECLUDES A CREDITOR FROM REDUCING ITS PREFERENCE EXPOSURE UNDER 11 U.S.C. § 547(C)(4) BY THE VALUE OF GOODS SOLD TO THE DEBTOR.

This Court should reverse the decision of the Thirteenth Circuit and hold that § 547(c)(4) allows for the reduction of preference exposure by the value of goods sold to a debtor, notwithstanding a later grant of administrative expense priority under § 503(b)(9).

Two sections of the Bankruptcy Code intersect in the case at hand — § 503 and § 547. Section 503 of the Bankruptcy Code provides for the payment of administrative expenses, including taxes and costs of preserving the estate. 11 U.S.C. § 503(b). Section 503(b)(9) was added to the Bankruptcy Code in 2005 and awards priority for the value of goods received by the debtor within 20 days before the petition is filed, if sold to the debtor in the ordinary course of

business. 11 U.S.C. § 503(b)(9). Section 503(b)(9) is significantly different from the other provisions of § 503, as it grants administrative priority for pre-petition debts. 4 Collier on Bankruptcy P 503.16 (16th 2021). As such, § 503(b)(9) prioritizes payment of pre-petition debts to vendors as administrative, elevating certain vendors above other classes of creditors. *Id.*

Section 547 of the Bankruptcy Code permits the trustee to avoid a transfer by the debtor to a creditor toward a debt owed, made on or within 9 days of the petition date if the transfer would enable the creditor to receive more than it would otherwise. 11 U.S.C. § 547(b). Section 547(b) was enacted by Congress to promote equality of distribution of shares of the debtor's estate among creditors and to provide a stable atmosphere for the debtor to work through and recover from financial challenges. *Lubman v. C.A. Guard Masonry Contractor, Inc. (In re Gem Constr. Corp.),* 262 B.R. 638, 644-45 (Bankr. E.D. Va. 2000). However, the Bankruptcy Code also provides exceptions to the trustee's avoidance power for transfers that would not promote these objectives. *Id*. Section 547(c) lists defenses that bar the trustee from avoiding transfers that meet certain criteria. 11 U.S.C. § 547(c).

The new value defense, also known as the subsequent advance exception, contained in § 547(c)(4) has been interpreted consistently to require two things: (1) the creditor gave new value to the debtor after the payments in question were made, and (2) the new value was unsecured. *Charisma Investment Company, N.V., Plaintiff-Appellant, v. Airport Systems, Inc. (In re Fla. Sys.),* 841 F.2d 1082, 1083 (11th Cir. 1988). Courts have regularly included a third requirement that, as of the petition date, the debtor has not fully compensated the creditor for the new value advanced. *In re N.Y.C. Shoe*s, 880 F.2d 679, 680 (3d Cir. 1989). New value is defined broadly by the Bankruptcy Code as: "money or money's worth in goods, services, or new credit, or release by a transferee of property previously transferred…" 11 U.S.C. § 547(a)(2). While courts have in

the past interpreted the new value defense to require that the new value remains unpaid, there has been a shift rejecting this approach as incompatible with the statutory language and potentially leading to absurd results. *Roberds, Inc. v. Broyhill Furniture (In re Roberds, Inc.)*, 315 B.R. 443, 470 (Bankr. S.D. Ohio 2004). Instead, more recent cases ask whether the new value has been paid for by "an otherwise unavoidable transfer." *In re IRFM, Inc.*, 52 F.3d 228, 232 (9th Cir. 1995).

This brief will first analyze the plain language and statutory context of § 547(c)(4). Next, this brief will address the new value replenished to the debtor's estate by the sale of goods on credit. Finally, this brief will review the intersection of the policy goals of §§ 503 and 547. The plain language and statutory context support closing the preference analysis window on the petition date, excluding the post-petition administrative payment from calculation of preference liability. Because the creditor replenished the debtor's estate, equipping the debtor to serve its customers and better positioning it to recover financially, the creditor's preference exposure should be reduced by the value of the goods advanced. Moreover, the overarching policy themes of §§ 503 and 547 encourage rewarding creditors that supply new value to financially distressed businesses by shielding them from preference exposure.

A. Read with the Context of the Rest of § 547, the Language of § 547(c)(4) Closes the Preference Analysis Window on the Petition Date.

The plain language and statutory context of § 547(c)(4) clearly delineate that the preference window closes on the petition date and, thus, Touch of Grey should be permitted to reduce its preference exposure accordingly. The Supreme Court maintains that "[s]tatutory construction is a holistic endeavor," particularly when it comes to the Bankruptcy Code. *United Sav. Ass'n of Tex. v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 371 (1987). Though

the statutory language should always be the starting point, context from the statutory scheme can illuminate ambiguity. *Id.*

1. Plain Language

The starting point for analysis of a statute should always begin with the plain language. *U.S. v. Ron Pair Enters., Inc.*, 489 U.S. 235, 241 (1989). Section 547(c)(4) states:

> "The trustee may not avoid under this section a transfer – 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). When the language of a statute is clear and unambiguous, the analysis should end there, and the courts should enforce the statute accordingly. *Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 6 (2000).

