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 APPEAL FROM THE
UNITED STATES COURT APPEALS
FOR THE THIRTEENTH CIRCUIT

BRIEF FOR THE PETITIONER

TEAM NUMBER 31
COUNSEL FOR PETITIONER

JANUARY 20, 2022

QUESTIONS PRESENTED

I. Whether a creditor may receive benefit of both the administrated expense allowance of 11 U.S.C. § 503(b)(9) and the new value defense under 11 U.S.C. § 503(b)(9) when the acts permitting use of these sections arise from the same transactions.

II. Under 11 U.S.C. § 365(d)(3), when a trustee is considering how the estate used a property during the post-rejection period, is it acceptable for them to reach back in time and partially reduce payment of rent that that was due before the debtor rejected the unexpired non-residential property lease?

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The Thirteenth Circuit Court of Appeals' decision is available at No. 20-0803 and reprinted at Record 2. The Bankruptcy Court for the District of Moot decided in favor of Casey Jones, Chapter 7 Trustee. The United States District Court for the District of Moot affirmed, the United States Court of Appeals for the Thirteenth Circuit affirmed on appeal.

STATEMENT OF JURISDICTION

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

PERTINENT STATUTORY PROVISIONS

This action requires statutory interpretation of certain provisions of Title 11 of the United States Code.

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

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

The relevant portions of 11 U.S.C. § 503(b) provide:

> **(b)** After notice and a hearing, there shall be allowed, administrative expenses, other than claims allowed under section 502(f) of this title, including—
>
> > **(9)** the value of any goods received by the debtor within 20 days before the date of commencement of a case under this title in which the goods have been sold to the debtor in the ordinary course of such debtor's business.

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

I. FACTUAL HISTORY

A. Touch of Grey and the Debtor partner under a franchise agreement and property lease.

Petitioner Touch of Grey Roasters, Inc. ("Touch of Grey") is an international coffee company and coffeehouse chain with corporate-owned and franchised stores all around the world. R. at 3. Terrapin Station, LLC (the "Debtor") is the owner and operator of "Terrapin Station Coffeehouse," a Touch of Grey franchise that operated in a warehouse owned by Touch of Grey. R. at 4. Respondent Casey Jones (the "Trustee") is appointed as the chapter 7 Trustee for the Debtor's estate. R. at 8.

Touch of Grey has over 1,900 coffeehouses worldwide, both corporate-owned and franchised. R. at 3. Responding to consumer demand, Touch of Grey franchised with owners of already existing, independent coffeehouses to open a series of "neighborhood coffeehouses" that offered more food, services, and open hours than traditional coffeehouses. R. at 4. In the fall of 2017, Touch of Grey approached the Debtor to see if it was interested in franchising a neighborhood coffeehouse in Terrapin. R. at 4. Since the Debtor's earnings had become stagnant, and its store needed remodeling, the Debtor was intrigued by the neighborhood coffeehouse concept and the opportunity to partner with an industry giant like Touch of Grey. R. at 4. The parties agreed to move forward with the venture. R. at 4.

The next year, Touch of Grey partnered with the Debtor under a franchise agreement whereby the Debtor agreed to own and operate a neighborhood coffeehouse that exclusively sold Touch of Grey branded products purchased directly from Touch of Grey. R. at 4. In turn, Touch of Grey agreed to house the Debtor's new coffeeshop in its recently renovated warehouse space. R. at 4. Touch of Grey, as landlord of the property, and Debtor, as tenant, entered a twenty-year

triple-net *Lease Agreement* ("Lease") that required the Debtor to pay Touch of Grey $25,000 in monthly rent "due in advance on the first day of each month." R. at 4. Under the franchise agreement, Touch of Grey was the Debtor's sole vendor and supplier of coffee products for nearly a year. R. at 4.

B. Touch of Grey supports the Debtor when it faces financial problems.

Despite the new partnership, the Debtor struggled to generate enough sales to pay its debts throughout 2019. R. at 5. By November—less than one year after opening its doors—the Debtor owed over $700,000 in outstanding invoices for Touch of Grey branded products. R. at 5. Despite its poor sales performance, the Debtor remained current on its rent obligations under the lease and eager to continue the franchise agreement. R. at 5. After good faith negotiations, the parties agreed that Debtor would pay Touch of Grey $250,000 towards the outstanding invoices. R. at 5. On December 18, the Debtor sent an invoice (the "Invoice") to Touch of Grey requesting an additional $200,000 of product on credit. R. at 5. Touch of Grey delivered the goods three days later, even though the new Invoice was unpaid. R. at 6.

