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 R24
Counsel for Respondent

QUESTIONS PRESENTED

1. Whether a creditor can use the same value of goods, which has already been paid in full under 11 U.S.C. § 503(b)(9), to also reduce its preference exposure under a new value defense pursuant to 11 U.S.C. § 547(c)(4).

2. Whether 11 U.S.C. § 365(d)(3) requires a trustee to pay rent due before rejection of an unexpired non-residential lease even though the rent relates to the period after the date of rejection when the estate no longer derives any benefit from the lease.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

CASES

STATUTES

OTHER AUTHORITIES

OPINIONS BELOW

The United States Bankruptcy Court for the District of Moot (the "Bankruptcy Court") ruled in favor of Casey Jones, the chapter 7 trustee (the "Trustee") appointed to administer the bankruptcy estate of Terrapin Station, LLC's (the "Debtor") when it held that: (i) creditor Touch of Grey Roasters, Inc. ("Touch of Grey") was not entitled to reduce its preference exposure under section 547(c)(4) of the Bankruptcy Code[1] by the value of goods it sold to the Debtor within twenty days prior to the commencement of the Debtor's chapter 11 proceeding where it received payment in full for such goods under section 503(b)(9); and, (ii) Touch of Grey, as the Debtor's landlord, was entitled under section 365(d)(3) only to a prorated administrative expense for the rent up to rejection of the lease on May 5, 2020 instead of the full month's rental payment. R. 9.

The United States District Court for the District of Moot (the "District Court") granted Touch of Grey's appeal of both decisions on a consolidated basis. R. 9. The District Court adopted the Bankruptcy Court's findings of fact and conclusions of law and affirmed its ruling in favor of the Trustee on both issues. R. 3. After such ruling, Touch of Grey appealed both issues to the United States Court of Appeals for the Thirteenth Circuit (the "Thirteenth Circuit"), which affirmed the District Court's ruling. R. 3. Touch of Grey then petitioned this Court for writ of certiorari, which the Court granted. R. 1.

STATEMENT OF JURISDICTION

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

[1] As used herein, the term "Bankruptcy Code" refers to 11 U.S.C. §§ 101 *et. seq*. (2020). All statutory references hereinafter are to the Bankruptcy Code, unless otherwise noted.

RELEVANT STATUTORY PROVISIONS

United States Constitution, Art. I, § 8, cl. 4
[The Congress shall have the Power…] To establish … uniform Laws on the subject of Bankruptcies throughout the United States.

11 U.S.C. § 547(c)(4)
The trustee may not avoid under this section a transfer—

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

(A) not secured by an otherwise unavoidable security interest; and

(B) on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor ….

11 U.S.C. § 503(b)(9)
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.

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

11 U.S.C. § 365(g)(1)
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 ….

11 U.S.C. § 502(g)(1)
A claim arising from the rejection, under section 365 of this title or under a plan under chapter 9, 11, 12, or 13 of this title, of an executory contract or unexpired lease of the debtor that has not been assumed shall be determined, and shall be allowed under subsection (a), (b), or (c) of this section, or disallowed under subsection (d) or (e) of this section, the same as if such claim had arisen before the date of the filing of the petition.

STATEMENT OF FACTS

The Independent Coffeehouse

For more than a decade, the Debtor operated as a popular and successful independent coffeehouse in Terrapin, Moot. R. 3. Mr. Tell, the Debtor's founder and sole proprietor, started operations in 2005. The coffeehouse did well—it had a loyal customer base and received awards including "Independent Coffee House of the Year" by Java Digest. R. 3, 4.

Touch of Grey is an international coffee company with a chain of over 1,900 coffeehouses around the world, some of which it owns, some of which are franchise operations. R. 3. As a response to increased consumer demand for local, independent businesses, Touch of Grey expanded into this market by opening a series of "neighborhood coffeehouses" that would be owned by the company, but not branded as such so that consumers would not realize they were patronizing the international chain. R. 4.

A New Business Venture

As a part of its new "neighborhood coffeehouses" strategy, Touch of Grey approached the Debtor to solicit its interest in franchising one of its new stores. R. 4. Notwithstanding the Debtor's success up to that point, Mr. Tell was intrigued by the opportunity to partner with the industry giant because he was looking to remodel his store. R. 4.

Accordingly, the Debtor and Touch of Grey made a deal on July 1, 2018, whereby Touch of Grey purchased and leased under the terms of a lease agreement (the "Lease") a new, renovated warehouse space (the "Premises") to the Debtor in Terrapin's downtown entertainment district. R. 4. The Lease, a twenty-year triple-net lease, required the Debtor to pay monthly rent of $25,000 due "in advance of the first day of each month." R. 4. Furthermore, the Debtor as franchisee, and Touch of Grey, as franchisor, entered into a franchise agreement

whereby the Debtor would exclusively purchase and sell Touch of Grey branded coffee products (the "Franchise Agreement"). R. 4. Completely beholden to Touch of Grey under the Lease and Franchise Agreement, Mr. Tell closed the Debtor's original coffeehouse location to focus his efforts on operating and maintaining the new coffeehouse. R. 5.

Signs of Trouble

Touch of Grey's "neighborhood coffeehouse" concept fared poorly—a group of local independent coffeehouse owners quickly became outraged when they learned that the Debtor's new store had been transformed into a "big-coffee in disguise." R. 5. The angry owners launched an effective local advertising campaign to spread word of Touch of Grey's veiled attempts to penetrate the local, independent coffee market. The business also struggled to establish itself in the competitive environment of Terrapin's entertainment district. R. 5.

Burdened by lower-than-expected sales and above-market rent in the new location, the Debtor became unable to pay debts as they became due as early as September 2019. R. 5. The Debtor remained current on the Lease, but by early November 2019 owed Touch of Grey $700,000 for Touch of Grey products it had been required to purchase under the Franchise Agreement. R. 5. On top of its debt to Touch of Grey, the Debtor also owed over $500,000 to various unsecured creditors who ceased providing the Debtor goods and services on credit. R. 6. Rather than give the Debtor time and support to turn its business around, in early December 2019 Touch of Grey chose to threaten to terminate the Franchise Agreement. It used that threat to procure the Debtor to enter into a forbearance agreement (the "Forbearance Agreement"), whereby the Debtor (i) paid $250,000 of the outstanding invoices immediately, (ii) reaffirmed the Debtor's obligations under the Lease, and (iii) granted Touch of Grey a broad release in return for Touch of Grey forbearing from terminating the Franchise Agreement. R. 5.

Notwithstanding the prompt payment made under the Forbearance Agreement, Touch of Grey subsequently refused to advance any more goods to the Debtor until Mr. Tell signed a personal guarantee to purchase $200,000 worth of Touch of Grey coffee products on December 18, 2019 (the "Personal Guarantee"). R. 5. The goods were delivered on December 21, 2019. R. 5, 6. However, the holiday season sales were not enough to sustain the coffeehouse, and the Debtor filed a voluntary petition for relief under chapter 11 of the Bankruptcy Code on January 5, 2020 (the "Petition Date"). R. 6. On the Petition Date, the Debtor was current on its obligations to Touch of Grey under the Lease, but Touch of Grey held a $650,000 claim for its products.