The plain language of § 547(c)(4) delineates the new value defense to include only pre-petition value and payments, closing the preference window when the bankruptcy petition is filed. *Phx. Rest. Grp., Inc. v. Ajilon Prof'l Staffing LLC (In re Phx. Rest. Grp., Inc.)*, 317 B.R. 491, 496 (Bankr. M.D. Tenn. 2004). Section 547(c)(4) refers only to "the debtor" rather than to "the debtor's estate," indicating that the new value must be pre-petition to qualify for the defense. *Bergquist v. Anderson–Greenwood Aviation Corp. (In re Bellanca Aircraft Corp.)*, 850 F.2d 1275, 1284 (8th Cir. 1988). Correspondingly, the only payments excluded by § 547(c)(4) are those for which the debtor made an unavoidable transfer to the creditor. 11 U.S.C. § 547(c)(4)(B). Just as post-petition transfers of value would not refer to "the debtor," post-petition payments would refer to "the trustee" or "the debtor-in-possession." *In re Bellanca Aircraft*

Corp., 850 F.2d at 1284. Section 547 consistently uses "the debtor" to refer specifically to the pre-petition party conducting business with the preference defendant and Congress did not distinguish § 547(c)(4) to refer otherwise. *In re Phx. Rest. Grp., Inc.*, 317 B.R. at 497. Consequently, the analysis of the new value defense closes at the petition date, without taking into consideration any post-petition payments, as the new value remains uncompensated by "the debtor," as required by § 547(c)(4). *Id.*

The phrase "otherwise unavoidable" included in § 547(c)(4)(B) is unambiguous and should not be misconstrued to require that the new value remains unpaid. *In re Phx. Rest. Grp., Inc.*, 317 B.R. at 498. The provision merely permits the new value defense unless the new value is repaid by the debtor by an otherwise unavoidable transfer. *In re Roberds*, 315 B.R. at 471. This interpretation tracks the statutory language and does not result in a windfall for the creditor. *Id.* at 473. Section 547(c)(4) replaced § 60(c), which did require that only unpaid value may be used to offset preference recovery. *In re Phx. Rest. Grp., Inc.*, 317 B.R. at 499. Congress could have retained this language but chose not to when formulating § 547(c)(4). *Id.* Requiring that the new value go unpaid "does not comport with the plain meaning of § 547(c)(4)." Robert H. Bowmar, *The New Value Exception To The Trustee's Preference Avoidance Power: Getting The Computation Straight*, 69 Am. Bankr. L.J. 65 (Winter 1995).

Because Touch of Grey only received administrative payment for the new value it provided Terrapin post-petition, this must not be considered when allocating preference liability. The debtor in *Phx. Rest. Grp., Inc.* made post-petition payments to a creditor that had provided staffing services, which the trustee later sought to avoid and recover as preferential. 317 B.R. at 493. Because these services were unpaid by "the debtor," the bankruptcy court stated that post-petition payments must not be considered when analyzing eligibility for the new value defense.

Id. at 497. Similarly, in a case out of the Eighth Circuit, *Bellanca Aircraft Corp.*, the creditor made payments to creditors, suppliers, and employees of the debtor on the debtor's behalf, which was found to constitute new value under § 547(c)(4). 850 F.2d at 1279-1281. The Eighth Circuit found that the language of § 547(c)(4) precludes consideration of post-petition transfers for the new value defense. *Id.* at 1284. Consistent with this reasoning, Touch of Grey's supply of goods, paid as an administrative expense under § 503(b)(9), was unpaid by Terrapin, the debtor, and should be protected by the new value defense and not subject to recovery as a preferential payment.

Consistent with the plain language of § 547(c)(4)(B), Touch of Grey may successfully assert the new value defense to preference exposure, regardless of whether the value has been paid post-petition. In *Roberds,* the court held that the creditor may use even paid new value in defense of preference liability, if the subsequent new value remains "otherwise avoidable" by the debtor. 315 B.R. at 472. In accordance with the plain language of the statute and the findings of the court in *Roberds*, this Court should not take post-petition payments into consideration in calculating and granting preference avoidance.

2. Statutory Context

Statutory context is a critical tool in interpreting a statute and in determining whether a provision is, in fact, ambiguous. *See Official Comm. of Unsecured Creditors of Cybergenics Corp., ex rel. Cybergenics Corp. v. Chinery*, 330 F.3d 548, 559 (3d Cir. 2003) (en banc). The Supreme Court has encouraged examination of the whole Bankruptcy Code, rather than simply homing in on a single sentence or provision. *Kelly v. Robinson*, 479 U.S. 36, 43 (1986). There are at least five contextual factors to consider when deciphering whether post-petition transfers should be included when calculating preference liability.

First, the statute of limitations to initiate a preference avoidance action usually begins on the date of the bankruptcy petition, so, logically, the debtor's estate should not be considered damaged by transfers after that date. *See* 11 U.S.C. § 546(a). Otherwise, the calculation of preference liability could greatly fluctuate based on the date the avoidance action was calculated and filed. *Friedman's Liquidating Tr. V. Roth Staffing Cos. LP (In re Friedman's Inc.)*, 38 F.3d 547, 556 (3d. Cir. 2013). Congress could have included a statute of limitations specifically for post-petition transactions, but it did not. *Id.* Therefore, it is implied that preference liability should remain fixed after the petition is filed and later transfers should not be considered. *Id.*

Second, § 547 is titled "Preferences." 11 U.S.C. § 547. Though minor, the title is likely not arbitrary. R. at 24. As the dissent in the Thirteenth Circuit suggested, this should guide interpretation of the section to relate to specifically to the preference period, which begins 90 days prior to the petition date and ends on the petition date. R. at 24.

Third, § 547(b)(5) contains a hypothetical liquidation test that is performed as of the petition date. 11 U.S.C. § 547(b)(5). The test instructs courts to determine whether the preferential payment received by a creditor is greater than what the creditor could have instead received in a liquidation. *Id.* Although the statute does not specify, courts have regularly interpreted that the test should be completed using the petition date as the cutoff. *See, e.g., In re Union Meeting Partners*, 163 B.R. 229, 237 (Bankr. E.D. Pa. 1994). As such, extending analysis of preference liability beyond the petition date is inconsistent with the hypothetical liquidation test set forth in § 547(b)(5). *In re Friedman's*, 38 F.3d at 556.