C. The Debtor files chapter 11 bankruptcy and Touch of Grey supports its reorganization efforts as a critical vendor.

Touch of Grey's preemptive efforts were ultimately in vain. Though the Debtor was able to timely pay rent, it could not pay for the new Invoice or the outstanding invoice, under which Touch of Grey was still owed $650,000. R. at 6. Additionally, the Debtor was unable to pay over $500,000 owed to other unsecured creditors. R. at 6. As a result, the Debtor filed for chapter 11 bankruptcy on January 5, 2020 (the "Petition Date") with a strategy to reorganize the business, find a sub-lessee, and continue selling Touch of Grey products under the franchise agreement. R. at 6. Despite its concerns, Touch of Grey engaged in good faith discussions with the Debtor about future business under the reorganization strategy. R. at 6.

Mindful that the Debtor wanted to continue business operations and that some of the Debtor's other unsecured creditors refused to provide it with goods and services on credit, Touch of Grey agreed to resume selling goods to the Debtor on credit if the Debtor agreed to pay $200,000 for the goods Touch of Grey delivered two weeks before the Petition Date. R. at 6–7. The Debtor requested authority to pay Touch of Grey, asserting that Touch of Grey was a "critical vendor" with whom an ongoing relationship was critical to Debtor's reorganization strategy. R. at 6–7. The court ultimately awarded Touch of Grey the Invoiced amount as an administrative expense. R. at 7. After the Debtor made the payment, Touch of Grey resumed selling goods to the Debtor on credit, and the Debtor continued operating and timely making rent payments on the Lease. R. at 7.

D. The COVID-19 pandemic halts reorganization efforts in March and the Debtor waits until May to convert the case to chapter 7 and reject the Lease.

Once again, Touch of Grey's best efforts to support the Debtor were in vain. The organization quickly devolved when the COVID-19 pandemic forced the Debtor to shut down in March and kept its customers home in April. R. at 7. Things got worse when, for the first time, the Trustee/Debtor did not pay rent on May 1st. R. at 7. Finally, though the Debtor went two months without customers, it waited until May 5th to reject the Lease and convert the case to chapter 7. R. at 7. The parties filed a series of motions with the bankruptcy court. R. at 7. Touch of Grey sought to compel payment of the skipped May rent, but the Trustee argued it need only partially pay the May 1st rent since the Debtor ended up not using the space post-rejection. R. at 8. The Trustee tried to claw back the $250,000 preference payment, but Touch of Grey asked the court to reduce its exposure by $200,000 (the cost of the coffee products it delivered to the Debtor two weeks before the Petition Date). R. at 8–9.

II. PROCEDURAL HISTORY

The bankruptcy court ruled in favor of the Trustee on both issues and the District Court for the District of Moot affirmed. R. at 3. On appeal, a three-judge panel from the Court of Appeals for the Thirteenth Circuit affirmed, holding that (1) section 547(c)(4) precludes a seller from reducing its preference exposure by the value of goods that it sold to a debtor during the twenty days before the petition date if it received full payment for such goods under section 503(b)(9), and (2) section 365(d)(3) limits payment of rent due to a landlord under an unexpired non-residential property lease to that allocable to the period before rejection. R. at 2–3.

STANDARD OF REVIEW

The questions presented are based on statutory construction and interpretation of the Bankruptcy Code,[1] and, as such, are pure issues of law. Thus, the standard of review for this appeal is *de novo*. *See Texas v. Soileau (In re Soileau)*, 488 F.3d 302, 305 (5th Cir. 2007).

SUMMARY OF THE ARGUMENT

The Court of Appeals erred when it concluded Touch of Grey could not reduce its preference exposure by the new value it provided to the replenish the estate when the estate will end up with both the new goods and the value of those goods. It also erred when it concluded the Trustee could avoid fully paying rent that was due before the Debtor rejected the Lease. The Order affirming Summary Judgment impermissibly blurs the terms of the Bankruptcy Code and confers greater power to the Trustee than allowed by the Act.

