No. 20-0909

IN THE

Supreme Court of the United States

IN RE TERRAPIN STATION, LLC, DEBTOR,

TOUCH OF GREY,
Petitioner,

v.

CASEY JONES, CHAPTER 7 TRUSTEE,
Respondent.

On Appeal From The
United States Court of Appeals
For The Thirteenth Circuit

BRIEF FOR THE RESPONDENT

JANUARY 20, 2022

TEAM NUMBER 2
COUNSEL FOR RESPONDENT

QUESTIONS PRESENTED

I. Whether a seller of goods is entitled to reduce its preference exposure pursuant to 11 U.S.C. § 547(c)(4) by the value of goods sold even though the debtor in possession paid for such goods in full pursuant to 11 U.S.C. § 503(b)(9).

II. Whether a trustee must timely perform the obligations of a debtor under 11 U.S.C. § 365(d)(3) by paying rent due prior to the rejection of an unexpired non-residential real property lease but allocable to the period after the effective date of rejection.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

UNITED STATES SUPREME COURT CASES

FEDERAL COURT OF APPEALS CASES

FEDERAL DISTRICT COURT CASES

STATUTES

OTHER AUTHORITIES

OPINIONS BELOW

The Thirteenth Circuit Court of Appeals' decision is available at No. 20-0803. The Bankruptcy Court for the District of Moot ruled in favor of the Trustee and against Touch of Grey on both questions. R at 3. The United States District Court for the District of Moot affirmed the ruling of the Bankruptcy Court. R. at 3. On direct appeal, the United States Court of Appeals for the Thirteenth Circuit affirmed these decisions. R. at 3.

STATEMENT OF JURISDICTION

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

PERTINENT CONSTITUTIONAL AND STATUTORY PROVISIONS

This action implicates statutory construction of certain provisions of Title 11 of the United States Code. The relevant portions of the statutes are below and in the Appendix.

The relevant portion of 11 U.S.C. § 365(d)(3) provides:

> (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. 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. 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.

The relevant portion of 11 U.S.C. § 503(b)(9) provides:

> (b) After notice and a hearing, there shall be allowed administrative expenses, other than claims allowed under section 502(f) of this title, include–
>
> (3) 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 court of such debtor's business.

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

> (c) The trustee may not avoid under this section a transfer–
>
> (4) to or for the benefit of a creditor, to the extent that, after such transfer, such creditor gave new value to or for the benefit of the debtor–
>
> (A) not secured by an otherwise unavoidable security interest; and
>
> (B) on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor.

STATEMENT OF THE CASE

This appeal arises from the Thirteenth Circuit's proper interpretation of numerous provisions of the Bankruptcy Code. The issues between the parties have been conceded to be purely legal in nature.

I. FACTUAL HISTORY

A. Lease Agreement And Franchise Agreement Between Petitioner And Debtor.

Petitioner, Touch of Grey ("Creditor"), is an international coffee company and coffeehouse chain headquartered in San Francisco, California. R. at 3. Touch of Grey decided to open a new series of coffeehouses under a different brand called Dark Star. R. at 4. Touch of Grey approached William Tell ("Debtor") to see if he would be interested in franchising a neighborhood coffeehouse under the new brand. R. at 4. Touch of Grey agreed that it would purchase and lease to Debtor a space located at 5877 Shakedown Street in Terrapin, executing a lease agreement (the "lease") on July 1, 2018. R. at 4. The lease term was twenty years and required the Debtor to pay monthly rent of $25,000 "due in advance on the first day of each month." R. at 4. The lease was on a triple-net basis. R. at 4. Touch of Grey and Debtor also entered a franchise agreement on July 1, 2018, where debtor would sell "Dark Star" products it purchased from Touch of Grey. R. at 4.

B. Coffeehouse Difficulties

Unfortunately, Debtor's new coffeehouse was unsuccessful, and by September 2019 Debtor was unable to pay its debts as they became due. R. at 5. By November 1, 2019, Debtor owed Touch of Grey over $700,000 for goods it had purchased. R. at 5. Following threats to terminate the franchise agreement, the parties entered a forbearance agreement in which Touch of Grey agreed to forbear from terminating the franchise agreement in exchange for (i) $250,000

from the Debtor on account of the outstanding invoices for product; (ii) reaffirmation by the Debtor of its obligations under the lease; and (iii) a release of any and all claims or causes of action that the Debtor had against Touch of Grey. R. at 5. Debtor made the $250,000 payment the same day. R. at 5. One week later, Debtor purchased $200,000 worth of product from Touch of Grey on credit. R. at 6. The goods were delivered on December 21, 2019. R. at 6.

C. Bankruptcy

Debtor filed a petition for relief under Chapter 11 of the Bankruptcy Code ("Code") in the United States Bankruptcy Court for the District of Moot on January 5, 2020. R. at 6. On this date, Debtor was current on its lease obligations with Touch of Grey but owed Touch of Grey $650,000 for goods purchased. R. at 6. In addition, Debtor, while having no secured debt, owed over $500,000 to various other unsecured creditors. R. at 6. Two weeks after the petition, Debtor filed a motion asserting that Touch of Grey was a "critical vendor" and requesting authority to make a payment of $200,000 to be applied to the invoice for the December 18, 2019, product purchase. R. at 6. The Bankruptcy Court allowed the payment as an administrative expense under section 503(b)(9) of the Code, and Debtor made the payment days later. R. at 7.

While Touch of Grey resumed selling goods to Debtor following payment, Debtor continued to struggle in its operations. R. at 7. The COVID-19 pandemic forced Debtor to close its doors in March 2020, and despite a reopening a month later, Debtor decided to permanently close its doors on May 5, 2020. R. at 7. Upon ceasing operations, Debtor vacated the leased property, returned its keys to Touch of Grey, and within a day filed a motion to reject the lease and franchising agreement with Touch of Grey under section 365(a) of the Code. R. at 7. On May 8, 2020, Touch of Grey filed a motion to compel payment of the May rent, which was due under the

Lease on May 1, arguing that it was entitled to the full month of rent because it became due before the date of rejection. R. at 7-8.

At a May 29, 2020 hearing, the Debtor converted its case to chapter 7 of the Code pursuant to section 1112(a), and an order appointing the Trustee over the Debtor's estate was entered. R. at 8. Also at the hearing, the Bankruptcy Court granted Debtor's motion to reject the lease and franchising agreement "effective as of May 5, 2020." R. at 8. The court required additional briefing on the issue of the payment of May rent in full. R. at 8. The Trustee objected to the payment of the full May rent, given that Debtor only occupied the Premises for five days of May. R. at 8. Additionally, the Trustee sought to avoid and recover the $250,000 forbearance agreement payment to Touch of Grey as a preferential transfer "pursuant to sections 547(b) and 550(a)." R. at 8. Touch of Grey argued in its answer and affirmative defenses that "it was entitled to reduce any preference exposure by the $200,000 in goods that it sold to the Debtor . . . pursuant to section 547(c)(4)." R. at 8. The parties sought to resolve these disputes by mediation but failed to reach an agreement. R. at 8.

II. PROCEDURAL HISTORY

Following unsuccessful mediation, the parties agreed that the subsequent new value dispute was exclusively a legal issue and therefore filed cross-motions for summary judgment. R. at 9. The parties also agreed to hold a hearing for the request for full payment of May 2020 rent concurrently with the summary judgment motion hearing. R. at 9. The Bankruptcy Court ruled in favor of the Trustee on both issues, concluding that section 365(d)(3) required payment for only the five days of occupancy prior to rejection of the lease. R. at 9. Additionally, the Bankruptcy Court granted the Trustee's motion for summary judgment on the preference issue, "holding that Touch of Grey could not use the value of the goods reflected on the Invoice as new value to reduce its preference

exposure given that the Invoice was paid pursuant to section 503(b)(9).” R. at 9. Touch of Grey appealed both issues “on a consolidated basis to the United States District Court for the District of Moot.” R. at 9. The district court affirmed the Bankruptcy Court on both issues. R. at 9. On appeal from the district court, the Court of Appeals for the Thirteenth Circuit affirmed on both issues on March 4, 2021. R. at 9.