Fourth, § 547(c)(5) includes another defense to preference liability determined by the "improvement-in-position" test. 11 U.S.C. § 547(c)(5). This test refers specifically to post-petition transfers reducing debt owed to the creditor and focuses the analysis of the test to pre-

petition transfers exclusively. *Id.* The Third Circuit has interpreted this to support the argument that post-petition payments should not affect preference analysis under § 547(c)(4), either. *In re Friedman's*, 38 F.3d at 556.

Finally, post-petition payments and post-petition advancements of new value should be treated consistently under the new value defense. *In re Friedman's*, 38 F.3d at 557. It would be illogical and inequitable to permit post-petition payments to affect preference liability while excluding post-petition extensions of new value from consideration. *Id.* The "vast majority" of courts have held that any new value extended post-petition may not be used in preference analysis or to advance a new value defense under § 547(c)(4). *Id.* (collecting cases that have excluded post-petition new value from consideration for a creditor's new value defense). As referenced in *Friedman's*, "[l]ogically, and as a matter of statutory consistency," post-petition extensions of new value should not be excluded under § 547(c)(4) while simultaneously including post-petition payments in preference analysis. *Id*; *see also Kaye v. Accord Mfg., Inc. (In re Murray, Inc.)*, 2007 WL 5595447, at 2 (Bankr. M.D. Tenn. June 6, 2007).

The contextual clues discussed above come together to signal that the post-petition payments must not be considered when calculating preference exposure. This reasoning extends to administrative payments made pursuant to § 503(b)(9), because they are made post-petition. The petition date functions as the cutoff for analysis of preference exposure and availability of the new value defense.

B. Touch of Grey's Pre-petition Sale of Goods to the Debtor on Credit was an Otherwise Avoidable Transfer that Replenished the Estate with New Value, so Touch of Grey's Preference Exposure Should Have Been Reduced.

Congress created § 547(c)(4) with the intent to reward creditors that support financially fragile debtors. *In re Friedman's Inc.*, 738 F.3d at 558. As such, the defense should be interpreted

to shield the creditor advancing new value to the same extent they have attempted to benefit the debtor. *Id.* Providing new value positions the debtor to better recover and allows it to collect the profit margins on the goods and fulfill customer demands which "achieves the most important goal of a business entity -- to maximize its goodwill." *Commissary Operations, Inc. v. Dot Foods, Inc. (In re Commissary Operations, Inc.),* 421 B.R. 873, 879 (Bankr. M.D. Tenn. 2010).

The new value defense of § 547(c)(4) recognizes the value the creditor has contributed by protecting the creditor from later preferential effect. See, e.g., *In re Pitman*, 843 F.2d 235, 241-42 (6th Cir. 1988). A creditor that has replenished the debtor's estate "should not later be deemed to have depleted the bankruptcy estate to the disadvantage of other creditors," and, accordingly, the creditor should not later be subject to preference exposure. *Charisma Investment Company, N.V., Plaintiff-Appellant, v. Airport Systems, Inc. (In re Jet Florida Sys.), Inc.*, 841 F.2d 1082, 1083 (11th Cir. 1988) (per curiam). The creditor has acted consistently with an overarching purpose of the Bankruptcy Code and provided the debtor with necessary tools to attempt to avoid bankruptcy. *In re Commissary Operations, Inc.*, 421 B.R. at 878. The estate remains balanced, even if full or partial payment is later made, as the new value transfer to the debtor counteracts the payments made to the creditor. *In re Gem Constr. Corp.*, 262 B.R. 63, 645 (Bankr. E.D. Va. 2000).

Permitting a creditor that has advanced new value toward the debtor to avoid preference exposure does not result in a windfall for the creditor. *In re Friedman's*, 738 F.3d at 559. When a creditor has provided goods or services on credit, even during the preference period, the debtor realizes that benefit, even if the creditor is later paid for all or some of the value provided. *Id.* Thus, permitting the creditor to avoid preference liability for the payments received does not unjustly enrich the creditor. *Id.*

Touch of Grey's pre-petition sale of goods to the debtor on credit was an otherwise avoidable transfer that replenished the estate, so Touch of Grey's preference exposure should have been reduced accordingly. *In re Jet Florida Sys., Inc.*, 841 F.2d at 1083. In *Jet Florida Sys.*, the debtor made a sizable payment to a creditor during the 90-day preference window. *Id.* The Eleventh Circuit Court held that the creditor could have met the requirements for the new value defense had the debtor benefited from an extension of the new value. *Id.* at 1084. Because Terrapin made the payment to Touch of Grey within the preference window of 90 days, the transfer would ordinarily be recoverable by the Trustee under § 547(b). 11 U.S.C. § 547(b); R. at 5. However, the new value defense of § 547(c)(4) protects Touch of Grey from preference exposure for this transfer. 11 U.S.C. § 547(c)(4). Unlike the creditor in *Jet Florida Sys.*, the goods offered on credit by Touch of Grey clearly replenished the Debtor's estate with new value, and, as such, its preference liability should be reduced. R. at 6. Thus, consistent with the Bankruptcy Code, Touch of Grey should be permitted to avoid its preference exposure for that transfer.

Touch of Grey would not receive a windfall if permitted to avoid preference liability for the new value it provided. In *Friedman's*, the creditor provided services to the debtor during the preference period. 738 F.3d at 559. After the debtor filed its petition for bankruptcy, the creditor was paid for a portion of these services pursuant to a wage order by the court. *Id.* The Third Circuit held that because the creditor actually provided the services for which it was paid, it was not unjustly enriched and may use the new value to offset its preference liability. *Id.* Touch of Grey provided considerable value when it advanced goods to Terrapin. Though it did receive payment for a portion of the invoice, it should still be permitted to avoid preference exposure.

C. Reducing Touch of Grey's Preference Exposure by the Value of Goods Sold to the Debtor on Credit Would Serve the Bankruptcy Code's Overarching Policy Goal of Encouraging Trade Creditors to Continue Extending Credit to Distressed Businesses.