An Interrupted Reorganization

Upon the commencement of its chapter 11 case, the Debtor announced its intentions to return to traditional coffeehouse operations and find a sub-lessee for a portion of the premises the Debtor occupied under the Lease to make the Debtor's rent more manageable, while also proposing to continue the sale of Touch of Grey branded products as required under the Franchise Agreement. R. 6. However, Touch of Grey refused to continue to sell goods to the Debtor postpetition without concurrent payment. R. 6. Because such goods were essential to continue operating, the Debtor filed a motion requesting authority to pay Touch of Grey $200,000 of its $650,000 claim as a critical vendor. R. 6.

Unsure whether such a payment was permitted under the Bankruptcy Code, the Bankruptcy Court ultimately awarded Touch of Grey an administrative expense under section 503(b)(9) for the value of the $200,000 invoice of goods delivered to the Debtor on December 21, 2019. R. 7. Shortly after the ruling, the Debtor paid Touch of Grey's

administrative expense claim in full and Touch of Grey resumed advancing goods on credit to the Debtor. R. 7.

Despite the Debtor's best efforts, the Debtor's reorganization prospects took a drastic hit once the COVID-19 pandemic forced it to temporarily close its doors in March 2020. R. 7. Even when the Debtor was able to reopen in April 2020, the customers did not return. As a result, the Debtor permanently ceased its operations, vacated the Premises, and returned the keys to Touch of Grey on May 5, 2020. R. 7.

The next day, the Debtor filed a motion to reject the Lease and Franchise Agreement with Touch of Grey, effective May 5, 2020. R. 7. In response, on May 8, 2020, Touch of Grey filed a competing motion ("Rent Motion") to compel payment of the May rent in full, claiming it was due under the Lease as of May 1, 2020. R. 7.

At the hearing on the competing motions held on May 29, 2020, the Debtor announced that it was converting its case to a chapter 7 liquidation pursuant to section 1112(a) of the Bankruptcy Code. R. 8. No parties objected to the Debtor's request, and as a result, the Bankruptcy Court entered an order converting the case and appointing the Trustee that same day. R. 7–8. The court granted the Debtor's motion to reject the Lease and Franchise Agreement effective May 5, 2020, but reserved ruling on Touch of Grey's Rent Motion. R. 8.

The Adversary Proceeding

The Trustee, as the new fiduciary of the Debtor, objected to Touch of Grey's Rent Motion and filed an adversary proceeding (the "Adversary") against Touch of Grey to avoid and recover, for the benefit of all creditors, the Debtor's $250,000 prepetition payment to Touch of Grey under sections 547(b) and 550(a) of the Bankruptcy Code. In its answer, Touch of Grey asserted a new value defense under section 547(a)(4). R. 8. After briefing and oral arguments on

the Rent Motion and cross-motions for summary judgment in the Adversary, the Bankruptcy Court ruled in favor of the Trustee on both matters. R. 9. With respect to the Rent Motion, this resulted in a prorated $4,032.26 rent payment for May instead of the $25,000 due for the full month. As for the Adversary, summary judgment was granted in favor of the Trustee and Touch of Grey was not allowed to use the value of the *same* goods for both its administrative expense, which had already been paid, and a new value defense. R. 9.

Touch of Grey appealed both decisions to the District Court, which affirmed both rulings of the Bankruptcy Court. R. 3. Subsequently, the Thirteenth Circuit again affirmed both holdings. R. 3. Touch of Grey then petitioned for writ of certiorari, which this Court granted. R. 1.

SUMMARY OF THE ARGUMENT

While the Bankruptcy Code confers a multitude of benefits and provides a variety of incentives to creditors, nowhere in the Code is double dipping permitted. International coffee giant Touch of Grey is attempting to use its position as the most powerful creditor in this case to enhance its position to the detriment of other parties in the Debtor's bankruptcy estate. First, Touch of Grey seeks to offset its preference liability utilizing the new value defense under section 547(c)(4), despite its administrative claim for the same goods already being paid in full. Second, Touch of Grey seeks to recover rent accrued post-rejection when no value is provided to the estate for the same. Such a result would elevate Touch of Grey above all other unsecured creditors in this matter at the expense of all other parties in this case.

The plain language, surrounding provisions, and fundamental policy goals of sections 503(b)(9) and 547(c)(4) and the federal bankruptcy system confirm that when a creditor is paid its claim in full under section 503(b)(9) for the value it extended to the debtor shortly

before bankruptcy, it cannot also use that same value to reduce its preference exposure under section 547(c)(4).

The plain language of section 547(c)(4) is clear. There is no cutoff in the statute that would, as Touch of Grey suggests, limit the new value defense calculation to only include prepetition payments. Accordingly, section 503(b)(9) administrative expense payments can and should be considered when calculating the new value defense when there is no ongoing benefit to the estate. Section 503(b)(9) administrative expense claims constitute an "otherwise unavoidable transfer" because the Bankruptcy Court authorized the Debtor to make the payment to Touch of Grey.

A plain language interpretation of section 547(c)(4) most effectively balances the dual policies of preference law as well as the overarching policy goals of bankruptcy. While bankruptcy law creates incentives for creditors not to race to the courthouse and rewards those who provide ongoing benefits by creating exceptions to its policy of equality of distribution, such exceptions have limits. Creditors cannot "have their cake and it, too" while unnecessarily depleting the estate. Here, such double dipping would place Touch of Grey far above its intended priority status as an administrative expense claimant at the expense of the debtor's estate.

As with reclamation claims, paying a creditor in full its administrative expense claim for the same goods it claims added new value to the debtor's estate would negate the material benefit to the estate provided by such value. Congress could not have intended that a creditor can subsequently deplete the estate of the same value it contributed—and was paid for—to the restructuring postpetition.

Moreover, allowing creditors to reap the benefits under both provisions is wholly unnecessary. Even if the creditor knew a bankruptcy was imminent, benefitting under one

provision would provide adequate incentive for a creditor to continue to extend value. Not only did Touch of Grey know that the Debtor was in financial trouble when it extended credit, but it leveraged this fact by threatening to terminate its Franchise Agreement with the Debtor in the event that the Debtor did not execute the Forbearance Agreement and Mr. Tell executed the Personal Guarantee. Thus, the estate should not suffer because of Touch of Grey's selfish desire to recover more than it is entitled to from the Debtor's estate.

Touch of Grey's attempts to profit from the Debtor's estate also extend to rent by it seeking payment of May rent in full. The plain language of section 365(d)(3) unambiguously supports the proration of post-rejection rent charges. Rent and other services are paid in advance under a lease, but the obligations accrue with each day of occupancy. Upon rejection of an unexpired lease, the lessor is entitled to immediate possession and a prepetition breach claim under the Bankruptcy Code. Touch of Grey is only entitled to priority payments for May for each day of occupancy until rejection on May 5, 2020.

Prior to the enactment of section 365 in the Bankruptcy Code, courts applied a proration approach to post-rejection rental payments. The legislative history does not support a Congressional intent to depart from the long-standing proration approach. Proration supports the policy of providing priority payment to creditors who provide postpetition benefits to the estate. The legislative history indicates that section 365(d)(3) was intended to provide current payment for current services provided to the estate pending assumption or rejection of an unexpired lease.

Further, proration of post-rejection obligations complies with the underlying policy of section 365(d)(3) and the overall goals of the Bankruptcy Code. Debtors could wait to receive bills that pay for services in advance and then file a petition for bankruptcy. Under the "billing

date" approach, lessors would be forced to provide postpetition services but only receive a prepetition claim because of the bill was due prior to the filing of the petition.