SUMMARY OF THE ARGUMENTS

This Court should affirm the Thirteenth Circuit’s holding that Touch of Grey cannot recover for value provided to Debtor under section 503(b)(9) while also reducing its preference exposure under a subsequent new value defense. This Court should so hold because a proper statutory interpretation leads to the conclusion a payment pursuant to section 503(b)(9) is an “otherwise unavoidable transfer” under section 547(c)(4); section 547(c)(4) specifically precludes asserting a subsequent new value defense when there was an “otherwise unavoidable transfer” made for the value. A proper statutory interpretation leads to this conclusion because there is no mechanism in the Code to avoid an authorized administrative expense, and an “otherwise unavoidable transfer” in section 547(c)(4) can be a post-petition payment. Moreover, a holding precluding Touch of Grey from double dipping supports the overarching goal of bankruptcy and the underlying legislative purposes of sections 503(b)(9) and 547(c)(4). In fact, a holding permitting Touch of Grey to double dip would completely undermine the purpose of section 547(c)(4) and permit creditors to abuse bankruptcy.

This Court should also affirm the Thirteenth Circuit’s holding that section 365(d)(3) does not require a trustee to satisfy rent obligations allocable to the post-rejection period. In reaching this holding, a reading of the plain text of the statute must be the initial inquiry. The plain text of section 365(d)(3) is ambiguous because it is unclear whether its language should be understood on

an accrual or absolute billing date basis. The text is equally susceptible to either interpretation. However, consideration of interrelated Code sections reveals statutory conflicts under the billing date interpretation. In contrast, the interpretation prorating obligations to the period before rejection is consistent with Code provisions dealing with breach of executory contracts and pre-petition claim treatment. Further, this proration interpretation is logical in consideration of the Code's policy of creditor equality and the principle that priorities must be construed narrowly. Finally, the legislative history provides no indication of Congressional intent to do away with the pre-section 365 practice of prorating administrative expenses. The legislative history evidences an intent to provide landlords with current payment for current services, and the proration approach is consistent with this concern.

STANDARD OF REVIEW

The issues involve interpretations of the Bankruptcy Code and are strictly questions of law. The standard of review is *de novo*. *Pierce v. Underwood*, 487 U.S. 552, 558 (1988).

ARGUMENT

This Court should affirm the Thirteenth Circuit's holding that 11 U.S.C. § 547(c)(4) precludes a creditor from asserting a subsequent new value defense for goods subject to a satisfied administrative expense under 11 U.S.C. § 503(b)(9). Additionally, this Court should affirm the Thirteenth Circuit's holding that 11 U.S.C. § 365(d)(3) does not require a trustee to satisfy obligations allocable to the post-rejection period.

I. THE THIRTEENTH CIRCUIT CORRECTLY HELD CREDITOR CANNOT REDUCE ITS PREFERENCE EXPOSURE WITH A NEW VALUE DEFENSE PURSUANT TO 11 U.S.C. § 547(c)(4) WHEN CREDITOR WAS PAID IN FULL FOR THE NEW VALUE AS AN ADMINISTRATIVE EXPENSE PURSUANT TO 11 U.S.C. § 503(b)(9).

The first issue in this case requires determining the proper relationship and interworking of 11 U.S.C. § 547(c)(4) and 11 U.S.C. § 503(b)(9). These two sections of the Code share the

underlying legislative purpose of encouraging creditors to continue working with financially distressed debtors; both sections also contribute towards the goal of rehabilitating debtors through bankruptcy reorganization. *See, e.g., In re Arts Dairy, LLC*, 414 B.R. 219, 220 (Bankr. N.D. Ohio 2009); *Roberds, Inc .v. Broyhill Furniture* (*In re Roberds, Inc.*), 315 B.R. 443, 468 (Bankr. S.D. Ohio 2004). Section 547(c)(4) provides a creditor that has preference exposure pursuant to section 547(b) may reduce such exposure to the extent the creditor gives new value "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). Section 503(b)(9) was enacted nearly twenty-five years after 11 U.S.C. § 547 and provides similar protection to trade creditors who continue to extend credit to financially distressed debtors. Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23, § 1227 (Apr. 20, 2005). Importantly, section 503(b)(9) provides protection even if the creditor does not have preference exposure. Section 503(b)(9) states "there shall be allowed administrative expense . . . [for] the value of any goods received by the debtor within 20 days before the date of commencement of a case under this title in which the goods have been sold to the debtor in the ordinary course of such debtor's business." 11 U.S.C. § 503(b)(9).

There is no dispute sections 547(c)(4) and 503(b)(9) both provide a mechanism for creditors to recover the value of goods provided to a financially distressed debtor in their respective circumstances. However, whether a creditor may utilize *both* available mechanisms for recovery is not so settled. In other words, it is disputed whether a creditor who has preference exposure and extends new value within twenty days of the petition date may reduce its preference exposure by applying a subsequent new value defense under section 547(c)(4) and also be paid in full for the new value as an administrative expense under section 503(b)(9).

In addressing this question, a majority of courts have held that a creditor cannot be paid in full for value provided to the debtor under section 503(b)(9) and also use that same extended value to reduce its preference exposure 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); *Circuit City Stores, Inc. v. Mitsubishi Dig. Elecs. Am. (In re Circuit City Stores, Inc.)*, 2010 WL 4956022, at *9 (Bankr. E.D. Va. Dec. 1, 2010); *TI Acquisition, LLC v. Southern Polymer, Inc. (In re TI Acquisition, LLC)*, 429 B.R. 377, 385 (Bankr. N.D. Ga. 2010). In contrast, a minority of courts have held that a creditor can receive administrative payments for new value provided and also use that same extension of value to reduce its preference exposure. *See, e.g., Commissary Operations, Inc. v. Dot Foods, Inc. (In re Commissary Operations, Inc.)*, 421 B.R. 873, 879 (Bankr. M.D. Tenn. 2010); *Friedman's Liquidating Tr. v. Roth Staffing Cos. LP (In re Friedman's Inc.)*, 738 F.3d 547, 554-55 (3d Cir. 2013).

This Court should adopt the majority approach and hold that a creditor cannot reduce its preference exposure under 11 U.S.C. § 547(c)(4) when the creditor was paid in full for the new value pursuant to 11 U.S.C. § 503(b)(9) for two reasons. First, the plain language of section 547(c)(4) precludes a creditor from doing so because an administrative expense under section 503(b)(9) is an "otherwise unavoidable transfer" and an "otherwise unavoidable transfer" for new value disallows the defense in section 547(c)(4). Second, the overarching purpose of bankruptcy law and the legislative purpose underlying sections 547 and 503(b)(9) support the preclusion of a creditor from reducing preference exposure under a subsequent new value defense when a creditor was already paid in full for the new value as an administrative expense.

A. An Administrative Expense Paid Pursuant To 11 U.S.C. § 503(b)(9) Is An "Otherwise Unavoidable Transfer" Under 11 U.S.C. § 547(c)(4) And Therefore Cannot Be Used By Creditor To Reduce Its Preference Exposure.

A creditor cannot reduce its preference exposure under a subsequent new value defense in section 547(c)(4) when the debtor makes an "otherwise unavoidable transfer" to a creditor for the new value. 11 U.S.C. § 547(c)(4). Thus, this Court must determine whether a 503(b)(9) administrative expense is an "otherwise unavoidable transfer" under section 547(c)(4). The majority approach interprets a 503(b)(9) administrative payment as an "otherwise unavoidable transfer" under the language of sections 547(c)(4) and 503(b)(9). *See, e.g., In re Beaulieu Grp.*, 616 B.R. at 878 (holding such payment "constitutes an 'otherwise unavoidable transfer' by the debtor, and the new value represented by the § 503(b)(9) claim cannot be used to offset the creditor's preference liability.'"). Alternatively, the minority approach does not interpret 503(b)(9) administrative payments as "otherwise unavoidable transfer[s]" because a post-petition payment cannot constitute an "otherwise unavoidable transfer." *See In re Friedman's Inc.*, 738 F.3d at 554-55 (holding post-petition payments are not included in the "preference liability equation."). These conflicting approaches provide two questions that this Court must answer through statutory interpretation: whether a debtor's payment of an administrative expense under 11 U.S.C. § 503(b)(9) is avoidable and, if not, whether a post-petition payment pursuant to 503(b)(9) constitutes an "otherwise unavoidable transfer" in section 547(c)(4). This Court should hold an administrative expense is not avoidable and a post-petition payment pursuant to section 503(b)(9) can constitute an "otherwise unavoidable transfer" based on the plain language of section 547(c)(4).