First, the Bankruptcy Court correctly granted Debtor's request to pay $200,000 to Touch of Grey as a critical vendor, supplying goods necessary for Debtor's reorganization attempt. Touch of Grey has reiterated its willingness to partner with the Debtor. No party has ever asserted, nor

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

could they reasonably assert, that Touch of Grey broke any laws, or conventions, critical to the bankruptcy process. Use of both sections 547 and 503 are legitimate when used individually, and the argument that they cannot be used together amounts to poorly construed policy-based punishment of good faith, proactive acts on the part of Touch of Grey. These acts further bankruptcy goals themselves, namely revitalization of the estate, and assisting a distressed debtor with the Chapter 11 reorganization process.

Second, section 365(d)(3) of the Bankruptcy Code explicitly requires the Trustee to satisfy all payment obligations under a lease until the lease is assumed or rejected, without consideration of the benefit to the estate under section 503(b)(1) that applies in other matters. The Debtor did not reject its lease with Touch of Grey until May 5th—after May 1st, when a rental payment of $25,000 was due to Touch of Grey. Section 365(d)(3) is unambiguous as to the enhanced status applied to rental amounts due before the date the Debtor rejects a lease. Furthermore, proration based on some analysis of benefit to the estate under section 503 or other more general equitable considerations is not appropriate.

STANDARD OF REVIEW

The questions presented are based on statutory construction and interpretation of the Bankruptcy Code,[2] and, as such, are pure issues of law. Thus, the standard of review for this appeal is *de novo*. *See Texas v. Soileau (In re Soileau)*, 488 F.3d 302, 305 (5th Cir. 2007).

ARGUMENT

This Court should reverse the Thirteenth Circuit Court of Appeals' decision to use 11 U.S.C. § 503(b)(9) to block a critical vendor from applying new value under 11 U.S.C. § 547(c)(4)

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

to reduce its preference exposure. This Court should further reverse the circuit court's decision to apply the proration approach in cases depending on 11 U.S.C. § 365(d)(3).

I. THE THIRTEENTH CIRCUIT IGNORES REAL-WORLD TIMING ISSUES IN FAVOR OF ABSTRACT EQUITABLE ISSUES TO FIND THAT A CREDITOR CANNOT TAKE ADVANTAGE OF BOTH SECTIONS 503 AND 547.

It should be stated at the outset that no laws were broken when Touch of Grey applied some sections of the Bankruptcy code in a way that might have been unanticipated. It hardly follows that this novelty should imply impropriety. The worst that can be said about Touch of Grey is that it was creative in taking advantage of both sections 547 and 503, insisting on its rights much like any other party in the court system.

The root of the circuit court's opinion is that two legitimate applications of the Bankruptcy Code somehow become illegitimate once combined. Though this "double dip" language may have dramatic colloquial appeal, it has no basis in law, especially given that Touch of Grey followed met all requirements necessary under the rules, whether official and statutory, or unofficial and conventional.

A. The Court should recognize the Seventh Circuit standard of the critical vendor doctrine in *In re Kmart.*

Touch of Grey is uniquely positioned because it was a critical vendor for the Debtor. R. at 6. Chapter 11 debtors have used the "critical-vendor doctrine" to pay vendors pre-petition debts deemed "critical" to their reorganization efforts. *See* Kenneth A. Rosen, *Why Do Vendors Get Burned Twice in Bankruptcy?*, Chain Store Age, (July 12, 2021), https://chainstoreage.com/why-do-vendors-get-burned-twice-bankruptcy. The doctrine is based on the theory that such vendors would refuse to engage in post-petition business with the debtor unless and until their pre-petition obligations are paid in full. *Id*. Because these vendors are integral to the debtor's ongoing business

operation, their refusal to engage in prospective business would cripple the debtor's ability to carry on, thus frustrating the debtor's reorganization efforts and injuring all the debtor's creditors. *Id*.