Proration also protects the fundamental principle in bankruptcy that similarly situated creditors are treated equally. Proration ensures that priority payments are only provided insofar as the amount of value the estate receives the benefit for. Allowing full payment of a landlord's pre-rejection claim for rent based on time that accrued post-rejection would disrupt the priority scheme and fail to treat similarly situated creditors equally. Finally, the "billing approach" would allow a landlord to double dip by re-letting the property upon rejection of the lease while also receiving full payment from the estate.

ARGUMENT

Bankruptcy involves balancing. The bankruptcy process seeks to balance the interests of creditors in immediate payment against the larger potential payment in a reorganization. Such balancing not only benefits creditors, but also their debtors. *See Williams v. U.S. Fid. & Guar. Co.*, 236 U.S. 549, 554–55 (1915) (stating the overarching policy goals of the federal bankruptcy system). In furtherance of these goals, the Bankruptcy Code incentivizes creditors who provide beneficial services to the bankruptcy estate. Congress enacted section 547(c)(4) as one such incentive to encourage creditors to continue to lend to financially stressed debtors, and another, section 503(b)(9), to provide avenues by which creditors may recoup the value of goods they supply to debtors who shortly thereafter file for bankruptcy. While Touch of Grey contends that it is entitled to recover under both provisions, here the Bankruptcy Code is clear—a creditor cannot receive payment as an administrative expense under section 503(b)(9) for the value of goods transferred prepetition to the debtor while simultaneously using such value to reduce its

preference exposure under section 547(c)(4). To do so would constitute double dipping at the expense of the debtor's estate.

Similarly, Congress enacted section 365(d)(3) to protect landlords who were providing nonresidential real property without receiving prompt payment pending the assumption or rejection of leases. Touch of Grey seeks to extend the protections of section 365(d)(3) beyond the assumption or rejection period. Touch of Grey asks to recover the full rent for May, yet the Debtor no longer received the benefit of occupancy as of May 5, 2020. This would allow a creditor to re-let property while receiving full payment from the estate and thus, double dip. Additionally, the Bankruptcy Code entitles the landlord to a prepetition breach claim. Allowing payment of a full month's rent under section 365(d)(3) would elevate the landlord's prepetition breach claim at the expense of other similarly situated unsecured creditors.

Accordingly, the Court should hold in favor of the Trustee and affirm the ruling of the Thirteenth Circuit.

I. Touch of Grey Cannot Reduce Their Preference Exposure Under Section 547(c)(4) For Goods Already Paid in Full Under Section 503(b)(9) When No Additional Benefit to the Estate is Provided.

The Court should affirm the Thirteenth Circuit and rule in favor of the Trustee because a creditor cannot both be paid its full administrative expense claim under section 503(b)(9) for the value it extended to the debtor and use that same value to reduce its preference exposure under section 547(c)(4). Therefore, Touch of Grey cannot assert a new value defense to reduce its preference exposure from $250,000 to $50,000.

Section 547(b) allows bankruptcy trustees and debtors in possession to avoid transfers made by insolvent debtors to creditors within 90 days prior to filing a bankruptcy petition, if such creditor receives more than it would in a hypothetical chapter 7 liquidation had the transfer

not been made. 11 U.S.C. § 547(b). However, such avoidance powers are subject to multiple defenses and exceptions. *See generally* 11 U.S.C. § 547(c). One such defense is the so-called "subsequent new value defense" found under section 547(c)(4), which reduces a creditor's preference liability for transfers to or for the benefit of a creditor if, after such transfer, the creditor gave "new value" to or for the benefit of the debtor so long as such value was unsecured and that such transfer was not an "otherwise unavoidable transfer." 11 U.S.C. § 547(c)(4).

Another protection provided to creditors is codified in section 503(b)(9) of the Bankruptcy Code. Congress enacted section 503(b)(9) in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 to provide trade creditors an administrative expense claim for the value of goods transferred in the ordinary course of the debtor's business to the debtor within twenty days before the filing of bankruptcy petition. *See* 11 U.S.C. § 503(b)(9). Holders of administrative expense claims receive high priority and are generally guaranteed payment in a chapter 11 plan before other claims. 11 U.S.C. §§ 507(a)(2), 1129(a)(9)(A). For a court to confirm a plan of reorganization, creditors with such claims must typically be paid in full or otherwise agree to alternative treatment. *See* 11 U.S.C. § 1129(a)(9)(A) (a court shall confirm a plan of reorganization only if "the holder of [a section 507(a)(1) or (a)(2)] claim will receive on account of such claim cash equal to the allowed amount of such claim"). In a liquidation, which may follow a reorganization attempt such as it did in this case, section 503(b)(9) may provide the only avenue for creditors who extend the value needed for the debtor to attempt to reorganize to recover their losses where other creditors merely receive cents on the dollar. *See* Paul R. Hage & Patrick R. Mohan, *Is it Still New Value? Application of Section 503(b)(9) to the Subsequent New Value Preference Defense*, 19 J. BANKR. L. & PRAC. 4, Art. 7 (2010).

While both sections 503(b)(9) and 547(c)(4) provide protections to creditors, protection does not require both to be used in conjunction with one another. Touch of Grey should not be entitled to use the same value to receive both protections, as both claims are "predicated upon the same recitation of value." *Cir. City Stores, Inc. v. Mitsubishi Dig. Elecs. Am.* (*In re Cir. City Stores, Inc.*), 2010 WL 4956022, at *8 (Bankr. E.D. Va. Dec. 1, 2010). Both the plain language and overarching policy goals of the Bankruptcy Code support this interpretation of section 547(c)(4).

A. The Plain Language of Section 547(c)(4) Precludes Touch of Grey from Asserting the New Value Defense for Goods Also Satisfied as an Administrative Expense Under Section 503(b)(9).

The plain language of section 547(c)(4) unambiguously supports the conclusion that a creditor may not reduce its preference exposure by treating as new value under section 547(c)(4) value that has previously been paid in full postpetition under section 503(b)(9). This Court has repeatedly held that interpretation of the Bankruptcy Code begins by consulting the statute's plain language. *See Ransom v. FIA Card Servs., N.A.*, 562 U.S. 61, 69 (2011). When there is no ambiguity in a statutory text, a court's analysis both begins and ends with the statute's plain language. *Kelly v. Robinson*, 479 U.S. 36, 43 (1986); *see also Caminetti v. United States*, 242 U.S. 470, 485 (1917) (recognizing the same).

Nothing in the section 547(c)(4) requires the preference calculation to end at the petition date. Instead, section 547(c)(4) only requires that (1) any new value given by the creditor must not be secured by an otherwise unavoidable security interest, and (2) the debtor must not have made an otherwise unavoidable transfer to or for the benefit of the creditor on account of the new value given. 11 U.S.C. § 547(c)(4); *Kaye v. Blue Bell Creameries, Inc.* (*In re BFW Liquidation, LLC*), 899 F.3d 1178, 1189 (11th Cir. 2018) (stating the same).

The majority of courts who have reviewed this issue are correct for two reasons:
(1) section 547(c)(4) contains no temporal limitation excluding postpetition payments, which (2) allows section 503(b)(9) administrative expenses to constitute an "otherwise unavoidable transfer" under section 547(c)(4). *See, e.g., Beaulieu Liquidating Tr. 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); *Circuit City Stores*, 2010 WL 4956022, at *9; *but see Commissary Operations, Inc. v. Dot Foods, Inc.* (*In re Commissary Operations, Inc.*), 421 B.R. 873, 878-79 (Bankr. M.D. Tenn. 2010). Each are discussed herein.