1. Debtor's Payment Of An Administrative Expense Under 11 U.S.C. § 503(b)(9) Is Not An Avoidable Transfer.

This Court must first address whether a post-petition payment pursuant to section 503(b)(9) is avoidable. Section 549 is the only section in the Code that addresses avoidance of post-petition payments and it provides "the trustee may avoid a transfer of property of the estate . . . that is not

authorized under this title or by the court." 11 U.S.C. § 549(a)(B). Payment of an administrative expense pursuant to 503(b)(9) is plainly authorized to the extent of "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." As a result, a payment pursuant to section 503(b)(9), including the one in this case, is an unavoidable transfer in a bankruptcy proceeding because such payment is explicitly authorized by the Code. The remaining question is whether unavoidable post-petition payments under section 503(b)(9) constitute "otherwise unavoidable transfer[s]" under section 547(c)(4).

2. A Post-Petition Payment Pursuant To 11 U.S.C. § 503(b)(9) Does Constitute An "Otherwise Unavoidable Transfer" Based On The Unequivocally Unambiguous Text Of 11 U.S.C. § 547.

Courts are split as to the question of whether a post-petition payment can constitute an "otherwise unavoidable transfer" under 11 U.S.C. § 547(c)(4); however, "just because a particular provision may be, by itself, susceptible to differing constructions does not mean that the provision is therefore ambiguous," and a court must still interpret the statute as it normally would. *In re Price*, 370 F.3d 362, 369 (3d Cir. 2004). Courts interpret the Code by starting with "the language of the statute itself." *Ransom v. FIA Card Servs., N.A.*, 562 U.S. 61, 69 (2011) (citing *United States v. Ron Pair Enters.*, 489 U.S. 235, 241 (1989)). When a provision of the Code is unambiguous "the plain language controls . . . [if] the provision does not produce an absurd result or one that is 'demonstrably at odds with intentions of its drafters.'" *Jumpp v. Chase Home Fin., LLC (In re Jumpp)*, 356 B.R. 759, 793 (1st Cir. BAP 2006). "The plainness or ambiguity of statutory language is determined by reference to the language itself, the specific context in which the language is used, and the broad context of the statute as a whole." *Robinson v. Shell Oil Co.*, 519 U.S. 337, 341 (1997). It should be presumed in statutory interpretation that Congress does not alter

fundamental details of a regulatory scheme absent clear language to the contrary. *Whitman v. Am. Trucking Ass'ns, Inc.*, 531 U.S. 457, 468 (2001).

In addressing the question facing this Court, the majority of courts have concluded a post-petition payment can constitute an "otherwise unavoidable transfer." *See, e.g., In re Furr's Supermarkets, Inc.*, 485 B.R. 672, 733-34 (D.N.M. 2012); *In re Login Bros. Book Co.*, 294 B.R. 297, 300 (N.D.Ill. 2003). The reasoning of these courts is perhaps best explained in *In re Beaulieu Group*. In that case, the debtor made payments to the defendant during the preference period, creating preference exposure. *Id.* at 861. Additionally, within twenty days of the debtor's bankruptcy petition, the defendant sold debtor approximately $160,000 worth of goods that were typically purchased by debtor in the ordinary course of business, creating a claim for an administrative expense under section 503(b)(9). *Id.* at 862. The defendant sought to recover the value of those goods pursuant to section 503(b)(9) and reduce its preference exposure under section 547(c)(4). *Id.* at 866. In addressing whether section 547(c)(4) imposed a temporal limit, the court stated the omission of such a limit was intentional, pointing to section 547(c)(5)'s inclusion of an explicitly outlined temporal limit in contrast to 547(c)(4)'s lack thereof. *Id.* at 872. The court stated the temporal limit in section 547(c)(5) "show[ed] Congress knew how to impose such a limitation when it intended to do so" and therefore the absence of such a limit in in 547(c)(4) was deliberate. *Id.*

Touch of Grey argues 547(c)(4) does contain a temporal limit and a payment pursuant to section 503(b)(9) cannot constitute an "otherwise unavoidable transfer." R. at 14. This argument, however, in terms of a pure statutory interpretation analysis, is only tangentially supported by the case that is most helpful to its position. *See In re Friedman's Inc.*, 738 F.3d at 554-55. The *In re Friedman's Incorporated* court addressed the question of whether an "otherwise unavoidable

transfer" made after the filing of bankruptcy could affect a new value defense. *Id.* at 550. The court held that such a transfer could not affect the new value defense. *Id.* In that case, however, the court departed from "the presence or absence of individual words and phrases within § 547(c)(4)(B) [and took] a broader approach to [the] analysis [by] examining the provisions in the context of the Code as a whole." *Id.* at 555. The court reasoned there were many contextual factors that indicated the petition date was a "cutoff for analysis of the new value defense." *Id.* at 555. The contextual indicators the court listed all dealt with the fact that section 547 was concerned with pre-petition transfers to the detriment of other creditors. *Id.* Moreover, the court thought important that the calculation of the statute of limitations, the hypothetical liquidation test, and the improvement-in-position test all are bound to the date of the petition. *Id.* at 556. For those reasons, not the plain language and context of the Code indicating Congress knows how to set temporal limits when desired, the court held post-petition payments could not affect a new value defense. *Id.* at 550.

The different approaches applied by the courts in *In re Beaulieu Group* and *In re Friedman's Incorporated* are the result of differing statutory interpretation analyses. In *In re Beaulieu Group* the court held there was no temporal limit in section 547(c)(4) because Congress knew how to put such a limit and chose not to do so. 616 B.R. at 872. Thus, the court reasoned the plain language Congress used without such a temporal limit controlled. *Id.* This analysis is correct. *See In re Jump*, 356 B.R. at 793 ("the plain language controls . . ."). In contrast, the *In re Friedman's Incorporated* court stated the lack of such a temporal limit meant the court should look at the whole context of the Code. 738 F.3d at 555. It is true the broad context of a statute may be used to understand whether language is ambiguous. *See Shell Oil Co.*, 519 U.S. at 341 ("The plainness or ambiguity of a statute is determined by reference to . . . the broad context of the statute as a whole."). However, it is equally as true that Congress will not alter fundamental details of the

Code without clear language to the contrary. *See Whitman*, 531 U.S. at 468 (2001) ("Congress . . . does not alter the fundamental details of a regulatory scheme in vague terms or ancillary provisions."). Moreover, when looking at the context of whole Code, the *In re Friedman's Incorporated* court seemingly glossed over Congress's temporal limit in section 547(c)(5) despite its obvious indication Congress knew how to impose one. 738 F.3d at 556 (stating it could be argued an "omission from § 547(c)(4) was intentional, since Congress knew how to set forth a [temporal limit] . . . [but], on balance, we believe that the policy improvement of position prior to the petition date is central to the concept of preference.") In short, the difference between the two analyses is that the court in *In re Beaulieu Group* adhered to the plain language of Congress' written word while the court in *In re Friedman's Incorporated* made assumptions on Congress' behalf, fundamentally altering the application of section 547(c)(4). A proper statutory interpretation requires this Court to adopt the former analysis; a holding to the contrary requires the stretching assumption that Congress hid an elephant in a mousehole.

A proper statutory reading of the Code clearly indicates post-petition payment can constitute an "otherwise unavoidable transfer." This is because section 547(c)(4) contains no temporal limit on when a transfer must be made to constitute an "otherwise unavoidable transfer." Congress' silence as to whether post-petition payments can constitute an "otherwise unavoidable transfer" must speak loudly to this Court in its statutory interpretation because it clearly set temporal limits in other parts of the Code. *See, e.g.,* 11 U.S.C. § 547(c)(5) (specifically speaking to "as of the date of the filing of the petition"). In other words, because Congress knows how to set Bankruptcy Code temporal limits where and when it wants to, it would be utterly absurd to assume Congress hid the necessity of a temporal limit in such ambiguity. *See Whitman*, 531 U.S. at 468 ("Congress . . . does not alter the fundamental details of a regulatory scheme in vague terms

or ancillary provisions."); *Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 6 (2000) ("Congress 'says in a statute what it means and means in a statute what is says there.'"). A proper statutory interpretation requires this Court to look no further than the plain language of the Bankruptcy Code and recognize Congress knew how to set temporal limits and plainly did not do so here.