Though the meaning of § 547(c)(4) is clear in language and context, the policy goals advanced by Congress also support permitting Touch of Grey to reduce its preference exposure by the new value advanced, notwithstanding payments received as administrative expenses. Beyond the language and context of the statute itself, pre-Code practice, legislative history, and policy may be considered, though these tools should be a last resort. *Price v. Del. State Police Fed. Credit Union (In re Price)*, 370 F.3d 362, 369 (3d Cir. 2004). It is not the court's role to question how Congress balances competing policies underlying § 547 and the Bankruptcy Code as a whole. *Union Bank v. Wolas*, 502 U.S. 151, 162 (1991). While the Bankruptcy Code was intended to codify the pre-Code practice, providing stability for the debtors and equity of distribution for the creditors. *Id.* at 160-161. Equality of distribution among creditors is not always the goal – the Code provides for "reasoned and justified inequality" based on the interests of the estate. *In re Friedman's*, 38 F.3d at 560.

Section 503(b)(9) was added to the Bankruptcy Code in 2005. 11 U.S.C. § 503(b)(9). When Congress enacts new sections of the Bankruptcy Code, it is not writing "on a clean slate." *Emil v. Hanley*, 318 U.S. 515, 521 (1943). In the past, this Court has avoided construing provisions of the Bankruptcy Code to significantly change prior, pre-Code practice, without Congress stating that as its intention. *Dewsnup v. Timm*, 503 U.S. 410, 419. Congress chose not to amend § 547(c)(4) when it added § 503(b)(9) to the Code. *In re Commissary Operations, Inc.*, 421 B.R. at 879. Accordingly, § 503(b)(9) should not be construed to substantially change the new value defense contained in § 547(c)(4), as there is no legislative history supporting this argument. *Dewsnup*, 503 U.S. at 419.

Two overarching policies can be readily deduced from § 503(b)(9). First, it sought to discourage abuse by debtors seeking to acquire goods without making payment, knowing bankruptcy is inevitable. *In re Arts Dairy, LLC*, 414 B.R. 219, 220 (Bankr. N.D. Ohio 2009). Second, it rewards creditors who extend credit to debtors when bankruptcy is inevitable. *Id.* In § 503(b)(9), Congress gives special treatment for vendors providing goods to incentivize these creditors to support the debtor before and after the bankruptcy petition is filed. *In re Friedman's*, 38 F.3d at 560. Permitting creditors that have provided new value on credit and have received priority payment under § 503(b)(9) to avoid preference exposure under § 547(c)(4) is consistent with this purpose. *Id.*

This Court has described two overarching policies of § 547. First, the provision seeks to discourage the creation of a race to the courthouse as the creditors try to get as much out of the debtor as possible. *Union Bank*, 502 U.S. at 161 (quoting H.R. Rep. No. 95-595, at 177-78, 1978 U.S.C.C.A.N. 6137, 6138). Section 547 shields the debtor to increase its likelihood of recovering from its poor financial position. *Id.* Second, § 547 seeks to provide equal distribution to "similarly situated creditors." *In re First Jersey Sec., Inc.*, 180 F.3d 504, 511 (3d Cir. 1999). As stated above in relation to § 503(b)(9), the Bankruptcy Code does not offer equal distribution to all creditors, as some receive priority status, for example. *Id.*

The new value exception contained in § 547(c)(4) promotes the general policies of § 547 as a whole "because its utility is limited to the extent to which the estate was enhanced by the creditor's subsequent advances during the preference period." 4 *Collier on Bankruptcy*, para. 547.12, at 547-49 n. 5 (15th ed. 1987). More specifically, the new value defense is meant to reward creditors who extend new value to financially challenged businesses. *In re N.Y.C. Shoe*s, 880 F.2d at 681; *In re Roberds*, 315 B.R. at 468; *Chaitman v. Paisano Automotive Liquids, Inc.*

(In re Almarc Mfg., Inc.), 62 B.R. 684, 687-88 (Bankr. N.D. Ill. 1986); *Williams v. Agama Sys., Inc. (In re Micro Innovations Corp.)*, 185 F.3d 329, 336 (5th Cir. 1999); *Fitzpatrick v. Rockwood Water Wastewater & Natural Gas Sys. (In re Tennessee Valley Steel Corp.)*, 201 B.R. 927, 939 (Bankr. E.D. Tenn. 1996). The new value defense also allows for fair treatment of "a creditor who has replenished the estate after having received a preference." *In re N.Y.C. Shoe*s, 880 F.2d at 681.

Forcing such a creditor to choose between seeking payment under § 503(b)(9) and asserting a new value defense under § 547(c)(4) would thwart Congress' policy goals underlying §§ 503(b)(9) and 547(c)(4). *In re Commissary Operations, Inc.,* 421 B.R. at 879. Imposing this choice would "chill their willingness to do business with troubled entities" and would revoke the benefits Congress intended to reward sellers of goods. *Id.* Allowing payments to a creditor made under § 503(b)(9) to increase the creditor's preference liability and blocking use of the new value defense would counteract the policies of each section. *In re Friedman's,* 38 F.3d at 561. In *Friedman's,* the debtor received permission from the Bankruptcy Court to make payments to its personnel through the creditor, a staffing agency. *Id.* at 549. The trustee later sought to avoid the transfers as preferences under § 547(b). *Id.* The Third Circuit held that permitting the trustee to avoid the payments as preferences would defeat Congress' policy goals. *Id.* at 561. Additionally, the intent of providing the payments to the staffing agency, which was to "ensure continued service, satisfaction and loyalty" of the debtor's employees, would be negated if the court gave permission to pay the creditor one week, then allowed recovery from the creditor as a preference the next. *Id.* Here, Touch of Grey generously extended new value to the debtor, even with knowledge of the debtor's precarious financial position. Thus, like the creditor in *Friedman's*,

Touch of Grey should be shielded by the policies of both §§ 503(b)(9) and 547(c)(4) and permitted to avoid preference liability.