1. No Temporal Limitation Exists in Section 547(c)(4).

The plain language of section 547(c)(4) clearly and unambiguously allows postpetition transfers to be considered as "otherwise unavoidable transfers" when calculating permissible new value. Section 547(c)(4) is silent as to when a payment must be made by a debtor to defeat a creditor's new value defense. *See* 11 U.S.C. § 547(c)(4); *see also Friedman's Liquidating Tr. v. Roth Staffing Cos. LP* (*In re Friedman's Inc.*), 738 F.3d 547, 553 (3d Cir. 2013). The text of section 547(c)(4) lacks any specific language containing a temporal limitation on *when* new value must be given.

Thus, nothing in the plain language suggests that Congress intended the period in which "otherwise unavoidable transfers" could be offset against new value to end at the petition date. Rather, a well-known canon of statutory construction states that "where 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." *Russello v. United States.*, 464 U.S. 16, 23 (1983); *see also Whitman v. Am. Trucking*

Ass'ns, Inc., 531 U.S. 457, 468 (2001) (stating that Congress "does not, one might say, hide elephants in mouseholes.") (citations omitted). This canon operates no differently when applied to temporal limitations set forth by Congress in other portions of section 547(c). In section 547(c)(5), for example, Congress *did* limit transfers that could be brought into account to "the date of the filing the petition." 11 U.S.C. § 547(c)(5). Section 547(c)(5) shows that Congress does know how to expressly impose temporal limitations when it intends to do so.

Even when circuit courts arrive at different conclusions concerning whether section 547(c)(4) should be read to limit "otherwise unavoidable transfers" to prepetition transfers, all agree that the statute itself is silent. *Compare Friedman's*, 738 F.3d at 553 (holding that postpetition transfers should *not* be included in new value calculation); *with Beaulieu Grp.*, 616 B.R. at 872 (holding that postpetition transfers should be included in new value calculation). Even though the *Friedman's* court ultimately determines that a temporal limitation *should* be read into section 547(c)(4), the court reaches this conclusion on contextual and policy grounds, rather than by reference to the specific language of the statutory provision itself. *Friedman's*, 738 F.3d at 554. In lieu of relying on the plain language of section 547(c)(4)(B), the *Friedman's* court instead reads into the statute words that are not there—determining that such provision refers only to otherwise unavoidable *prepetition* transfers, rather than the stated "otherwise unavoidable transfers." *See Siegel v. Sony Electronics, Inc.* (*In re Circuit City Stores*), 515 B.R. 302, 313 (Bankr. E.D. Va. 2014). The Court should allow postpetition payments to be included in the calculation of section 547(c)(4)'s new value defense because the best evidence of Congress's intent is the language of the statute itself—and here, section 547(c)(4) is silent. *Beaulieu Grp.*, 616 B.R. at 872.

More importantly, because the plain language of section 547(c)(4)(B) is unambiguous, the Court need not consult legislative history to aid in its interpretation. *See Garcia v. United States*, 469 U.S. 70,75 (1984). Even if the Court determines that the statute is ambiguous, which it is not, the legislative history relevant to sections 503(b)(9) and 547(c)(4) is inconclusive at best and therefore should not substitute for the plain language of such provisions.

The legislative history of sections 503(b)(9) and 547(c)(4) indicates that these provisions were enacted by Congress to encourage trade creditors to contribute to the estate by continuing to do business with financially troubled debtors. *See Roberds, Inc. v. Broyhill Furniture* (*In re Roberds, Inc.*), 315 B.R. 443, 468 (Bankr. S.D. Ohio 2004). Specifically, the new value defense was intended to "leave undisturbed normal financial relations" and "discourage unusual action by either the debtor or his creditors during the debtor's slide into bankruptcy." H.R. REP. NO. 95-595, at 373 (1977), *as reprinted in* 1978 U.S.C.C.A.N. 5963, 6329. Similarly, the legislative history of section 503(b)(9) reveals that such provision was adopted as an attempt to "enhance certain types of reclamation claims raised by creditors." *In re Circuit City Stores, Inc.*, 416 B.R. 531, 536 (Bankr. E.D. Va. 2009). Thus, the applicable legislative history of both provisions merely reaffirms the overarching policy goals of preference avoidance.

2. The Payment of Section 503(b)(9) Claims Are "Otherwise Unavoidable Transfers" Within the Meaning of Section 547(c)(4).

Postpetition transfers, including payment of section 503(b)(9) administrative expenses, are "otherwise unavoidable transfers" for purposes of section 547(c)(4). The plain language of section 547(c)(4) requires that (1) any new value given by the creditor must not be secured by an otherwise unavoidable transfer, and (2) the debtor must not have made an otherwise unavoidable transfer to or for the benefit of the creditor on account of the new value given. *Beaulieu Grp.*, 616 B.R. at 868.

Aside from whether postpetition payments may be included in a new value calculation—as discussed above, the plain language supports their inclusion—the question remains whether a section 503(b)(9) administrative expense payment is an otherwise unavoidable transfer under section 547(c)(4). Based upon the plain meaning of section 547(c)(4), it certainly is.

While the text of section 547(c)(4)(B) contains a double negative, this alone does not render the provision ambiguous. *See Wahoski v. Am. & Efrid, Inc.* (*In re Pillowtex Corp.*), 416 B.R. 123, 129 (Bankr. D. Del. 2009) (describing section 547(c)(4)(B) as "complicated, but not ambiguous."); *Boyd v. The Water Doctor* (*In re Check Rep. Servs., Inc.*), 140 B.R. 425, 435 (Bankr. W.D. Mich. 1992). Section 547(a)(2) provides that new value "means money or money's worth in goods, services, or new credit . . . that is neither void nor voidable by the debtor or the trustee under any applicable law." 11 U.S.C. § 547(a)(2). "Otherwise" in section 547(c)(4) means a transfer unavoidable for reasons other than section 547(c)(4). *Phx. Rest. Grp., Inc. v. Ajilon Prof'l Staffing LLC* (*In re Phx. Rest. Grp., Inc.*), 317 B.R. 491, 499 (Bankr. M.D. Tenn. 2004).

The answer to the question whether the "transfer" is "otherwise unavoidable" turns on the Bankruptcy Code provisions governing the trustee's avoidance powers, which include sections 544, 545, 547, 548, 549, 553(b), and 727(a). *Cir. City Stores*, 2010 WL 4956022, at *7. However, any provisions relating to transfers made *before* the petition date are not relevant, because the question at issue here concerns section 503(b)(9) expenses, which only ever arise *after* the petition date. *Beaulieu Grp.*, 616 B.R. at 870. Thus, the only remaining, applicable provision is section 549, which permits a trustee to avoid a transfer made after the petition date if the transfer was not authorized by the Bankruptcy Code *or if the transfer was not authorized by*

the bankruptcy court. 11 U.S.C. § 549(a) (emphasis added); *see also Cir. City Stores*, 2010 WL 4956022, at *8.