B. The Overarching Purpose of Bankruptcy Law And The Specific Legislative Purpose Underlying Sections 547 And 503(b)(9) Further Support Precluding Creditor From Reducing Preference Exposure By Asserting A Subsequent New Value Defense When Creditor Is Paid In Full For The New Value.

This Court's analysis needs not go further than a pure statutory interpretation that indicates a payment pursuant to section 503(b)(9) is an "otherwise unavoidable transfer" precluding a subsequent new value defense under section 547(c)(4). However, if this Court determines there is ambiguity, it should resolve the ambiguity by considering everything indicating the true intent and purpose of Congress, such as policy goals, legislative history, and pre-code practice. *United States v. Fisher*, 6 U.S. 358, 386 (1805) ("Where the mind labours to discover the design of the legislature, it seizes everything from which aid can be derived."). This Court has long recognized the overarching purpose of bankruptcy law is to support the equality of distribution among similarly situated creditors. *Union Bank v. Wolas*, 502 U.S. 151, 161 (1991). Furthermore, the underlying policy purposes of sections 503(b)(9) and 547(c) are to encourage trade creditors to continue to work with distressed debtors and discourage abuse by debtors on the eve of bankruptcy. *In re Arts Dairy, LLC*, 414 B.R. at 220; *In re Roberds, Inc.*, 315 B.R. at 468.

A fair consideration of the overarching policy goals of the Code and the legislative purposes underlying sections 547(c)(4) and 503(b)(9) support precluding Creditor from using both sections to recover from the estate for the new value provided for three reasons. First, granting Creditor both payment pursuant to section 503(b)(9) and reduction of its preference exposure

would create unintended inequality among creditors. Second, allowing Creditor to recover under both sections would permit abuse of section 547(c). Third, and perhaps most importantly, allowing both an administrative expense payment and preference reduction would allow for flagrantly absurd results in this case and bankruptcy proceedings to come.

1. Payment To Creditor Pursuant To 11 U.S.C. § 503(b)(9) While Also Allowing Creditor To Reduce Its Preference Exposure Pursuant To 11 U.S.C. § 547(c)(4) Undermines Creditor Equality.

Maintaining equality among similarly situated creditors has long been the primary object of this Court in bankruptcy proceedings. *See Boese v. King*, 108 U.S. 379, 385-86 (1883); *Howard Delivery Service, Inc. v. Zurich American Ins. Co.*, 547 U.S. 651, 667 (2006). This Court requires a clear statutory purpose to permit departing from the principle of creditor equality. *Nathanson v. NLRB*, 344 U.S. 25, 29 (1952). Moreover, inequality among creditors will usually only prevail when it "is in the best interest of the estate." *In re Friedman's Inc.*, 738 F.3d at 554-55.

The Code has carved out many circumstances where a creditor will be treated differently than other creditors. *See, e.g.,* 11 U.S.C. §§ 503, 506, 507, 510, 547. Two of these are relevant in this issue. First, when a creditor has preference exposure and they subsequently advance new value, the Code treats that creditor differently by permitting full recovery through the reduction of preference exposure. 11 U.S.C. § 547(c)(4). Second, when a creditor provides new value to a debtor within twenty days of the petition, the Code entitles them to an administrative expense. 11 U.S.C. § 503(b)(9). This differential treatment is justified because without the ability for a creditor to fully recover for value provided to a distressed debtor, the creditor would simply not extend the credit in the first place. Nick Sears, *Defeating The Preference System: Using The Subsequent New Value Defense and Administrative Expense Claims to "Double Dip"*, 28 EMORY BANKR. DEV. J. 593 (2012). In other words, the Code essentially assumes that without these two carve outs to encourage creditors to extend new value, parties would refuse to extend value at all. Because of

this, the differential treatment does not harm other creditors. Thus, true equality among creditors, according to the underlying philosophy of the Code, is determined after paying a creditor for the value provided in the circumstances in sections 503(b)(9) and 547(c)(4).

The creditor inequality permitted under Touch of Grey's interpretation is as obvious as it is wrong. In this case, on the date of petition, there was a total of $1,150,000 of unsecured claims against Debtor, $650,000 of which was held by Creditor. R. at 6. Touch of Grey additionally had $250,000 worth of preference exposure because of a payment from Debtor to Touch of Grey on December 7, 2019. R. at 5. Creditor provided new value back to Debtor in the amount of $200,000 just eighteen days before the petition date, creating a both a subsequent new value defense and a right to an administrative expense. R. at 5. Considering the policy behind the preferential treatment in sections 503(b)(9) and 547(c)(4), true creditor equality is achieved here with a holding that allows Touch of Grey to recover to the extent of the value it provided. This could be done in one of two ways. First, Touch of Grey is paid in full for an administrative expense pursuant to section 503(b)(9) but retains $250,000 of preference exposure. Alternatively, Creditor asserts a subsequent new value defense under section 547(c)(4) and then only has $50,000 worth of exposure remaining with $200,000 in pocket. In either scenario, the other creditors are not disadvantaged because but-for the payment under either section 503 or 547, Creditor would not have extended the new value. Touch of Grey, however, advocates for inequality that the Code simply does not allow. Touch of Grey seeks to use both sections of the Code and, in effect, be paid twice for the value it provided; Touch of Grey seeks to recover $400,000 for goods valued at $200,000. Allowing this double dipping would obviously be at the detriment of other creditors as Touch of Grey provided only $200,000 worth of value to the estate. This type of inequality is not a clear design of the Bankruptcy Code, creates absurd results, and should be plainly prohibited by this Court.

2. Permitting Creditor To Be Paid For New Value Provided Pursuant To 11 U.S.C. § 503(b)(9) And Reduce Its Preference Exposure Would Permit Debtor/Creditor Abuse And Undermine The Purpose Of 11 U.S.C. § 547.

Congress broadly authorized bankruptcy trustees to avoid transfers under 11 U.S.C. § 547 if "(1) [it] benefits a creditor; (2) [is] on account of antecedent debt; (3) made while the debtor [is] insolvent; (4) [are] made within 90 days before bankruptcy; and (5) enable the creditor to receive a larger share of the estate than if the transfer had not been made" unless an exception in section 547(c) applies. *Wolas*, 502 U.S. at 161. The legislative history of section 547 is minimal but the general purpose of avoidance is to "discourage unusual action by either the debtor or his creditors during the debtor's slide into bankruptcy." *Logan v. Basic Distrib. Corp. (In re Fred Hawes Org., Inc.)*, 957 F.2d 239, 243 (6th. Cir. 1992).

There is no confusion as to the broad purpose of section 547 in bankruptcy proceedings: the section forbids a debtor from choosing which creditors get paid when approaching bankruptcy. Nonetheless, Touch of Grey argues for an interpretation of the Code that would permit a debtor, in the extreme, to choose which creditors get paid. Sears, *supra* at 603 (explaining how creditor and debtor could collude to undermine section 547). The flaws of the approach Touch of Grey advocates for become evident through a simple example. Hypothetical debtor is knowingly approaching bankruptcy and has a creditor she owes $100,000 who she would prefer to pay. This hypothetical debtor then goes to the creditor and pays him $50,000 sometime before declaring bankruptcy. The preferred creditor then advances new value on the eve of bankruptcy to debtor in the amount of $50,000. When the petition is filed, creditor does what Touch of Grey is attempting to do and files for an administrative expense pursuant to section 503(b)(9) and asserts a new value defense under section 547(c)(4). If permitted, the hypothetical debtor can successfully prefer a creditor and make it so the creditor recovered the entire value of his claim, despite being a sham.

The position Touch of Grey advocates for is wrong because it would create a loophole around section 547 with no indication "Congress intended either to permit or prohibit double dipping." *Id.* at 608. Certainly, if Congress intended to allow such a loophole, it would be clear to this Court. *See Cohen v. De La Cruz*, 523 U.S. 213, 221 (1998) (The Code should not be read to "erode past bankruptcy practice absent a clear indication that Congress intended such a departure. . . .").

3. Absurd Results Will Occur If Creditor Is Allowed To Recover For The Value Of Goods Provided Pursuant To 11 U.S.C. § 503(b)(9) And Reduce Its Preference Exposure.

If an interpretation of a provision plainly contradicts the intent of the Code or produces an absurd result, that interpretation should not be given effect. *In re Jumpp*, 356 B.R. at 793. "Double dipping allows certain creditors to defeat the preference system of the Code [and] [a]llowing a creditor to count the same goods in a subsequent new value defense as were claim for an administrative expense would vitiate § 547 and undermine the foundational policy goal of the Code—encouraging equity among all creditors." Sears, *supra* at 603-04.