There is a circuit split regarding the interpretation of the critical vendor doctrine. The Seventh Circuit has limited the critical vendor doctrine; the Fourth, Fifth, and Ninth Circuits have rejected the doctrine; and the Third Circuit has consistently recognized the doctrine. *See, e.g.*, *Off. Comm. of Equity Sec. Holders v. Mabey*, 832 F.2d 299 (4th Cir. 1987); *In re Oxford Mgmt., Inc*., 4 F.3d 1329 (5th Cir. 1993); *In re B&W Enters., Inc*., 713 F.2d 534 (9th Cir. 1983); *In re Penn Cent. Transp. Co*., 467 F.2d 100 (3d Cir. 1972). We ask this court to resolve this circuit split to accept the doctrine followed by the Seventh and Third Circuits.

The critical vendor doctrine is part of the broader "doctrine of necessity," which has been used to pay other critical constituencies for their pre-petition obligations so that the respective parties will continue to perform post-bankruptcy. *See, e.g.*, *In re Ionosphere Clubs, Inc*., 98 B.R. 174, 175–77 (Bankr. S.D.N.Y. 1989) (finding that sections 363 and 105 of the Bankruptcy Code allowed for payment of pre-petition wage claims of ongoing employees).

The Seventh Circuit decided Kmart Corporation filed under Chapter 11 of the bankruptcy code. *In re Kmart Corp.*, 359 F.3d 866 (7th Cir. 2004). K-Mart sought permission from the bankruptcy court to pay pre-bankruptcy claims of those creditors that K-Mart deemed critical vendors. *Id.* K-Mart argued the loss of their business would cease it to lease operations, thereby causing harm to all the K-Mart creditors. *Id*. The issue was under Chapter 11, may a debtor be allowed to make preferential payments to a class of creditors. The Seventh Circuit ruled that a vendor under Chapter 11, a debtor, may be permitted to make preferential payments to a class of creditors only if the payments serve to the benefit of all the creditors. *Id.*

Under the *In re K-Mart* critical vendor doctrine, debtors seeking authority to pay critical vendors for pre-petition goods or services must show: (1) such payments are "critical" to their reorganization; (2) discrimination among unsecured creditors is the only way to facilitate a reorganization; (3) non-critical vendors will be at least as well off as they would otherwise be if the critical-vendor order is not entered; (4) such payments will not diminish the number of funds that ultimately will be available for payment to non-critical vendors. *Id.* at 872.

The Third Circuit has also recognized bankruptcy courts' authority to render critical-vendor decisions according to section 105(a) of the Bankruptcy Code when such payments are necessary to ensure the continued operation of the debtor's business. In *In re Penn Central Transp. Co.*, the Third Circuit stated, "the necessity-of-payment doctrine permits immediate payment of claims of creditors where those creditors will not supply services or material essential to the conduct of the business until their pre-reorganization claims have been paid." *In re Penn Cent. Transp. Co.*, 467 F.2d at 102 n.1. Further, in *In re Lehigh & N. E. R. Co*., 657 F.2d 570, 581–82 (3d Cir. 1981), the Third Circuit held that a court might authorize the payment of pre-petition claims if such payment is essential to the continued operation of the debtor. Specifically, the court stated that such payments should be authorized when there "is the possibility that the creditor will employ an immediate economic sanction, failing such payment." *Id.* at 581.

Here, Touch of Grey is a critical vendor under the *K-Mart* standard. (1) The Debtor assigned Touch of Grey critical vendor status when it petitioned the Bankruptcy Court to allow an ongoing relationship with Touch of Grey since it was critical to its reorganization plans. R. at 6. (2) The discrimination amongst the other vendors which the debtor owes $500,000 is the only way to facilitate reorganization due to Touch of Grey being the necessity to the business. *Id*. (3) Made before the Chapter 11 filing, the $200,000 Invoice payment went towards purchasing goods that

were necessary to keep the business open, which would help get the non-secured vendors paid. (4) Lastly, contrary to the Trustee's argument, the $200,000 payment did not diminish Debtor's available funds. Instead, the bankruptcy court found it to be a section 503(b)(9) administrative expense, that is, necessary to keep the business running and working towards successful reorganization. R. at 7. In addition to the Seventh Circuit Kmart standard, the payment of $200,000 to Touch of Grey was essential to the business's continued operation of the business. This satisfies what the Third Circuit critical vendor test. *See In re Lehigh*, 657 F.3d at 581.