Because the Trustee was authorized by order of the Bankruptcy Court to pay Touch of Grey's administrative expense, such payment was not avoidable. The Bankruptcy Court authorized the Debtor to pay Touch of Grey for $200,000 pursuant to section 503(b)(9). Section 549 is the only provision that allows a trustee to avoid a postpetition transfer, explicitly excludes payments "authorized under this title or by the court." 11 U.S.C. § 549(a)(2)(B). The Trustee could not, in this case, avoid the payment to Touch of Grey for its administrative expense. The payment of the administrative expense to Touch of Grey is, therefore, an "otherwise unavoidable transfer" that cannot constitute new value under section 547(c)(4). *See Cir. City Stores*, 2010 WL 4956022, at *8.

Moreover, the plain language interpretation of section 547(c)(4) is further strengthened when viewed in context with the rest of section 547. A statutory provision should not be read in isolation. *See King v. St. Vincent's Hosp.*, 502 U.S. 215, 221 (1991) (stating that a statute should be "read as a whole, since the meaning of statutory language, plain or not, depends on context."); *see also Davis v. Mich. Dept. of Treasury*, 489 U.S. 803, 809 (1989) (statutes must be "read in their context and with a view to their place in the overall statutory scheme"). The surrounding provisions of section 547(c)(4) demonstrate that there is no temporal limitation to the new value defense to preferences. While the preference period is limited to transfers occurring prepetition, section 547(b) supports the proposition that there is no such limitation to the new value defense. *TI Acquisition, LLC v. Southern Polymer, Inc.* (*In re TI Acquisition, LLC*), 429 B.R. 377, 385 (Bankr. N.D. Ga. 2010). Looking to section 547(b)(5), the *prima facie* elements for preference recovery include determining what a creditor would receive in a hypothetical chapter 7

liquidation if the transfer had not been made. 11 U.S.C. § 547(b)(5). Such an analysis requires consideration of post-bankruptcy facts. *TI Acquisition,* 429 B.R. at 385. For example, even in a chapter 7 case, holders of section 503(b)(9) administrative claims created postpetition are treated differently than general unsecured creditors. Thus, postpetition events may affect whether a trustee can successfully make a *prima facie* case for preference avoidance. *Id.*

Touch of Grey should not be entitled to utilize the same value of goods it has been paid pursuant to an administrative expense claim for a new value defense under section 547(c)(4) as both claims are "predicated upon the same recitation of value." *Siegel*, 515 B.R. at 314. Therefore, it is not appropriate to replace the plain meaning of the text of section 547(c)(4) with any other contravening objectives.

B. The Plain Language Interpretation of Section 547(c)(4) Best Comports with the Overarching Policy Goals of Sections 547(c)(4) and 503(b)(9) and the Federal Bankruptcy System.

Not only is the plain language of section 547(c)(4) unambiguous, but the plain language interpretation is also consistent with the underlying congressional policies of sections 503(b)(9) and 547(c)(4) and the overarching policy goals of the Bankruptcy Code. Such provisions reflect the balancing act of bankruptcy by providing incentives to creditors to continue to lend to distressed debtors, thus enhancing the value of the bankruptcy estate such that equitable distribution among creditors is possible.

1. Allowing Touch of Grey to Double Dip Under Sections 503(b)(9) and 547(c)(4) Contravenes Preference Policy.

Allowing Touch of Grey to use the same delivery of goods to recover under sections 503(b)(9) and 547(c)(4) would subvert the two-fold policy rationale of section 547(c)(4). Section 547 was enacted to encourage creditors to contribute to the bankruptcy estate through continually doing business with distressed entities while also discouraging

creditors from "racing to the courthouse to dismember the debtor during his slide into bankruptcy." *Union Bank v. Wolas*, 502 U.S. 151, 161 (1991); *Charisma Inv. Co., N.V. v. Airport Sys., Inc.* (*In re Jet Fla. Sys., Inc.*), 841 F.2d 1082, 1083 (11th Cir. 1988). Section 547 also "facilitate[s] the prime bankruptcy policy of equality of distribution among creditors" by requiring certain creditors to disgorge preferential payments so that all creditors are treated equally. *Union Bank*, 502 U.S. at 161 (quoting H.R. REP. NO. 95-595, at 177–78, *as reprinted in* 1978 U.S.C.C.A.N.. 6137, 6138).

Moreover, the policies underlying preferences reflect the broader policy goals of the federal bankruptcy system, namely, providing a fresh start to debtors and ensuring an equitable distribution among creditors. *See Williams*, 236 U.S. at 554–55. The new value defense of section 547(c)(4) achieves such goals because the defense is limited to cases in which "the bankruptcy estate has been enhanced by the creditor's actions." *TI Acquisition*, 429 B.R. at 384; *Jet Fla. Sys.*, 841 F.2d at 1084; *see also Kroh Bros. Dev. Co. v. Continental Construction Engineers, Inc.* (*In re Kroh Bros Dev. Co.*), 930 F.2d 648, 654 (8th Cir. 1991) (concluding that the availability of the new value defense turns on the transfer's "ultimate effect on the estate").

Like section 547(c)(4), section 503(b)(9) was enacted with the same goal of rewarding creditors who continue to do business with financially distressed entities. *Circuit City Stores*, 416 B.R. at 536. However, courts have also held that claims conferred with administrative priority should be narrowly construed. *In re Dant & Russell Inc.*, 853 F.2d 700, 706 (9th Cir. 1988) (holding that minimizing administrative expenses "serves the overwhelming concern of the Code: preservation of the estate"); *Trs. of Amalgamated Ins. Fund v. McFarlin's Inc.*, 789 F.2d 98, 100 (2d Cir. 1986) (concluding that statutory provisions are narrowly construed because "the

presumption in bankruptcy cases is that the debtor's limited resources will be equally distributed among his creditors").

Although Congress has chosen to give section 503(b)(9) claims priority in payment over other claims, such policy choice does not negate the fact that allowing Touch of Grey to offset its preference liability using the same value for which it was paid in full as an administrative expense—and received the priority that Congress intended it to have— would confer a double benefit to a single creditor. It may be true that certain creditors are favored in the Bankruptcy Code, but nowhere does the Code confer such a double benefit to the detriment of all other parties. Such double benefit would elevate Touch of Grey far beyond its intended status as a holder of a section 503(b)(9) claim at the expense of the bankruptcy estate. *TI Acquisition*, 429 B.R. at 385. Conversely, requiring a creditor to choose whether to be paid via an administrative expense claim or by reducing its preference liability through the new value defense would merely put the creditor in an equal position with other similarly situated creditors.

2. Allowing Touch of Grey to Deplete the Estate Under Both Sections 503(b)(9) and 547(c)(4) Negates the New Value Conferred to the Estate.

When analyzing the interplay between sections 503(b)(9) and 547(c)(4), courts and scholars have analogized administrative expense claims to that of reclamation claims. As with reclamation claims, the allowance of double recovery under sections 503(b)(9) and 547(c)(4) would negate any material benefit conferred to the estate. Goods subject to a reclamation claim do not constitute new value because reclamation creditors "essentially keep strings on those goods." *See Phx. Rest. Grp., Inc. v. Proficient Food Company* (*In re Phx. Rest. Grp., Inc.*), 373 B.R. 541, 547–48 (M.D. Tenn. 2007). Just as creditors keep strings on goods subject to reclamation by virtue of their right to reclaim such goods, creditors who deliver goods to a debtor within twenty days before the petition date get administrative expense claims for the value

of those goods. *TI Acquisition,* 429 B.R. at 381. While Touch of Grey's prepetition delivery of goods enlarged the estate, allowing it a double benefit under both sections 503(b)(9) and 547(c)(4) would negate such effect by depriving the estate of the "uninhibited use of new value." *See id.* at 384; *Circuit City Stores*, 2010 WL 4956022, at *9. The estate would therefore be forced to fund Touch of Grey's administrative claim while being barred from pursuing its preference action. *See id.* Such a result does not add new value to the estate but instead depletes it at the expense of all other parties to the estate.