The results of allowing a creditor with preference exposure who provided new value to a debtor within twenty days of the bankruptcy petition to double dip have undoubtedly been explained as absurd in the previous two sections. The first section showed absurdity because the concept of equality among creditors was thrown to the wayside when allowing a creditor to double dip. The second section revealed how the allowance of double dipping would absurdly permit the abuses section 547 aims to prevent. The absurd results and unintended consequences, though, do not stop there. Consider, for example, the accidental absurdity that may occur when creditors know they can be paid twice the value of their goods if they have preference exposure and a debtor is approaching bankruptcy. These creditors will be incentivized to try to throw value at debtor with no regard for the ancillary creditor casualties this would cause. When the value of a debtor's estate

is limited and double dipping creditors run uninhibited, the value of payout to other creditors necessarily must decrease. Thus, this would discourage other creditors from engaging with such a debtor and create more liability for the debtor. Ultimately, permitting double dipping would create a race of creditors to supply a distressed debtor with goods on the eve of bankruptcy – the very 'feeding frenzy' the Bankruptcy Code seeks to regulate.

The absurdness of what allowing double dipping would lead to must be enough for this Court to preclude Creditor from double dipping under sections 503(b)(9) and 547(c)(4). *In re Jumpp*, 356 B.R. at 793 ("the plain language controls . . . [only if] the provision does not produce an absurd result or one that is 'demonstrably at odds with intentions of its drafters."). Courts have before declined to give effect to a possible interpretation of an ambiguous statute because it would create absurd results, and this Court has countless times suggested absurd results would preclude accepting an interpretation of a statute. *See, e.g., Pritchett v. Office Depot, Inc.*, 420 F.3d 1090, 1093 (10th Cir. 2005) (Concluding the word "less" should be read as "more" because of an absurd result otherwise); *Union Planters Bank, N. A.*, 530 U.S. at 7 ("'[T]he sole function of the courts'– at least where the disposition required by the text is not absurd–'is to enforce it according to its terms.'"); *United States v. Kirby*, 74 U.S. 482 (1868) ("[T]erms should be so limited in their application as not to lead to injustice, oppression, or an absurd consequence. . . ."). This Court should preclude Touch of Grey from being paid in full for new value and also using that new value to reduce its preference exposure because not doing so would create utterly absurd results that were not the intention of Congress.

* * *

This Court should hold an administrative payment authorized pursuant to section 503(b)(9) is an "otherwise unavoidable transfer" under the plain language section 547(c)(4) because such transfer cannot be avoided in a bankruptcy proceeding and Congress' silence as to whether post-

petition payments fall under section 547(c)(4) creates a necessary inference that they do fall under the section. The necessary inference is the result of considering that Congress' chose to impose temporal limits in some sections, including the section immediately after, but section 547(c)(4). In addition to the statutory analysis, a holding precluding Touch of Grey from double dipping is supported by the overarching philosophy of the Code and the legislative purposes underlying sections 503(b)(9) and 547(c)(4).

II. THE THIRTEENTH CIRCUIT CORRECTLY HELD THAT 11 U.S.C. § 365(d)(3) DOES NOT REQUIRE THE TRUSTEE TO SATISFY OBLIGATIONS ALLOCABLE TO THE POST-REJECTION PERIOD.

Section 365 gives the trustee the broad power to assume or reject an unexpired lease for the benefit of the estate upon court approval. 11 U.S.C. § 365(a). Section 365(d)(3) provides that the trustee must "timely perform all the obligations of the debtor . . . arising from and after the order for relief under any unexpired lease of nonresidential real property, until such lease is assumed or rejected, notwithstanding section 503(b)(1) of this title." This section was added by amendment in 1984 to address problems associated with administrative claim treatment of expenses due landlords during the post-petition, pre-rejection period. *In re NETtel Corp.*, 289 B.R. 486, 492 (Bankr. D.D.C. 2002) (explaining pre-1984 administrative claim problems).

Courts are currently split as to the meaning of the language within section 365(d)(3). The majority view, adopted by the Thirteenth Circuit below, has become known as the "proration" or "accrual" approach (the "proration approach"). Under this approach, the trustee's obligation to pay rent extends no further than the date of rejection, and the trustee is not liable for rent or other expenses due post-rejection, irrespective of the terms of the lease. *See, e.g.*, *El Paso Props. Corp. v. Gonzales (In re Furr's Supermarkets, Inc.)*, 283 B.R. 60, 70 (B.A.P. 10th Cir. 2012); *In re Ames Dep't Stores, Inc.*, 306 B.R. 43, 65 (Bankr. S.D.N.Y. 2004); *NETtel.*, 289 B.R. at 497; *Matter of Handy Andy Home Improvement Ctrs., Inc.*, 144 F.3d 1125, 1128 (7th Cir. 1998) (considering pre-

petition tax obligations); *In re Learningsmith, Inc.*, 253 B.R. 131, 134 (Bankr. D. Mass. 2000) (considering pre-petition tax obligations); *Heathcon Holdings, LLC v. Dunn Indus., LLC* (*In re Dunn Indus., LLC*), 320 B.R. 86, 90 (Bankr. D. Md. 2005) (considering proration of tax obligations); *In re Stone Barn Manhattan LLC*, 398 B.R. 359, 368 (Bankr. S.D.N.Y) (considering "stub rent" accruing between the payment date and order for relief). Conversely, the minority view interprets section 365(d)(3) to require full performance of the debtor's obligations as required by the lease, despite the decision to reject and the timing of such rejection (the "billing date approach"). *See, e.g.*, *CenterPoint Props. v. Montgomery Ward Holding Corp. (In re Montgomery Ward Holding Corp.)*, 268 F.3d 205, 212 (3d. Cir. 2001) (considering pre-petition tax payments); *Koenig Sporting Goods, Inc. v. Morse Rd. Co. (In re Koenig Sporting Goods, Inc.)*, 203 F.3d 986, 989 (6th Cir. 2000) (considering post-petition rent accrual); *HA-LO Indus., Inc. v. CenterPoint Props. Tr.*, 342 F.3d 794, 801 (7th Cir. 2003) (considering post-petition rent accrual). In reaching these interpretations, the majority reads the language of section 365(d)(3) to be ambiguous and examines the whole act, prior pre-section 365(d)(3) proration practice, legislative history, and the policies of the Code. *See Ames*, 306 B.R. at 65-75 (considering section 365(d)(3)'s plain language, context, bankruptcy policy, prior practice, and legislative history). Conversely, the minority approach reads section 365(d)(3) to be unambiguous and therefore argues the plain meaning compels the trustee to make lease payments as required in the lease. *See Koenig*, 203 F.3d at 989 (finding section 365(d)(3) text unambiguous).

This Court should affirm the Thirteenth Circuit and adopt the majority interpretation, holding that the proration approach is the proper interpretation of section 365(d)(3) for two reasons. First, section 365(d)(3) is ambiguous and the proration approach best fits the canons of

statutory interpretation in the context of the whole act and prior bankruptcy practice. Second, both the policy of the Code and the legislative history support the proration approach.

A. 11 U.S.C. § 365(d)(3) Is Ambiguous And The Proration Approach Is The Proper Interpretation In The Context Of The Bankruptcy Code And Prior Practice.

In interpreting the Code, the inquiry begins with the "language of the statute itself." *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 241 (1989) (citing *Landreth Timber Co. v. Landreth*, 471 U.S. 681, 685 (1985)). Where the statute's language is plain, "the sole function of the courts is to enforce it according to its terms." *Id.* (quoting *Caminetti v. United States*, 242 U.S. 470, 485 (1917)). However, "[t]he plainness or ambiguity of statutory language is determined by reference to the language itself, the specific context in which the language is used, and the broader context of the language as a whole." *Robinson v. Shell Oil Co.*, 519 U.S. 337, 341 (1997). In addition to the plain meaning and context of a statutory scheme, courts look to prior bankruptcy practice. *See Cohen v. de la Cruz*, 523 U.S. 213, 221 (1998) (citing *Pennsylvania Dept. of Pub. Welfare v. Davenport*, 495 U.S. 552, 563 (1990)).