This Court should reverse the decision of the Thirteenth Circuit and permit the creditor to reduce its preference exposure under § 547(c)(4) by the value of the goods sold regardless of receiving administrative expense payment for the new value under § 503(b)(9). The creditor has replenished the debtor's estates with new value, equipping it to recover from bankruptcy and better serve its customers. The plain language and the statutory context support closing the preference analysis window on the petition date, which bars consideration of the post-petition administrative payment while calculating preference exposure. The overarching policy goals of the Bankruptcy Code, and §§ 503 and 547 in particular, support rewarding creditors who advance new value to distressed businesses by reducing preference exposure by the value of the goods sold.

II. THE THIRTEENTH CIRCUIT ERRED IN PRORATING THE DISPUTED RENT BECAUSE THE BILLING DATE APPROACH IS EXPLICITLY SUPPORTED BY (1) THE PLAIN, UNAMBIGUOUS TEXT OF 11 U.S.C. § 365(D)(3); (2) LEGISLATIVE PURPOSE; AND (3) POLICY CONSIDERATIONS.

The Bankruptcy Code has "two overarching purposes, one equitable and the other rehabilitative." *Westmoreland Human Opportunities Inc. v. Walsh*, 246 F.3d 233, 250 (3d Cir. 2001). Courts diverge on whether the trustee's rent obligation to pay the debtor's rent to the landlord "arises" - either (1) each day that the tenant occupies the property (the "proration approach"), or (2) the day set under the lease for rent to be due (the "billing-date approach"). *Compare In re Montgomery Ward Holding Corp.*, 268 F.3d 205, 209 (3d Cir. 2001) *with In re Ames Dept. Stores, Inc.*, 306 B.R. 43, 45 (Bankr. S.D.N.Y. 2004).

Procedurally, subject to the court's approval, a bankruptcy trustee may elect to reject or assume unexpired leases pursuant. 11 U.S.C. § 365(a). When the debtor is a lessee bound to an

unexpired lease of nonresidential real property, the trustee has a 120-day clock from the order of relief date to choose whether to assume or reject the lease. 11 U.S.C. § 365(d)(4); *see also* Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (2005) (extending the assumption and rejection timeline from its original 60 days to 120 days). The Bankruptcy Court may elect to extend that limit up to 90 more days. 11 U.S.C. § 365(d)(4)(B)(I). The lease is deemed rejected as a matter of law if the trustee does not act within that period of time. *Id.* Prior to assumption or rejection, the trustee must continue to "perform all the obligations of the debtor" under the lease. 11. U.S.C. § 365(d)(3).

This brief will first address when the trustee's obligation to pay the debtor's debt arises. This brief will then analyze what Congress meant when it referred to the "obligations of the debtor arising under a lease for an order of relief"; specifically, whether Congress intended a proration of amounts or all amounts to be paid by the trustee. Finally, this brief will analyze policy considerations: the equitable nature of the billing date approach and the importance of encouraging uniformity in the circuit courts. Touch of Grey's embrace of the billing date approach, unlike the proration approach, is consistent with legislative history and the plain text of the statute, while also flexibly allowing courts to take into account policy and equity considerations foundational to the Bankruptcy Code.

A. Section 365(d)(3)'s Plain Language is Unambiguous and Explicit Concerning the Debtor's Post-petition Obligations: the Trustee Must Pay Post-petition Rent in Full Under the Lease's Terms.

Section 365(d)(3) provides:

> [T]he trustee shall timely perform all the obligations of the debtor . . . arising from and after the order for relief under any unexpired lease of nonresidential real

> property, until such lease is assumed or rejected, notwithstanding § 503(b)(1) of this title.

11 U.S.C. § 365(d)(3).

The Supreme Court has previously directed "the starting place in any case involving construction of a statute is the language itself." *U.S. v. Ron Pair Enters., Inc.*, 489 U.S. 235; *see also Good Samaritan Hosp. v. Shalala*, 508 U.S. 402, 409 (1993). "When a statute is unambiguous, resorting to legislative history and policy considerations is improper." *In re Lucas*, 924 F.2d 597, 600 (6th Cir. 1991). While equity considerations are important under the Bankruptcy Code, "[t]he fact that Congress may not have foreseen all of the consequences of a statutory enactment is not sufficient reason for refusing to give effect to its plain meaning." *In re Appletree Markets, Inc.*, 139 B.R. 417, 419 (Bankr. S.D. Tex. 1992).

Had Congress intended to adopt a proration approach, Congress would have used "claim" instead of "obligation." *In re Montgomery Ward Holding Corp.*, 268 F.3d at 208 (*citing In re R.H. Macy and Co., Inc.*, 236 B.R. 583, 585 (Bankr. S.D.N.Y. 1999)). "Claim" limits the debtor's responsibilities to liabilities post-petition, while "obligation" encompasses liabilities post-petition regardless of when the liability accrues. *Id*. In *Montgomery Ward*, the landlord sought for the trustee to pay its complete lease obligations in full. *Id.* The Third Circuit agreed, stating that "an approach which calls for the trustee to perform obligations as they become due under the terms of the lease fits comfortably with the statutory text." *Id*. at 209.