B. Section 547(c)(4) allows Touch of Grey to reduce its preference exposure by the invoice value even when it was paid to satisfy an administrative expense under section 503(b)(9).

1. The bankruptcy court correctly applied section 503(b)(9) when it gave the Invoice priority status and allowed the Debtor's ordinary business to continue.

The bankruptcy court appropriately applied elevated section 503(b)(9) status to the $200,000 Invoice payment. A court awards administrative expense priority for payments made when (1) the value of goods is received within twenty days before the filing, and (2) such value is sold to the debtor in the ordinary course of business. 11 U.S.C. § 503(b)(9). Courts analyzing "ordinary course" require a debtor to show either that a qualifying transaction does not increase exposure to economic risk, or it is a common transaction among similar businesses. *See In re Dant & Russell, Inc.*, 853 F.2d 700, 704 (9th Cir. 1988) (explaining courts use two tests, the vertical or the horizontal dimension tests, to evaluate ordinary course). Value can be shown by the presence of a contract or invoice. *In re Pilgrim's Pride Corp.*, 421 B.R. 231, 241–43 (Bankr. N.D. Tex. 2009).

Here, under the franchise agreement, Touch of Grey was the exclusive provider of coffee to Debtor's coffee shop. R. at 4–5. Debtor placed an order for goods on December 18th, and Touch of Grey delivered those goods on December 21st, as shown by the Invoice. R. at 5. Sixteen days

later—on January 5th—the Debtor filed Chapter 11 bankruptcy. R. at 6. Cognizant of Touch of Grey's vital status, Debtor soon petitioned the bankruptcy court for authority to pay Touch of Grey $200,000 for the Invoice, asserting that an ongoing relationship with Touch of Grey was critical to the Debtor's reorganization prospects. R. at 7. Receipt of these new goods made it possible for Debtor to continue normal business operations, which was necessary since Debtor's other unsecured creditors were refusing to provide the Debtor with goods and services on credit. R. at 6. The court agreed with the Debtor's strategy and granted the payment enhanced status as an administrative expense under section 503(b)(9). *Id.* Were it not for the payment on the Invoice, Debtor would not have been able to resume ordinary business, hobbling the Debtor's Chapter 11 reorganization efforts.

All legal requirements of 503(b)(9) were completely satisfied. Touch of Grey provided Debtor with the new goods sixteen days before the Petition Date. *See* 11 U.S.C. § 503(b)(9). And the Debtor ordered the goods via Invoice under the franchise agreement, just as the Debtor had done since the agreement was signed in July 2018. Consequently, the bankruptcy court properly found that the Debtor should pay Touch of Grey for the Invoiced goods.

2. Section 547(c)(4) applies since Touch of Grey's pre-petition efforts allowed Debtor to continue business operations after filing.

Section 547 serves the important purpose of preserving the value of the estate by granting the trustee the ability to avoid preferences. Congress wisely included exceptions to this more general rule by creating affirmative defenses for creditors that bring value to the estate by, for example, replenishing the estate. *See* 11 U.S.C. § 547(c)(4); Richard B. Levin, *An Introduction to the Trustee's Avoiding Powers*, 53 Am. Bankr. L.J. 173, 187 (1979). Vendors can rely on the new value defense to reduce their preference exposure when they supported a struggling business by supplying it with unsecured new goods. *See* 11 U.S.C. § 547(c). The invoiced goods must be

delivered before the Petition date—a critical cut-off in bankruptcy law. *See Phx. Rest. Grp., Inc. v. Ajilon Prof'l Staffing LLC*, 317 B.R. 491, 496 (Bankr. M.D. Tenn. 2004).

Here, Touch of Grey supported the Debtor's struggling business by delivering the Invoiced goods on unsecured credit. R. at 6–7. The goods were delivered on December 21st, before the Debtor filed for bankruptcy on January 5th. *Id.* Section 547(c)(4) applies since Touch of Grey's pre-petition efforts allowed Debtor to continue business operations after filing. It is stipulated on the record that Touch of Grey is an unsecured creditor. Touch of Grey provided an additional unit of coffee that was vital to the operation of the coffee business. Because this value was new and unsecured, the technical requirements of 547(c)(4) were met.