Insofar as Touch of Grey relies on the *Friedman's* case, where the court held that postpetition transfers made pursuant to a prepetition wage order did not factor into the creditor's section 547(c)(4) new value defense, such holding should not extend to the case at bar. *See Friedman's*, 738 F.3d at 561. There, the court explicitly indicated that its holding was confined to the effect of transfers made under a wage order. *Id.* at 561, n.9 ("[W]e need not resolve the question of whether assertion of a reclamation claim should reduce a new value defense, as we are only considering the effect of payments made pursuant to a Wage Order."). Thus, its ruling does not extend to section 503(b)(9) payments. *Siegel*, 515 B.R. at 313 (noting that the *Friedman's* court "did not intend for its decision to extend to [section] 503(b)(9) claims.").

In any event, the *Friedman's* rationale is not applicable to the facts presented here. As with critical vendor orders, the underlying rationale for granting wage orders like that in *Friedman's* is to incentivize creditor behavior that provides ongoing benefits to the estate during a reorganization. Such support from creditors is crucial in a reorganization, as it provides, wherein it may be necessary, an incentive for creditors to continue to perform during bankruptcy, thereby allowing a debtor to continue operating as a going concern for the benefit of all creditors of the estate. Here, unlike the case in *Friedman's*, the Debtor's reorganization efforts failed, and

its chapter 11 case converted to a chapter 7 liquidation. R. 8. Now that the Debtor is liquidating its business, the "new value" Touch of Grey extended to the Debtor did not further the Debtor's restructuring efforts, and as such, would only be used to reduce distributions to all other creditors of the estate.

Although creditors with section 503(b)(9) claims are vulnerable in cases where the estate faces administrative insolvency whereas holders of reclamation merely reclaim their goods, here, Touch of Grey's section 503(b)(9) claim was paid in full, and thus "not any more vulnerable than a reclamation creditor's [claim]." *TI Acquisition*, 429 B.R. at 381. This is true even though the present case involves a chapter 7 liquidation—the bankruptcy estate was fully capable of paying—and did pay—Touch of Grey's section 503(b)(9) claim. R. 7.

The argument that claims under section 503(b)(9) are more akin to critical vendor orders rather than reclamation claims ignores a crucial difference between critical vendor orders and statutory payments under section 503(b)(9). Unlike section 503(b)(9) payments, which are mandatory under the Bankruptcy Code, critical vendor orders are often the result of a negotiation process. *Id.* at 382. As the court in *TI Acquisition* noted, such orders confer the debtor-in-possession "a great deal of latitude in negotiating the terms and conditions of 'critical vendor' status while conditioning the designation as a 'critical vendor' on the creditor's agreement to provide postpetition credit to the debtor-in-possession." *Id.* (emphasis in original). Notably, preference liability is one such negotiation point. *See* Paul R. Hage & Patrick R. Mohan, *supra*. And while a bankruptcy court has considerable discretion to approve or deny critical vendor payments, section 503(b)(9) affords no such discretion. *TI Acquisition*, 429 B.R. at 382.

3. Recovery Under Either Sections 503(b)(9) or 547(c)(4) Provides an Adequate Incentive to Touch of Grey to Continue to Lend to the Debtor.

Touch of Grey's attempt to spark fear that the prohibition of double dipping would discourage creditors from lending to financially troubled entities is wholly baseless. The purpose of section 503(b)(9) is to protect creditors who dealt in good faith with financially distressed entities at the eve of a bankruptcy filing. *TI Acquisition,* 429 B.R. at 385. In such case, the creditor would not know whether it could assert a section 503(b)(9) claim when it ships the goods. Thus, a creditor's decision to ship goods or provide services to a distressed debtor is not influenced by whether it will be able to pursue claims under *both* the subsequent new value defense and section 503(b)(9). *Id.* Even if a creditor had such knowledge, a creditor's right to recover in full under section 503(b)(9) provides an adequate incentive to do business with a distressed entity while also furthering the twin policy aim of encouraging equal treatment among creditors. *See id.* ("[P]aying creditors in full for their claims is the ultimate method of encouraging them to continue to trade with the debtor.").

The estate should not suffer at the expense of Touch of Grey's attempt to double dip. While Touch of Grey contends that it engaged in good faith effort to aid in the Debtor's reorganization, its actions reflect otherwise, as Touch of Grey seeks to further deplete the Debtor's estate by reducing its preference exposure after being paid in *full* under section 503(b)(9). R. 7. Not only did Touch of Grey know that the Debtor was experiencing financial difficulties, but it leveraged such difficulties to induce the Debtor to sign both the Forbearance Agreement and Mr. Tell to sign the Personal Guarantee. R. 5, 6. Touch of Grey made clear that it would terminate its Franchise Agreement with the Debtor if it did not agree to such an arrangement. R. 5. Allowing Touch of Grey to doubly benefit under the Bankruptcy Code is especially absurd as Touch of Grey also maintains the ability to pursue Mr. Tell

personally via the Personal Guarantee he executed for the same payment Touch of Grey claimed it needed from the Debtor to induce performance. *See* R. 5.

Because sections 503(b)(9) and 547(c)(4) both provide adequate protection for creditors, both are not needed to achieve the same overarching policy goals here. Rather, allowing such double recovery would deplete estate resources at the expense of other creditors and fail to balance the interests Congress carefully considered when crafting the Bankruptcy Code.

II. Section 365(d)(3) Does Not Require the Trustee to Satisfy Obligations Allocable to the Post-Rejection Period but Billed Prior to Rejection.

The Trustee is not required to satisfy obligations billed pre-rejection but allocable to the post-rejection period under section 365(d)(3). Such a view reflects a majority of courts' position that a trustee may prorate an obligation billed during the postpetition pre-rejection period but arose prepetition or after rejection of the lease. *In re Handy Andy Home Improvement Centers, Inc.*, 144 F.3d 1125 (7th Cir. 1998); *In re NETtel Corp., Inc.*, 289 B.R. 486, 491 (Bankr. D.D.C. 2002); *Child World v. Campbell/Massachusetts Tr.* (*In re Child World*), 161 B.R. 571 (S.D.N.Y. 1993); *In re Ames Dep't Stores, Inc.*, 306 B.R. 43(Bankr. S.D.N.Y. 2004).

A trustee has the authority to assume or reject an executory contract or unexpired lease. 11 U.S.C. § 365(a). Under section 365, rejection is treated as a prepetition breach that gives rise to a general claim for damages. 11 U.S.C. § 365(g)(1). Damages from a claim for breach of a lease rejected under section 365 are treated as occurring before the petition date. 11 U.S.C. §§ 365(g)(1), 502(g).

Section 365(d) determines the time within which an executory contract or unexpired lease must be assumed or rejected. For nonresidential real property, the trustee has 210 days after the entry of an order for relief to assume or reject leases. 11 U.S.C. § 365(d)(4)(A)(i). A court may extend the period once for 90 days on a motion for cause. 11 U.S.C. § 365(d)(4)(B)(i). Upon

rejection, the landlord immediately regains possession of the property. 11 U.S.C. § 365(d)(4)(A). Pending assumption or rejection, the trustee must timely perform all the obligations of the debtor arising from and after the order for relief under any unexpired lease, until such lease is assumed or rejected, notwithstanding section 503(b)(1). 11 U.S.C. § 365(d)(3)(A).