The proration approach would render "arising from and after the order for relief" as superfluous and this "cannot be what Congress meant." *In re DeCicco of Montvale, Inc.*, 239 B.R. 475, 481 (Bankr. D.N.J. 1999) (quoting *In re F & M Distributors*, 197 B.R. 829, 831-32 (Bankr. E.D. Mich. 1995). When the statute is "clear on its face … enough to avoid creating an

ambiguity where none exists," then "the statute's plain language must be followed, regardless of equitable or policy considerations." *DiCicco,* 298 B.R. at 480. In *DiCicco,* the court looked to § 365(d)(3)'s plain language against the supermarket debtor's Modification Agreement which mandated payment of rent and taxes. *Id.* The plain language and lease terms governed the court's textualist ruling that the debtor must pay its taxes and additional rent in full. *Id.*

Regardless of whether "the billing date approach is more extreme … [courts] are nonetheless constrained to follow the language of § 365(d)(3) which applies to all unexpired leases of nonresidential real property…" *In re Burival,* 406 B.R. 548, 554 (Bankr. App. 8th Cir. 2009), *aff'd,* 613 F.3d 810 (8th Cir. 2010). In *Burival,* the debtors were obligated to pay two lease payments per year for crop land when the payment was due two days after the chapter 11 petition. *Id.* Despite the length of the two-year lease, the court adopted the bright-line billing date approach stating: "where the language of a statute is clear, [the court's] job is to enforce the language according to its terms." *In re Burival,* 406 B.R. at 553. The court conceded a crop land lease situation where rent is payable once or twice a year is "extreme" as opposed to a standard commercial lease where rent is paid monthly, the court nonetheless found the billing date approach most closely adhered to the text and enforced full payment of the two-year lease's terms. *Id.*

Section 365(d)(3) is clear on its face and contains no ambiguity that would require the Court to resort to the statute's legislative history. Section 365(d)(3)'s plain meaning requires payment of obligations that arise post-filing of the petition, and this Court is constrained to follow the explicit language of § 365(d)(3). Like the supermarket debtor in *DeCicco*, Terrapin's obligation to pay the lessor rent arose when the lease agreement mandated, and the court is constrained to follow the plain language of § 365(d)(3) which states the obligation to pay arises

under the lease's terms. Similar to the cropland debtor's lease in *Burival*, Terrapin rejected the lease mere days after filing and is required to pay the full amount of rent; but unlike the lessor in *Burival* requesting payment of an "extreme lease" for two years, Touch of Grey is merely requested a simple month's rent owed to it under the statute's plain language in accordance with the lease mutually agreed upon by both parties. Therefore, the trustee's obligation to pay Terrapin's rent to Touch of Grey is governed by § 365(d)(3) and the lease's terms.

B. Congress Intended § 365(d)(3) to be a Shield for Lessors – Not a Sword for Debtor-Tenants to Repel Lessors Seeking Rent Owed to them Under the Lease.

Even if this Court found the plain language of § 365(d)(3) unpersuasive, it should still find in favor of Touch of Grey and award "stub" rent under the billing date approach most circuit level courts have adopted. *See In re Oreck Corporation,* 506 B.R. 500, 506 (Bankr. M.D. Tenn. 2014). Section 365(d)(3) embodies the legislative intent to support "the principle of current payment for current services." *Koenig Sporting Goods, Inc. v. Morse Rd. Co. (In re Koenig Sporting Goods, Inc.),* 229 B.R. 388, 393 (Bankr. App. 6th Cir. 1999). Proration was the pre-Code amendment practice, and courts were previously cautioned not to "read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure." *Pennsylvania Dept. Pub. Welfare v. Davenport*, 495 U.S. 552, 563 (1990). In light of recent amendments, "Congress intended that the debtor in possession perform all the obligations at the time required in the lease." *Montgomery Ward*, 268 F.3d at 210. "[T]he legislative history indicates that the statute was enacted to ameliorate the immediate financial burden borne by lessors of nonresidential property during the period in which trustees decided whether to assume a lease[.]" *In re Pacific-Atlantic Trading Co.,* F.3d 401, 404 (9th Cir. 1994). In addition, the House Report for the 1984 Amendments discussed § 365(d)(3)'s effect on courts, stating: "[C]ourts will have to insure [sic] that the trustee's performance under the contract or lease gives

the other contracting party *the full benefit of his bargain*." Cherkis and King, 1 *Collier on Real Estate Transactions and the Bankruptcy Code*, § 3.01[6] (2008) (emphasis added).

Under §§ 503(b)(1)(A) and 507(a)(1), the property rent accrued by a debtor functions as an administrative expense. Joshua Fruchter, *To Bind or Not to Bind - Bankruptcy Code S 365(d)(3): Statutory Minefield*, 68 Am. Bankr. L.J. 437 (1994). The Bankruptcy Code provides administrative priority for "actual, necessary costs, and expenses of preserving the estate, including services rendered after the commencement of the case." *In re Appletree Markets, Inc.*, 139 B.R. at 419. Prior to the enactment of § 365(d)(3), upon the debtor rejecting the lease, the landlord could only receive the costs of preserving the debtor's estate instead of receiving the rent due – until the 1984 Shopping Center Amendments were passed to protect commercial landlords and ensure chapter 11 debtors continued to perform obligations under their leases which included rent. *See In re Burival*, 406 B.R. at 553. Congress passed this statute because it "intended § 365(d)(3) to shift the burden of indecision to the debtor: the debtor must now continue to perform all the obligations of its lease or make up its mind to reject it before some onerous payment comes due during the prerejection period." *In re Krystal Co.*, 194 B.R. 161, 163 (Bankr. E.D. Tenn. 1996). Congress found reapportioning the burden to the debtor to select when the party would reject the lease to be "a sensible adjustment of this particular debtor-creditor relationship." *Id.*

To reduce burdens on lessors and encourage creditors to assist a struggling debtor, Congress amended § 365 by incorporating subsection (d)(3) – which provides parameters that detail how and when lessors need be paid when the debtor has not rejected a lease. *Id.* The legislative history of the Bankruptcy Amendments and the Federal Judgeship Act of 1984 are both instructive to courts when applying the Billing Approach:

> "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 … 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 [sic] that debtor-tenants pay their rent, common area, and other charges on time pending the trustee's assumption or rejection of the lease."