Though not required under the Bankruptcy Code, Touch of Grey's critical vendor status, discussed below, adds further support to the propriety of applying an avoidance under section 547(c)(4). Continuance of business operation is a critical factor in Chapter 11 analysis. *See In re Ionosphere Clubs, Inc.*, 98 B.R. at 175.

These observations should be conclusive. All legal requirements are satisfied, and the Trustee has asserted no reasonable grounds to extend its discretionary power so far as to punish Touch of Grey for its admirable efforts. Touch of Grey is undoubtedly within its legal right to take advantage of both sections 547 and 503. The Trustee fabricated a false dichotomy between these two statutes by arguing against their merger. The circuit court stretched the bounds of statutory interpretation when it determined the two sections cannot be used in conjunction, relying on poorly formed policy arguments that only work by ignoring the statutorily imposed timeline controlling this case.

C. The reasonableness of touch of Grey's actions become apparent when as transpiring before the Chapter 11 reorganization, not with the benefit of hindsight after the Chapter 7 liquidation.

Since it is perfectly legitimate to apply both sections 547 and 503 under these circumstances, we should now move to an exploration of timing issues, critical to the bankruptcy system, and muddy in this instance. The opinion below relies on inconsistent disregard of timeline rules, and it is only because of this disregard that the arguments made by the Court of Appeals could appear tenable. Again, condemning actions taken pre-petition, when those same acts could be part of a post-petition plan is an untenable argument. Chapter 11 dictates maintenance of the estate, and facilitating this end was always the goal of Touch of Grey.

1. Touch of Grey acted reasonably before the bankruptcy was filed.

Filing of a bankruptcy petition is the all-important timing foundation for both 547(c), as an exception to 547(a)(4), and 503(b)(9). This date should resolve the 547(c)(4) issue in Touch of Grey's favor. *See Phx. Rest. Grp., Inc.*, 317 B.R. at 494. But the importance of the filing date is broader than that. The petition date also controls the automatic stay, hypothetical liquidation, valuations, and a host of other bankruptcy concepts, many of which are implicated in this case. Touch of Grey delivered the invoiced goods in December 2019, prepetition, and no actions in bankruptcy were taken until after January 5th. R. at 6. Furthermore, the entire narrative of the Debtor's financial struggle stretches eight months from its initial inability to pay debts to a failed reorganization, ending in a Chapter 7 liquidation.

This conversion from Chapter 11 to Chapter 7 deserves particular attention. The circuit court applied both 547(c)(4) and 503(b)(9) to the same proceeding, which implicitly assumes that Touch of Grey was doing more than intelligently navigating the law, and perhaps cheating other creditors in some manner. All costs incurred in this process all militate to imply that Touch of Grey was merely a spectator as the case moved through the courts. To label earlier actions as

inappropriate after obtaining the benefit of hindsight is inappropriate. More so in this context where there was hope for a successful reorganization, simply to be dashed by the completely unexpected arrival of COVID.

We will never know if but for COVID, Touch of Grey's actions may have helped to sustain the Debtor long enough so that all creditors could have been paid off. That this did not happen is no reason to disallow application of sections 547(c)(4) and 503(b)(9) in tandem, simply because this would be unusual, or unforeseeable. So long as the parties did not act in bad faith, the conversion should be permitted, and rules should not be construed against the parties in the absence of bad faith. This is true whether one uses a subjective bad faith test based on intention as in *In re Phoenix Piccadilly, Ltd.*, 849 F.2d 1393, 1394 (11th Cir. 1988) or on an objective bad faith test based on ability to reorganize as in *Carolin Corp. v. Miller*, 886 F.2d 693, 699 (4th Cir. 1989).

2. Describing post-petition treatment of Touch of Grey as undeserved favoritism ignores all costs it incurred pre-petition and up to conversion from Chapter 11 to 7.