A. The Plain Language and Legislative History of Section 365(d)(3) Unambiguously Supports Prorating the May Rental Payment.

The plain language of section 365(d)(3) unambiguously supports prorating rent and bifurcating a landlord's claim between that allocable to the pre-rejection, administrative claim period and the post-rejection, general breach of contract claim period. The trustee must perform all the obligations "arising from and after the order for relief under any unexpired lease of nonresidential real property, until such lease is assumed or rejected." 11 U.S.C. § 365(d)(3)(A). Statutory language "cannot be construed in a vacuum. It 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." *Sturgeon v. Frost*, 577 U.S. 424, 438 (2016) (*quoting Roberts v. Sea-Land Servs., Inc.*, 566 U.S. 93, 101 (2012)). The context consists not merely of other sentences but also of the real-world situation to which the language pertains. *Handy Andy*, 144 F.3d at 1128 (citations omitted).

The most important context for evaluating when an obligation "arises" under a lease is the overall purposes of assumption and rejection which support proration of post-rejection obligations. *NETtel Corp.*, 289 B.R. at 491. Assumption entitles the estate to the benefits of a lease, but also saddles the estate with all obligations under the lease as an administrative claim. Upon rejection the estate is no longer entitled to the benefits of the lease nor burdened with the obligations due under the lease. *Id*. Here, the Debtor rejected the lease effective May 5, 2020. R. 8. As of May 5, 2020, the bankruptcy estate was no longer entitled to receive the occupancy

benefits, nor was it burdened with an administrative claim for the rental obligation not yet accrued to Touch of Grey.

Additionally, the debtor-landlord relationship supports prorating post-rejection rental payments. "A landlord's entitlement to compensation for occupancy at a fixed periodic rate relates to the actual days the tenant was entitled to occupancy, and in a practical and fundamental economic sense can be said to arise on each occupancy day." *NETtel Corp.*, 289 B.R. at 490. "The compensation for occupancy on a particular date may be payable in advance of that date (or may be payable subsequent to that date), but . . . the compensation obligation arises on the date of occupancy." *Id*. Thus, the May rent must be prorated under section 365(d)(3) for the 5 days compensation accrued during the Debtor's occupancy.

Further, proration is supported by the surrounding statutes of the Bankruptcy Code. Rejection of an unexpired nonresidential lease is treated as a prepetition breach of the lease. 11 U.S.C. § 365(g)(1). A prepetition breach claim arising from the rejection of an unexpired lease under section 365 is treated as if the claim arose prepetition. 11 U.S.C. § 502(g). "The purpose of section 365(g) is to make clear that, under the doctrine of relation back, the other party to a contract that has not been assumed is simply a general unsecured creditor." 3 COLLIER ON BANKRUPTCY ¶ 365.10[1] (16th ed. 2021). The Debtor no longer occupied the Premises as of May 5, 2020, when it rejected the Lease. R. 8. Accordingly, "there ought not be any administrative claim attributable to the estate's nonexistent right of occupancy during the post-rejection period, otherwise the estate will be saddled with a burden that rejection is designed to avoid." *NETte Corp.*, 289 B.R. at 492.

The legislative history also does not indicate Congress intended section 365(d)(3) to overturn the long-standing use of the proration approach. A minority of courts have ruled that

section 365(d)(3) broke with the traditional proration approach, finding that the obligation arises on the date it is billed under the lease terms and instead opted for a "billing date" approach. *See Koenig Sporting Goods, Inc. v. Morse Rd. Co.* (*In re Koenig Sporting Goods, Inc.*), 203 F.3d 986 (6th Cir. 2000); *Centerpoint Props. v. Montgomery Ward Holding Corp.* (*In re Montgomery Ward Holding Corp.*), 268 F.3d 205 (3d Cir. 2001); *see also HA-LO Indus., Inc. v. CenterPoint Properties Tr.*, 342 F.3d 794, 798 (7th Cir. 2003) (requiring payment of full months' rent when billed first of the month but the lease was rejected mid-month); *but see Handy Andy*, 144 F.3d at 1125 (7th Cir. 1998) (holding the obligation to pay property taxes arose prepetition with each day of occupancy despite being billed during the postpetition pre-rejection period); *Vause v. Capital Poly Bag, Inc.* (*In re Vause*), 886 F.2d 794 (6th Cir. 1989) (holding farm rent was "due" under lease for the 361 days that accrued prepetition even though the petition was filed prior to the payment date).

To adopt a "billing date" approach would depart from pre-Code practice and "this Court has been reluctant to accept arguments that would interpret the Code, however vague the particular language under consideration might be, to effect a major change in pre-Code practice that is not the subject of at least some discussion in the legislative history." *Dewsnup v. Timm*, 502 U.S. 410, 419 (1992). Prior to the enactment of section 365(d)(3), lessors were required to seek payment for obligations that arose in the postpetition pre-rejection period as administrative expenses for "the actual, necessary costs of preserving the estate" under section 503. *See Handy Andy*, 144 F.3d at 1128; *Child World*, 161 B.R. at 574 (S.D.N.Y. 1993).

Under section 503, courts had discretion to lower the amount of rent due if they found the contracted rates unreasonable. *Handy Andy*, 144 F.3d at 1128. Courts prorated the rent due under the lease by only allowing an administrative claim for each day of occupancy by the bankruptcy

estate. *Id*. Courts also had discretion to delay payment until confirmation forcing lessors to provide services without timely payment. *Child World,* 161 B.R. at 575. Prior to the adoption of section 365, landlords were involuntary creditors of the estate. *Handy Andy,* 144 F.3d at 1128. Lessors were forced to provide services pending assumption or rejection with payment delayed until confirmation while the automatic stay prevented lessors from seeking foreclosure. *Id*.

Senator Hatch explained the purpose of the amendment was to address the unique status of landlords:

> In this situation, the landlord is forced to provide *current services*—the use of its property, utilities, security, and other services—*without current payment*. … 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 ensure 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. (1984), *as reprinted in* 1984 U.S.C.C.A.N. 576, 598–99 (emphasis added).

The amendment addressed the concern of timely performance by requiring current payment for current services. *Child World,* 161 B.R. at 575. It protected landlords by removing the burden of providing notice and a hearing to obtain payment as well as the discretion of the court to adjust the contracted rate or delay payment until confirmation by including the phrase "notwithstanding section 503(b)(1)." *Id*. at 575. Providing current payment for current services places lessors on equal footing as similarly situated creditors providing postpetition services. *Montgomery Ward*, 268 F.3d at 216 (Mansmann, J., dissenting). By only requiring payment for current services rather than waiting until confirmation, nothing in the legislative history suggests Congress intended to overturn the long-standing practice of prorating post-rejection rent when the estate no longer retains the benefits of occupancy regardless of the date billed. *Id.* at 575–76.

B. Prorating the Post-Rejection May Rental Payment Best Comports with the Underlying Policy of Section 365(d) and the Overarching Policy Goals of the Bankruptcy Code.