130 Cong. Rec. S8894-95 (daily ed. June 29, 1984) (remarks of Sen. Orrin Hatch) (emphasis added).

Section 365(d)(3)'s purpose 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." *In re Koenig Sporting Goods, Inc.*, 203 F.3d 986, 989 (6th Cir. 2000). In *Koenig*, the lessor sought to recover a full month's rent from the debtor who rejected the lease on December 2. *Id.* The bankruptcy court stated in dicta that "Congress was no doubt well aware that rental is usually paid monthly in advance" and thus "it is not possible" that § 365(d)(3) could accord the debtor leeway to not pay its rent. *Id.* at 740. If it were a multi-year lease or even a year's lease at stake, the court stated this would possibly "distort fundamental bankruptcy principles," but a month falls within the purview of § 365(d)(3). *Id.* The court also emphasized that "as a practical matter, debtors should usually be able to plan the time of lease rejection so as to minimize rent payments." *Id.*

"Congress passed § 365(d)(3) to relieve landlords of the uncertainty of collecting rent fixed in the lease 'in full, promptly, and without legal expense' during the awkward post-petition prerejection period." *HA-LO Industries, Inc. v. CenterPoint Properties Tr.*, 342 F.3d 794, 799 (7th Cir. 2003). In *HA-LO*, the debtor rejected the lease on November 2 when the rent was due

on November 1. *Id.* The court found the debtor had to pay the full month's rent, noting the statute's purpose of balancing "equity" led the court to suspiciously view the debtor "elect[ing] to reject the lease one day after its monthly rent obligation would arise." *Id.*

Section 365(d)(3) was specifically promulgated to protect creditors, who are in a unique position to continue dolling out services with no financial return, against debtors abusing the opportunity to time their bankruptcy filings, leading to a windfall for the debtor who reaps the benefits of using the property without paying the expense. Like the debtor who rejected the lease on the second of the month in *Koenig* and *HA-LO*, Terrapin rejected the lease less than a week into the month. Thus, Touch of Grey is entitled to secure the remainder of May's rent.

C. The Billing Date Approach Balances All Parties' Interests and Prevents Windfalls by Leaving the Right of Rejection in the Hands of Debtors.

In a month-to-month, payment-in-advance lease – wherein the debtor has complete control over the timing of rejection–equity favors full payment to the landlord. *In re Koenig*, 203 F.3d at 989. In *Koenig*, the Sixth Circuit addressed a dispute over the payment of post-petition, pre-rejection rent for a nonresidential lease. *Id.* at 987-88. The court rejected the debtor's argument that a payment of a full month's rent would be inequitable when the debtor only occupied the premises for the first two days of the billing term. *Id.* at 989. The court reasoned that the debtor had total discretion to reject the lease on the day before the billing date and could have avoided paying rent altogether had it so chosen. *Id.* at 989-90. Further, the court stressed that equity favors relieving the burden of landlords in the post-petition, pre-rejection period because of the landlord's particularly constrained role vis-a-vis the estate. *Id.* at 989 (*citing Omni Partners, L.P. v. Pudgie's Dev. of NY, Inc. (In re Pudgie's Dev. of NY, Inc.)*, 239 B.R. 688, 692 (S.D.N.Y. 1999)). The court held that the receipt of a full month's rent is not a "windfall" for the landlord but rather is fair payment for services rendered to the estate. *Id.* at 990. In essence, the

full payment of rent due on the billing date equitably balances the landlord's interest in the complete performance of the lease and the debtor's interest in freedom to assume or reject a lease based on its benefit to the estate. *Id.* at 988-89; *see also In re Krystal*, 194 B.R. at 164 ("Congress intended § 365(d)(3) to shift the burden of decision to the debtor."); *see also In re Burival*, 406 B.R. at 554 (adopting the billing date approach and concluding that the debtor must consider its lease obligations when timing its bankruptcy petition and lease rejection).

Much of the Sixth Circuit's reasoning in *Koenig* applies with equal force here. Under the billing date approach, the Debtor was free to reject the Lease and vacate the Premises prior to the May 1, 2020 billing date. Had the Debtor done so, Touch of Grey would not have been entitled to any rent for the month. The Debtor would avoid the pressure of paying another month's rent if the burden was too costly, while freeing Touch of Grey from its difficult position and allowing it to begin searching for a new tenant. Alternatively, the Debtor could pay its rent due under the Lease in exchange for the right to occupy the Premises for the entire month of May. The Debtor would continue operations for the entire month while also retaining the right to reject the lease; Touch of Grey would receive no more than the value of the service rendered to the estate (the right of occupancy). Neither of these choices would result in a windfall for either party, and Touch of Grey's interest in performance of the Lease would be equitably balanced against the Debtor's interest in using the right of rejection to the benefit of the estate. Finally, adoption of the billing date approach would encourage debtors to seriously consider the interests of the estate in timing lease-rejection and prevent costly litigation to determine exactly how much daily rent had accrued on a case-by-case basis.

D. The Thirteenth Circuit Erred in Creating an Unnecessary Circuit Split by Adopting the Accrual Approach Without a Compelling Reason to Do So, Because the Billing Date Approach is Better Supported by Persuasive Authority.

One of the most important cases in the development of the proration approach is *Handy Andy Home Improvement Ctrs.*, a bankruptcy case from the Seventh Circuit. *In re Handy Andy Home Improvement Ctrs.*, 144 F.3d 1125 (7th Cir. 1998). The lease in *Handy Andy* included a requirement that the lessee reimburse the lessor for all real estate taxes on the property during its term and explicitly provided that—should the lease end during rather than at the end of a tax period—the lessee would be responsible only for those taxes that had accrued *before* termination. *Id.* at 1126. The county taxes in question were billed to the lessor after the period for which the taxes had been assessed, and the lessor's reimbursement would typically occur on the billing date in the lease. *Id.* The question before the court was whether taxes assessed for a pre-petition period, but billed to the lessee between the petition date and the rejection of the lease, "arose" pre-petition or post-petition for the purposes of 11 U.S.C. § 365. *Id.* After considering the retroactive nature of the taxes and their sunken costs, the Seventh Circuit deferred to the lease and determined that the lessee's tax obligations "arose" when the lessee occupied the premises, not when the lessor sent the lessee the bill. *Id.* at 1127-28.