Because the Code cannot be used to condemn Touch of Grey's claims, the Court of Appeals relies on a series of policy arguments instead, all of which are reducible to a discussion of fairness. Under this interpretation, Touch of Grey is "double dipping" and receiving a "windfall." R. at 15. This characterization fails to fully appreciate that the Debtor was insolvent[3] in early September 2019. From that point in time to filing, Touch of Grey decided not to cut its losses. Instead, it entered arrangements (namely, the forbearance agreement, continuance of shipping, and willingness to persist under the franchise agreement despite the Debtor's inability to make on-time

[3] That is, the Debtor was unable to pay its debts as they became due. There is no information on whether liabilities exceeded assets, insolvency as defined under section 101(32) of the Bankruptcy Code. Of course, the filing for Chapter 11 did not occur until January 5, 2020. Although the definition of insolvency received clarification in *In Re Marshall III*, 2013 WL 3242478 (9th Cir. June 28, 2013), the term is used here simply to note the Debtor's problematic financial situation.

payments) designed to keep the Debtor's enterprise afloat. All of these were risky at the time. Eventually, the Debtor did file for bankruptcy, but this was only despite the best efforts of the Debtor and Touch of Grey to avoid such an outcome. In effect, Touch of Grey is special, both in the technical sense recognized by the Bankruptcy Code, and the colloquial sense distinguishing it from other creditors.

It is disingenuous to characterize the eventual treatment of the associated administrative expense of 503(b) or preference avoidance of 547(c)(4) as a windfall. The arrangements mentioned above were vital for the continued operation of the business, and they were made without the expectation that the business would flounder. Indeed, given the unique nature of COVID, it was impossible to predict that we would be in court today arguing over these issues.

Furthermore, the proactive actions taken by Touch of Grey before the Debtor filed for Chapter 11 are quite similar to actions that could have been ordered by a trustee after filing, in the form of an eventual reorganization plan. Retroactively punishing Touch of Grey's assistance is completely out of bounds (refusing to uphold legitimate uses of the Bankruptcy Code can clearly be called punishment). This is especially true when the assistance offered serves the same goals as the code itself—replenishment of value and maintenance of the business.

The Court of Appeals chooses to ignore the statutory time demarcation by the stressing equality of distribution among creditors—an overarching goal of bankruptcy law not served by strict application of the code. R. at 15 (citing *Union Bank v. Wolas*, 502 U.S. 151, 161 (1991)). This is true enough, but should policy goals be used to annul procedural avenues expressly created by Congress to aid trade creditors like Touch of Grey? *See In re Arts Dairy, LLC*, 414 B.R. 219, 220, 222 (Bankr. N.D. Ohio 2009) (citing statutes with equity interests). Nevertheless, if one wishes to entertain policy arguments and ignore the plain language of the code, the more

compelling policy goal should be keeping cases out of bankruptcy court in the first place. Touch of Grey acted in good faith throughout 2019 trying to keep the Debtor afloat. The circuit court's decision would precisely discourage those proactive acts which would keep cases out of the bankruptcy court system in the first place.

All other things being equal, keeping court logs clear is desirable. But this point is only reached if one party cannot show that they acted more equitably, generally speaking. But this point is only reached if one party cannot show they that they acted within the clear bounds of the law. And Touch of Grey Acted within the clear bounds of the Bankruptcy Code, under sections 503 and 547.

II. THE THIRTEENTH CIRCUIT INCORRECTLY ADOPTED AND APPLIED THE PRORATION APPROACH WHICH IMPERMISSIBLY RELIES ON POST-REJECTION PROPERTY USE TO JUSTIFY PARTIAL PAYMENT OF RENT THAT WAS DUE BEFORE THE DEBTOR REJECTED THE UNEXPIRED LEASE.

Section 365(d)(3) of the Bankruptcy Code controls this dispute over the Trustee's obligation to pay Touch of Grey for May 2020 rent. It dictates a simple command to the Trustee: "[T]imely 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)." 11 U.S.C. § 365(d)(3). Contrary to the circuit court's opinion, the plain language of section 365(d)(3) is easily applied here. The Debtor did not reject its Lease with Touch of Grey until May 5th, after May 1st when a rental payment of $25,000 was due to Touch of Grey. Thus, the Trustee must perform and make such payment. Moreover, the statutory directive to disregard 503(b)(1) compels this Court to reject the Trustee's attempt to prune its obligation with an analysis that requires the court to search the post-rejection period for "current services" that benefit the estate.

A. The plain language of section 365(d)(3) unambiguously requires the trustee to perform lease obligations when they are due under the terms of a pre-rejection lease.