The language of section 365(d)(3) read in light of the statutory scheme and the legislative history supports prorating the May rental payment when the Lease was rejected only 5 days into the month. Proration is also more consistent with the underlying policy of section 365(d)(3) that is to protect landlords forced to provide postpetition services to the creditor without timely payment. The proration approach is clearly in line with all of the broad policy goals of the Bankruptcy Code—to provide protection to creditors doing business with distressed companies while also enhancing the value of the bankruptcy estate so that similarly situated creditors are treated equally.

One of the fundamental policies underlying the Bankruptcy Code is that similarly situated creditors be treated equally. Josef S. Athanas & Scott A. Semenek, *Pro-Ration of Rent Dead in Third and Sixth Circuits-Landlords Won the Battle, but Will They Lose the War?,* 19 BANKR. DEV. J. 123, 129 (2002). Postpetition creditors are given high priority claims because postpetition creditors 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. *In re Jartran, Inc.*, 732 F.2d 584, 586–88 (7th Cir. 1984). The prioritizing of postpetition debt enables a debtor to ignore sunk costs and continue operating as long as the debtor's business is yielding a net economic benefit. *Handy Andy*, 144 F.3d at 1127. Proration allows for the priority payment of postpetition debt while allowing a debtor to ignore post-rejection obligations when a debtor no longer gains the economic benefit.

In *Handy Andy*, the lessor sought full payment for property taxes that accrued prepetition but were payable postpetition. *Id*. Under the zero sum approach of the “billing date”, the property

taxes would have to be paid in full even though they covered a period entirely prepetition. *See Montgomery Ward*, 268 F.3d at 205. Judge Posner instead applied proration because taxes accrued prepetition "really are a sunk cost, and shouldn't affect the current operations of a bankrupt tenant; and so the obligation to pay or reimburse the taxes that accrued prepetition is a pre-rather than postpetition obligation." *Handy Andy*, 144 F.3d at 1128. Otherwise, the rights of creditors turn on the dating of bills and the strategic moves of landlords and tenants rather than when they accrued. *Id.*

The "billing date" approach, advocated by Touch of Grey, fails to give administrative expense treatment to lessors who provide postpetition services to the debtor due to a debtor's strategic behavior. *Id.*; *NETtel Corp.*, 289 B.R. at 493. A debtor can strategically file for bankruptcy shortly after a large payment to be paid in advance is due under a lease leaving the lessor with a prepetition claim. *NETtel Corp.*, 289 B.R. at 493. Proration protects landlords from the situation where they provide postpetition services without receiving administrative claim treatment.

Just like property taxes accrued prepetition, rent allocable post-rejection is a prepetition claim regardless of the date payment is due. *Ames Dep't Stores*, 306 B.R. at 77 (stating the *HA-LO* court failed to consider the treatment of post-rejection obligations as prepetition debts under the Code when applying the *Handy Andy* court's section 365(d)(3) analysis to post-rejection rent). The rejection of an unexpired lease is viewed as a breach. 11 U.S.C. §365(g)(1). Obligations owed under the breach are treated as a prepetition claim under section 502(g). *NETtel*, 289 B.R. at 493. Following the "billing date" approach, had the Debtor failed to pay its rent on January 1, 2020, then Touch of Grey would have been limited to a prepetition claim for the full January rent while forced to provide postpetition services from the Petition Date of

January 5, 2020. The treatment of 27 days of postpetition services as a prepetition claim in January is equally as unjust as treating Touch of Grey's prepetition claim for rent accrued during the 27 days in May post-rejection as a postpetition claim.

The benefit of continued occupancy until rejection of a lease requires payment of the full rent for "every day that [trustee] continued to occupy the property." *Handy Andy*, 144 F.3d at 1128. Thus, the application of the proration approach is more suitable "because it tracks the purpose of giving postpetition creditors a high priority in the distribution of the debtor's estate." *Id.* at 1127. Touch of Grey is only entitled to administrative claim treatment for each day postpetition it was providing services to the estate. Proration would allow current payment for each day of Touch of Grey's postpetition services, which is an equitable approach that is in line with the policies of the Bankruptcy Code.

Further, the "billing date" approach allows the elevation of prepetition obligations to postpetition administrative expense status by happenstance and disrupts the overall priority scheme enacted by Congress. *El Paso Props. Corp. v. Gonzales* (*In re Furr's Supermarkets, Inc.*), 283 B.R. 60, 69 (B.A.P. 10th Cir. 2002); *Ames Dep't Stores*, 306 B.R. at 77 (Bankr. S.D.N.Y. 2004). Elevating the prepetition debts "inappropriately burdens the administration of the bankrupt estate and unfairly favors landlords over similarly situated prepetition creditors." *Montgomery Ward*, 268 F.3d at 213 (Mansmann, J., dissenting). Allowing Touch of Grey to recover post-rejection rent would elevate their prepetition breach claim for that rent to the same status as postpetition creditors. However, Touch of Grey no longer provides any benefits to the bankruptcy estate.

The "billing date" approach also encourages strategic behavior from landlords seeking windfalls at the expense of the bankruptcy estate. *Handy Andy*, 144 F.3d at 1128. Prior to

bankruptcy, a landlord dealing with a tenant in distress may delay sending bills until the postpetition period in order to receive full payment on what should have been prepetition debts. Then pending assumption or rejection, lessors would send bills for services to be paid in advance in order to receive full payment prior to the rejection of the lease. *Id*. Proration protects the Debtor from providing administrative expense treatment to payments accruing post-rejection when the estate no longer receives any benefit from Touch of Grey. Additionally, proration protects the Bankruptcy Code's fresh start policy by disallowing administrative claim treatment for prepetition debts payable under an unexpired lease.

Additionally, a landlord may re-let the property and gain a windfall under the "billing date" approach. The lessor immediately regains possession of the property upon rejection. 11 U.S.C. § 365(d)(4)(A). When the lessor regains possession of the property, they can double dip by re-letting the property while recovering fully from the estate. *Ames Dep't Stores*, 306 B.R. at 71. "[R]equiring payment, as an administrative expense, for the post-rejection period while, at the same time, the landlord would be free to re-rent the premises, could result in a double recovery for the landlord." *Id*. No creditor is afforded the privilege of double recovery at the expense of the estate under the Bankruptcy Code.

Touch of Grey could have re-let the property on May 5, 2020, when the lease was rejected, and the Debtor no longer occupied the Premises. Touch of Grey could have received a double benefit for the May rent without conferring any additional benefits to the estate. Under different lease terms, a landlord who bills rent annually on the first day of the year whose debtor-tenant rejects the lease three months into the year would recover the full rental payment from the debtor-tenant as well as any amounts from re-letting the property the rest of the year. *Matter of Swanton Corp*., 58 B.R. 474, 475 (Bankr. S.D.N.Y. 1986). The "billing date" approach

advocated by Touch of Grey would allow landlords to double dip at the expense of the estate and disrupt the distribution scheme as enacted by Congress in the Bankruptcy Code.

Proration allows landlords to recover only for the period they provide benefits to the estate and is consistent with the plain meaning interpretation of section 365(d)(3) within the overall context of assumption and rejection. The legislative history does not indicate Congress intended to change from the long-standing proration approach. Proration most effectively balances and serves the two policies of protecting postpetition creditors who provide benefits to the bankruptcy estate while ensuring similarly situated creditors are treated equally.

CONCLUSION

For the foregoing reasons, the Court should affirm the judgment of the Thirteenth Circuit in all respects.