Many bankruptcy courts have cited *Handy Andy* to support an adoption of the proration approach to rental obligations under § 365(d)(3). *See, e.g.*, *In re NETtel Corp., Inc.*, 289 B.R. 486, 492-496 (Bankr. D.D.C. 2002) (relying heavily on *Handy Andy* to support prorating pre-rejection rent for a commercial lease under § 365(d)(3)); *El Paso Props. Corp. v. Gonzales (In re Furr's Supermarkets, Inc.)*, 283 B.R. 60, 66-68 (B.A.P. 10th Cir. 2012) (referring to *Handy Andy* as the "leading case for the proration rule" and citing *Handy Andy* to support prorating pre-rejection rent under § 365(d)(3)). As noted in Judge Weir's dissent below, this so-called "*Handy*

Andy" proration approach to interpreting § 365(d)(3) slowly gained favor in a majority of bankruptcy courts, despite finding no support in the circuit courts, including the Seventh Circuit itself. R. at 30. *But see In re GCP CT School Acquisition, LLC*, 443 B.R. 243, 254 n.70 (Bankr. D. Mass. 2010) (adopting the proration approach but conceding that the Seventh Circuit's decision in *HA-LO* and decisions by the Third, Sixth and Eighth Circuits have made it unclear whether proration is still the "majority" approach). In *HA-LO*, the Seventh Circuit clarified the nature and limits of its prior holding in *Handy Andy*: *Handy Andy* applied specifically to "sunken cost" tax assessments and the dividing-line between pre-petition and post-petition debts, not traditional rental obligations arising after the petition date. *In re HA-LO,* 342 F.3d at 798 ("We held in *Handy Andy* that the portion of taxes that accrued during Handy Andy's pre-petition occupancy therefore had arisen pre-petition, and thus were akin to "sunk costs" that are not chargeable to Handy Andy even though billed postpetition.") In a dispute over a rental obligation that arose post-petition but was allocable past the date of rejection, the lessee was obligated to pay the rental obligation in full. *Id.* at 799; *see also GCP CT School Acquisition*, 443 B.R. at 254 n.69 (discussing the distinguishable holdings in *Handy Andy* and *HA-LO*, noting that "the Seventh Circuit has held that the billing date is determinative for rent, but taxes should be prorated").

The precise relationship between the Seventh Circuit's holding in *Handy Andy* and its holding in *HA-LO* is particularly useful for addressing our case, and of § 365(d)(3) cases in general. The facts and holding of *Handy Andy* can be distinguished from the case at hand on multiple grounds. First, the Lease did not include any express proration provisions. R. at 4. Second, the issue in our case does not center on the dividing-line between pre-petition and post-petition debt, but rather on the dividing line between the post-petition period and the post-

rejection period for § 365(d)(3) purposes. R. at 9, 16. Finally, the disputed payment is not a retroactive tax liability that had accrued over the previous year's occupation of the premises, but rather were traditional rental obligations that came due in the post-petition, pre-rejection period. R. at 9. Considering these distinctions, the facts in our case fall closer to *HA-LO* than to *Handy Andy*. Curiously, the Thirteenth Circuit chose not to address any of these factual and legal distinctions in the decision below, instead dismissing the two holdings as "conflicting opinions." R. at 17, n.7.

The majority of circuit courts avoid creating a circuit split absent a "compelling" reason to do so. *See Alternative Sys. Concepts, Inc. v. Synopsys, Inc.*, 374 F.3d 23, 31 (1st Cir. 2004) ("A court of appeals should always be reluctant to create a circuit split without a compelling reason, and none exists here."); *United States v. Thomas*, 939 F.3d 1121, 1130 (10th Cir. 2019) (collecting cases). This is especially relevant regarding bankruptcy, where "uniformity is sufficiently important that our Constitution authorizes Congress to establish 'uniform laws on the subject of bankruptcies throughout the United States.'" *In re Ultra Petroleum Corp.*, 943 F.3d 758, 763-64 (5th Cir. 2019) (citing U.S. CONST. art. 1, § 8, cl. 4). The decision below gave no direct explanation – beyond noting a "prevalence of conflicting decisions" – as to what compelling reason motivated the Thirteenth Circuit to depart from the interpretation of § 365(d)(3) reached by every circuit court that addressed the issue prior. R. at 17 n.7.

This Court should reverse the decision of the Thirteenth Circuit and grant Touch of Grey the full payment of May, 2020's rent in the value of $25,000, pursuant to 11 U.S.C. § 365(d)(3). The plain language and the statutory context of § 365(d)(3) unambiguously support deferring to the lease to determine when an obligation arises, demanding full performance on the billing date. The billing date approach best achieves equitable outcomes by balancing the landlord's interest

in payment for services rendered to the estate with the tenant's interest in holding the right of rejection. Finally, the Thirteenth Circuit's decision erroneously created an unnecessary and undesirable circuit split without a compelling reason to do so. Therefore, a reversal of the Thirteenth Circuit's decision would best uphold the statutory and equitable purposes of § 365(d)(3) and the Bankruptcy Code's preference for uniformity.

CONCLUSION

For the foregoing reasons, this Court should reverse the decisions of the Court of Appeals for the Thirteenth Circuit on both issues and find in favor of Petitioner.

Respectfully Submitted,

Team 21
Counsel for Petitioner
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