This Court should hold the proration approach is the correct interpretation of section 365(d)(3) for two main reasons. First, the plain language and context of section 365(d)(3) render it ambiguous. Second, the proration approach better aligns with the canons of statutory interpretation based on the context of the Code and pre-section 365 practice.

1. The Plain Language And Context Of 11 U.S.C. § 365(d)(3) Render It Susceptible To Competing Interpretations.

This Court must first determine whether the language of section 365(d)(3) is ambiguous. While the starting point in interpretation is the text, "in expounding a statute, [this Court] must not be guided by a single sentence or member of a sentence, but [should] look to the provisions of the whole law, and to its object and policy." *Kelly v. Robinson*, 479 U.S. 36, 43 (1986) (quoting *Offshore Logistics, Inc. v. Tallentire*, 477 U.S. 207, 222 (1986)). Further, "[i]t is a fundamental

canon of statutory construction that the words of a statute must be read in their context and with a view to their place in the overall statutory scheme." *Roberts v. Sea-Land Servs., Inc.*, 566 U.S. 93, 101 (2012) (quoting *Davis v. Michigan Dep't of Treasury*, 489 U.S. 803, 809 (1989)).

The split of authority on this issue begins with different approaches as to the plain language of section 365(d)(3). Courts advocating for the proration approach find that the text of the statute is "inherently ambiguous" because it does not speak directly to the issue at hand. *Learningsmith*, 253 B.R. at 134. Conversely, courts advocating for the billing date approach argue that "[t]he clear and express intent of the section 365(d)(3) is to require the trustee to perform the lease in accordance with its terms." *Montgomery*, 268 F.3d at 209.

As stated by this Court, proper interpretation begins with "the language of the statute." *Ron Pair*, 489 U.S. at 241. Section 365(d)(3) in relevant part provides:

> 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 majority of the Thirteenth Circuit correctly determined that the language of section 365(d)(3) is ambiguous for multiple reasons. First, "arises," is not defined in the Code and, as used in section 365(d)(3), is subject to two different meanings. Specifically, the word can be construed "to mean having arisen in (a) absolutist terms or (b) in an accrual sense." *Ames*, 306 B.R. at 67. In other words, rent may be payable on a particular date, "but in the economic and historical senses that Congress had in mind, the compensation obligation arises on the date of occupancy," supporting an accrual based interpretation. *NETtel*, 289 B.R. at 490. Second, it is unclear whether the phrase "until such lease is assumed or rejected" modifies the term "perform" or the term "obligations." While a construction interpreting the phrase to modify "perform" could foreclose a proration approach, an interpretation of the phrase modifying "obligation" is consistent with the

proration approach. *See Ames*, 306 B.R. at 67. Critically, neither interpretation does "violence to the statutory language." *Montgomery*, 268 F.3d at 213 (Mansmann, J., dissenting). Accordingly, the majority, in abiding by the statutory interpretation rule that the inquiry begins with the "language of the statute," correctly determined that the plain language is susceptible to more than one reasonable interpretation. *See Ron Pair*, 489 U.S. at 241.

Section 365(d)(3) becomes more ambiguous when reconciled with other provisions of the Code. For example, section 365(g) treats rejection of a lease as a breach. *See* § 365(g) ("[T]he rejection of an executory contract or unexpired lease . . . constitutes a breach of such contract or lease."). Further, section 502(g) confirms that claims for rejection under section 365 are treated as pre-petition in nature. *See* § 502(g)(1) ("A claim arising from the rejection, under Section 365 . . . shall be determined . . . as if such claim had arisen before the date of the filing of the petition."). Thus, construing "obligation" as the full amount payable in a given date, "without regard to whether any part of the amount accrued prepetition [or post-rejection], . . . would conflict with, and constitute an exception to, the provisions of the Code governing claims" by elevating the pre-petition or post-rejection portion to post-petition priority. *Learningsmith*, 253 B.R. at 134. Given that the statute "does not state that it is meant to constitute an exception" to the clearly defined treatment of claims for breaches of executory contracts, "[t]he statutory language is inherently ambiguous." *Id.*

In contrast, in examining the plain language of section 365(d)(3), the minority of the Thirteenth Circuit slaps a dictionary definition to the word "obligation" and, with little discussion, quickly purports that the statute is unambiguous. This approach fails. The minority relies especially on the Sixth Circuit in *Koenig* and Third Circuit in *Montgomery*. The *Koenig* court similarly fails to account for the ambiguity in section 365(d)(3) beyond cursory examination of the word

"obligation." Further, both the *Koenig* and *Montgomery* courts' reasoning are devoid of any meaningful analysis as to what "'until such lease is assumed or rejected' refers to." *See Ames*, 300 B.R. at 77 ("[Koenig] failed to discuss what it believed 'until such lease is assumed or rejected refers to.'"). Additionally, the Third Circuit in *Montgomery* goes no further than declaring that the "intent of § 365(d)(3) is to require the trustee to perform the lease in accordance with its terms," admitting even that it reaches its conclusion "with some reluctance." *Montgomery*, at 209, 211. Reluctance is justified because the Third Circuit gives no consideration to the interpretation "that the obligation arises as it accrues over time, not when the payment is due" and provides little basis for its unexplained discovery of the "intent" of the statute. *See NETtel*, 289 B.R. at 494 (explaining that though a lease may specify payment date, the obligation "arises as it accrues").

The minority approach also fails to interpret section 365(d)(3) in the context of other provisions of the Code. Critically, neither the minority nor any court adopting the billing date approach can reconcile the billing date interpretation's conflict with the pre-petition treatment of claims for rejection in section 502(g). Indeed, a reader can make any term unambiguous by simply isolating it from the statute and applying a dictionary definition, but such an approach does not give a proper construction under this Court's canons of statutory interpretation. *See Roberts*, 566 U.S. at 101 (explaining that a statute must be read in its context in the statutory scheme). Accordingly, the majority's interpretation properly finds ambiguity not only based on a plain reading of the text but also in the context of other provisions of the bankruptcy Code.

2. The Proration Approach Is The More Sensible Interpretation In The Context Of The Bankruptcy Code And Prior Practice.

This Court should construe section 365(d)(3) in the context of other Code provisions and consider the practice of courts before the enactment of the statute. This is because statutory interpretation is a "wholistic endeavor," and often "[a] provision that may seem ambiguous in

isolation is often clarified by the remainder of the statutory scheme." *United Sav. Ass'n of Tex. v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 371 (1988). This Court has stated that it "will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure." *Cohen*, 523 U.S. at 221 (quoting *Davenport*, 495 U.S. at 563). Indeed, "[w]hen Congress amends the bankruptcy laws, it does not write 'on a clean slate.'" *Dewsnup v. Timm*, 502 U.S. 410, 419 (1992) (citing *Emil v. Hanley*, 318 U.S. 515, 521 (1943)).

The majority of the Thirteenth Circuit read section 365(d)(3) in the context of the whole act, as required under this Court's canons of statutory interpretation. *See United Sav.*, 484 U.S. at 371 ("Statutory construction . . . is a wholistic endeavor."). In doing so, the majority correctly determined that the proration approach is the most sensible interpretation of section 365(d)(3). The billing date approach, in contrast, fails because it conflicts with other sections of the Code dealing with obligations following rejection. Specifically, "Congress has directed the federal courts, with its enactment of sections 365(g) and 502(g), to treat claims for breaches of lease obligations following rejection as *prepetition claims*." *Ames*, 306 B.R. at 70 (emphasis added). However, the billing date approach takes landlord claims for post-rejection rent and elevates them to post-petition claim treatment, "a result exactly contrary to the plain meaning, and purpose, of section 365(g) and 502(g)." *Id.* Furthermore, while section 365(d)(3) specifically makes an exception to the section 503(b)(1) actual and necessary requirements for administrative expenses, "the section does not make an exception for the provisions of the Bankruptcy Code that deal with claims." *In re Dunn*, 320 B.R. 86. It is hard to imagine that Congress would intend such a substantial departure from claim treatment without explicitly saying so, especially given its express inclusion of excepting language in relation to the Code's administrative claim requirements. *See Whitman v. Am. Trucking Ass'ns, Inc.*, 531 U.S. 457, 468 (2001) ("Congress does not alter the fundamental

details of a regulatory scheme in vague terms or ancillary provisions."). Therefore, the billing date approach is not consistent with the Code and the most sensible interpretation is the proration approach. Applying the proration approach in this case reveals the practical nature of the approach. In this case, rent for the five days of occupancy in May is a post-petition prioritized expense under section 365(d)(3) entitled to relief from the actual and necessary treatment ordinarily required under section 503(b). However, rent for the remainder of May shall be treated "as if such claim had arisen before the date of the filing of the petition," as stated in section 502(g). Therefore, because "the estate . . . ceased occupancy of the property by the date or rejection, the estate is saddled with liability for the post-rejection period only as a pre-petition claim." *NETtel*, 289 B.R. at 491.

The majority of the Thirteenth Circuit's interpretation is further supported by the consistent pre-amendment proration practice with administrative expenses. Prior practice is paramount to interpreting any ambiguity in the Code because this Court has stated it will only depart from prior bankruptcy practice when clearly indicated by Congress. *See Cohen*, 523 U.S. at 221. Prior to the enactment of section 365(d)(3), lease obligations during the post-petition, pre-rejection period fell under section 503 as administrative expenses and were prorated to the post-petition pre-rejection period. *See NETtel*, 289 B.R. at 492 ("[N]othing in § 365(d)(3) itself plainly requires the elimination of the pre-1984 practice of prorating administrative expenses."). This prior practice must only be departed from if it was clearly stated by Congress. *See Cohen*, 523 U.S. at 221. Congress' intent was not to depart from the prior practice of proration. Rather, Congress' intent in enacting section 365(d)(3) was taking landlords "out from under the 'actual, necessary' provision of 503(b)(1) and allow[ing] them during that awkward post-petition pre-rejection period to collect the rent fixed in the lease." *Handy Andy*, 144 F.3d at 1128. Accordingly, the majority of

the Thirteenth Circuit in adopting the proration approach properly recognized that Congress was not writing "on a clean slate" and more realistically discerned Congress' intent in enacting section 365(d)(3). *See Dewsnup*, 502 U.S. at 419 (explaining that Congress "does not write on a clean slate" when it amends bankruptcy laws). Furthermore, the idea that section 365(d)(3) was not intended to bring an end to proration during the post-petition pre-rejection period is further supported by the inclusion of section 365(d)(4) in the 1984 amendments. *See NETtel*, 289 B.R. at 497 n. 6 ("§ 365(d)(4) is a recognition of the estate's ceasing to have a right under the lease to enjoy occupancy once the lease is rejected."). It should be evident to this Court that Congress would not include a provision dealing with discontinuing occupancy after rejection if it intended to depart from the practice of prorating rent to the period before rejection.

In short, sections 365(g) and 502(g) establish that unperformed obligations following rejection are to be treated as unsecured claims, and the proration interpretation is consistent with such treatment. Further, Congress' silence as to the consistent prior practice of prorating administrative expenses further supports the proration interpretation. Thus, the obligations of the trustee for the use of a property should extend no further than the date of rejection, in this case May 5, 2020.

B. Bankruptcy Policy And The Legislative History Of 11 U.S.C. § 365(d)(3) Support the Proration Approach.

Statutory purpose is relevant to giving a proper construction of a statute. *See Griffin v. Oceanic Contractors, Inc.*, 458 U.S. 564, 572 (1982) (considering statutory purpose where the literal words would produce an absurd result). Further, legislative history may also be examined where the statute is ambiguous, or a construction according to its terms leads to absurd or impracticable results. *See United States v. Mo. Pac. R. Co.*, 278 U.S. 269, 277 (1929) (declining to turn to legislative history because a literal interpretation did not lead to absurd results). Because

section 365(d)(3) is ambiguous, this Court should consider underlying bankruptcy policy as well as the legislative history of the statute. In doing so, this Court should find that bankruptcy policy and the legislative history of section 365(d)(3) support the proration interpretation.

1. The Proration Approach Aligns With The Statutory Policy Of Creditor Equality And Avoids The Absurd Results Created Under The Billing Date Approach.

When interpreting statutes, in cases where the literal application of a statute would produce a result "demonstrably at odds with the intentions of its drafters," the intent of the drafters controls. *See Griffin*, 458 U.S. at 571. Bankruptcy policy "aims . . . to secure equal distribution among creditors. . . . [and] preferential treatment of a class of creditors is in order only when clearly authorized by Congress." *Howard Delivery Serv., Inc. v. Zurich Am. Ins. Co.*, 547 U.S. 651, 655 (2006). Therefore, "provisions allowing preferences must be tightly construed," and doubts in interpretation are "best resolved in accord with the . . . equal distribution aim." *Id.* at 667-68.

The split of authority on this issue is implicated by differing views on the policy implications of section 365(d)(3)'s interpretation. Courts advocating for the proration interpretation argue that the billing date approach contradicts creditor equality by leaving landlords uncompensated in certain cases and drastically overcompensated in others solely based on the terms of the lease and timing of filing and rejection. *E.g.*, *NETtel*, 289 B.R. at 492-93 ("The performance date approach . . . violat[es] the principle of creditor equality and distort[s] the priority and distribution provisions of other sections of the Bankruptcy Code."). Conversely, courts advocating for the billing date approach brush aside these concerns and argue that the debtor controls the time of rejection. *E.g.*, *Koenig*, 203 F.3d at 989 (explaining that "debtor had complete control over the obligation").

This Court should not ignore the absurd results created under the billing date interpretation. The most fundamental absurdity created by the billing date interpretation is its elevation of pre-

petition claims to post-petition priority, resulting in "lessors leap-frogging over other unsecured creditors." *Furr's Supermarkets,* 283 B.R. at 69. Notably, this absurdity arises in the absence of any authorization from Congress and occurs in multiple scenarios.

The first problematic scenario arises when rent, taxes, and other charges in the lease are paid in arrears. Often, payments that relate to pre-petition possession may actually become due under the lease in the post-petition, pre-rejection period. *See Learningsmith*, 131 B.R. at 134 (involving pre-petition tax obligations coming due during the post-petition, pre-rejection period). As long as the payment date falls within the post-petition, pre-rejection period, the billing date approach treats these expenses as post-petition prioritized expenses to the detriment of other unsecured creditors. *Cf. id*. (rejecting billing date interpretation because it would transform pre-petition tax expenses into post-petition prioritized expenses).

The second problematic scenario involves rent, taxes, and other expenses payable in advance. *See Ames*, 306 B.R. at 63. Payments relating in part to post-rejection possession may be due before rejection. *See id.* (rejecting the lease mid-month and vacating on rejection). The current case is an example, as the full monthly rent is paid in advance, but the trustee rejected the lease and ceased occupancy on the fifth day of the month. R. at 7. A conflict arises in that rent for the remainder of the month after rejection constitutes a claim "because the service being compensated arises post-rejection," *NETtel*, 289 B.R. at 496, and section 502(g) explains that claims for rejected leases under section 365 shall be treated "as if such claim had arisen before the date of the filing of the petition." The billing date approach contravenes section 502(g) in this scenario because rent for the remainder of the month following rejection receives post-petition priority. While this particular case deals with a single $25,000 per month lease, the results can be drastic in situations involving quarterly or annual rent paid in advance or situations involving hundreds of leases.

Under the billing date approach "a trustee would be obligated to pay for a full years rent that came due immediately after the order for relief even if the lease were rejected prior to the commencement of the year of occupancy covered by the payment." *Ames*, 306 B.R. at 73. Such an interpretation creates enormous and unjustified expansion of post-petition priorities. Further, the windfall granted to landlords in this situation plainly contradicts the purpose behind priority for post-petition claims aiming to enable the debtor to continue operating as long as its current revenues cover current costs. *See Handy Andy*, 144 F.3d at 1127 ("The purpose [of post-petition priority] is to enable the debtor to keep going as long as its current revenues cover its current costs."). Rather than promoting creditor equality and the interests of the estate, the billing date approach distorts pre- and post-petition priorities and may require payment of substantial obligations outside of the narrow priority window. An interpretation leading frequently to such results is "demonstrably at odds with the intention of its drafters." *Griffin*, 458 U.S. at 571.

Some courts adopting the billing date approach have sought to resolve these problems by arguing that the Debtor is in control of the date of rejection. *E.g.*, *Koenig*, 203 F.3d at 989. This reasoning fails for multiple reasons. First, even accepting the debtor control argument as true, the debtor is then incentivized to time its filing and rejection to avoid its obligations. For example, a debtor may attempt strategically to "convert a prospective real property tax obligation into a prepetition claim, rather than an administrative priority expense." *Dunn*, 320 B.R. at 90. Second, that the debtor has sole control over the date of rejection is not accurate. As the court explained in *Stone Barn Manhattan* "a debtor does not necessarily have effective control over its liability even for the last month's rent." 398 B.R. at 368. In that case, the debtors filed their petition on July 9 and immediately took actions "to avoid accrual of another full month's rent if the billing date approach were determined to be the law of [the] Circuit." *Id.* However, the court refused to

schedule such a hearing because a creditors' committee had yet to be appointed and thus debtor was not able to control its liability. *Id.* Similarly the *NETtel* court explained, the "[control] premise is somewhat flawed because rejection of a commercial lease . . . requires a court order. There are often cases in which the trustee, despite valiant efforts, is unable to obtain entry of the order of rejection prior to a payment for future occupancy being due under the lease." *NETtel*, 289 B.R. at 497 n. 15. Thus, "it is undesirable to interpret § 365(d)(3) as operating in a manner . . . that depends on the fortuity of the time of the month of the order of relief or the rejection of the lease." *Id.* at 489-90.

One circuit tries to subdue these absurd results under the billing approach by adjusting its interpretation based on whether the lease obligation involves rent or non-rent expenses and whether the expense was related to the pre-petition or post-rejection period. *Compare HA-LO*, 342 F.3d at 800 (holding full month rent due despite accruing post-rejection)*, with Handy Andy*, 144 F.3d at 1128 (adopting proration approach for property taxes). In essence, under the Seventh Circuit's interpretation, when the expense accrues pre-petition but is billed post-petition, the pre-petition accrued portion can be ignored as a "sunk cost." *Handy Andy*, 144 F.3d at 1128. However, when the obligation is rent that extends beyond the date of rejection, the full amount of rent is due, despite accruing beyond the date of rejection. *HA-LO*, 342 F.3d at 800. The fundamental inconsistency between these interpretations is that the billing date approach in *both* situations "would transmogrify pre-petition debt into debt with administrative priority, contrary to the rigid standards Congress has imposed for such priority." *Ames*, 306 B.R. at 77. The court must apply section 365(d)(3) consistently to avoid both results, not twist the interpretation to yield the result it desires in each case. The court's distinction between rent and non-rent expenses and pre-petition versus post-rejection accrual is also not supported by the text of section 365(d)(3). The statute

"makes no distinctions with respect to . . . types of lease obligations." *Id.* at 78. Consequently, the more sensible interpretation is to prorate lease obligations in both situations to avoid inconsistent interpretations.

The billing date approach yields the greatest variance in payments under a lease. It creates windfalls for the debtor or the landlord, producing "drastic swings across economically identical leases based solely on the appearance or structure of the lease." Victoria Kothari, *11 U.S.C. § 365(d)(3): A Conceptual Status Argument for Proration*, 13 AM. BANKR. INST. L. REV. 297, 320 (2005) (calculating various lease obligations under both the proration and billing date approach and concluding that the proration approach is the more consistent and equitable interpretation). In contrast, the proration method "produces equitable results as it allows both landlords and tenants to get what they bargained for – current services for current payment – at the rate agreed in the lease." *Stone Barn Manhattan*, 398 B.R. at 364 (*citing Ames*, 306 B.R. at 68-80). Accordingly, the proration approach properly abides by both the policy of the Code to secure equal distribution for creditors and the principle that statutory priorities should be narrowly construed.

2. The Legislative History Of 11 U.S.C. § 365(d)(3) Supports The Proration Approach.

Legislative history is instructive in construing an ambiguous statute. *See Mo. Pac. R. Co.*, 278 U.S. at. 277. While the proration approach is better supported by both the context and policy of the Code, a dive into its legislative history still remains necessary and proper. *See United States v. Fisher*, 6 U.S. 358, 386 (1805) ("Where the mind labours to discover the design of the legislature, it seizes everything from which aid can be derived.").

The split of authority on this issue continues with differing views on the statute's legislative history. The majority approach, advocating for the proration interpretation, views the legislative history as providing no evidence of Congressional intent to do away with the consistent proration

practice before enactment of section 365(d)(3). *E.g.*, *Ames*, 306 B.R. at 70 ("Consideration of the legislative history plainly indicates to what the clause 'notwithstanding section 503(b)(1) of this title' refers, and it plainly was not to do away with the hardly-offense concept of prorating."). The majority approach also finds support in the legislative history's concern for "current payment" for "current services." *Id.* (referencing Senator Hatch's concern regarding *current services*). In contrast, the minority approach, while sticking to its claim that the text is unambiguous, argues that the legislative history supports the billing date approach through its concern for performing "all the obligations of the debtor." *E.g.*, *Montgomery*, 268 F.3d at 211.

The congressional intent behind the enactment of section 365 can best be understood through examination of the historical context of its enactment. Before the enactment in 1984 of section 365(d)(3), "the landlord was in an awkward spot during the interval between the entry of the tenant into bankruptcy and the tenant's decision to assume or reject the unexpired lease." *Furr's Supermarket*, 283 B.R. at 67. This is because before section 365(d)(3) the automatic stay would prevent the landlord from evicting the tenant, and the "actual, necessary" provision of section 503(b)(1) could prevent the landlord from collecting the full rent promptly without expense. *Id.* Moreover, administrative expenses usually would not be paid until the end of the case. *Id.* Collectively, these problems required the landlord "to make their property available to the debtor during the pre-rejection period without receiving compensation for their services." *Stone Barn Manhattan*, 398 B.R. at 362. The legislative history of section 365(d)(3) explains that the section was added to address these specific problems. The purpose of section 365(d)(3) was explained by Senator Hatch:

> [D]uring the time the debtor has vacated space but has not yet decided whether to assume or reject the lease, the trustee has stopped making payments under the lease. In this situation, the landlord is forced to provide current 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 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. S8887, 8895 (daily ed. June 29, 1984) (statement of Sen. Hatch) ("Hatch Statement"). Consideration of the Hatch Statement in the context of the history and language of section 365(d)(3) makes abundantly clear that the intent of the amendment was not to "do away with the hardly-offensive concept of prorating" or to nullify the pre-petition treatment of claims in the Code. *Ames*, 306 B.R. at 70. Rather, the intent was that "notwithstanding section 503(b)(1)" the trustee must provide current payment for the current services it receives before rejection. § 365(d)(3). In other words, landlords receive post-petition priority for the services it provides without the actual and necessary requirement and the related delay in payment associated with administrative expenses. The legislative history goes no further than this. Accordingly, the proration interpretation sufficiently alleviates the landlord from the difficulties it experienced before 1984 without nullifying other provisions of the Code and contravening bankruptcy policy.

The dissent and courts adopting the billing date approach argue that the legislative history supports their interpretation through the Hatch Statement's reference to "all the obligations of the debtor." *See Montgomery*, 268 F.3d at 211. This interpretation fails for the same reasons that these courts fail to recognize the ambiguity in the plain text of the statute. The Hatch Statement "merely indicates when an obligation must be *performed*: 'at the time required in the lease', which . . . does not address how to determine when the obligation *arises*." *Id.* at 215 (J., Mansmann, dissent) (emphasis added). Furthermore, Senator Hatch's concern regarding payment for "current" services "has no application in the period after rejection." *Ames*, 306 B.R. at 71. Accordingly, under the

majority's interpretation the landlord receives beneficial relief from the requirements of section 503(b) and the policy, principles, and statutory coherence of the Code remain intact.

* * *

This Court should hold section 365(d)(3) is ambiguous because its plain text is susceptible to more than one interpretation, and its context in the Code leads to conflicts with other provisions under the billing date interpretation. After consideration of section 365(d)(3)'s relationship to other provisions in the Code, bankruptcy policy, and legislative history, the proration approach is the more sensible interpretation.

CONCLUSION

For the foregoing reasons, this Court should AFFIRM the decision of the Thirteenth Circuit Court of Appeals.

APPENDIX

11 U.S.C. § 365(d)(3)

> (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. 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. 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.

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11 U.S.C. § 503(b)(9)

> (b) After notice and a hearing, there shall be allowed administrative expenses, other than claims allowed under section 502(f) of this title, include–
>
> (3) 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 court of such debtor's business.

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11 U.S.C. § 547(c)(4)

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

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