The Supreme Court directs that the "starting point in any case involving the construction of a statute is the language itself." *St. Paul Fire & Marine Ins. Co. v. Barry*, 438 U.S. 531, 541 (1978); *see United States v. Ron Pair Enters.*, 489 U.S. 235, 241 (1989). The strong preference in favor of a statute's language exists because "[t]here is . . . no more persuasive evidence of the purpose of a statute than the words by which the legislature undertook to give expression to its wishes." *In re Cont'l Airlines*, 932 F.2d 282, 287 (3d Cir. 1991). Thus, when the statutory language is clear, "the sole function of the courts is to enforce it according to its terms." *Ron Pair Enters.*, 489 U.S. at 241; *In re CEC Entm't, Inc.*, 625 B.R. 344, 353 (Bankr. S.D. Tex. 2020) ("Section 365(d)(3) unambiguously requires that debtors timely perform obligations under commercial leases. The Court cannot override that statutory mandate.").

The plain language of section 365(d)(3) creates a mandatory performance obligation that steers the trustee to fully satisfy all payment obligations arising under an unexpired residential lease. Even though Congress did not define the terms "obligation" or "arise" in the Bankruptcy Code, this provision is not ambiguous. "Courts properly assume, absent sufficient indication to the contrary, that Congress intends the words in its enactments to carry their ordinary, contemporary, common meaning." *Pioneer Inv. Servs. v. Brunswick Assocs. Ltd. P'ship*, 507 U.S. 380, 388 (1993) (internal quotation marks omitted). Congress apparently used the words "obligation" and "arising" in section 365(d)(3) in their commonly understood sense. "Arise" is commonly understood to mean "to come into being." *Arise*, Merriam-Webster (2022). Similarly, "the word 'obligation' in Section 365(d) [is] clear and unambiguous." *R.H. Macy & Co. v. Lakewood Mall Shopping Ctr.*, 1994 WL 482948, at *12 (S.D.N.Y. Feb. 23, 1994). Ordinarily, an obligation refers to anything that a person is bound to do. *Obligation*, Black's Law Dictionary (11th ed. 2019).

Combining the plain meaning with the statutory language, section 365(d)(3) requires the trustee to perform all duties that it is bound to perform if they come into being under the unexpired lease after the bankruptcy is filed. If an obligation comes due on a day after the petition date, then the estate is obligated to make the payment. This mandatory performance obligation to pay rent ends on the day the lease is rejected. Here, the Lease created a duty to pay $25,000 of rent, "in advance on the first day of each month." The obligation to make that payment came into being on a day after the petition date—January 29th—and before the rejection date—May 5th. Thus, section 365(d)(3)'s mandatory performance obligation controls the Trustee's duty to pay Touch of Grey $25,000 for the May 1st rent. The analysis is simple, and this Court should apply the statute according to its terms. *See Ron Pair Enters*, 489 U.S. at 241.

1. The plain meaning of section 365(d)(3) best achieves its remedial objectives.

The Court of Appeals misses the point of the enactment of section 365(d)(3)—to protect landlords from uncertainty and delay regarding the debtor's performance of lease obligations before acceptance or rejection of the lease. *See Koenig Sporting Goods, Inc. v. Morse Road Co.* (*In re Koenig Sporting Goods Inc.*), 203 F.3d 986, 989 (6th Cir. 2000); *In re Hitz Rest. Grp.*, 616 B.R. 374, 376 (Bankr. N.D. Ill. 2020). Because section 365(d)(3) provides that a debtor's obligations to its landlord arise according to the terms of the unexpired lease, a landlord (and the debtor) need to look no further than the terms of the lease to determine what obligations must be performed. This step protects landlords enhanced right to the timely performance of the terms under an unexpired commercial lease during the post-petition, pre-rejection period. Any construction of section 365(d)(3) to the contrary would override the plain and unambiguous language of the statute and the arrangement reached by the parties.

Interpreting section 365(d)(3) as a bright-line rule, encompassing all obligations contained in a bargained-for agreement, ensures prompt performance of lease obligations by bankruptcy trustees. *Cukierman v. Uecker* (*In re Cukierman*), 265 F.3d 846, 851–52 (9th Cir. 2001). The simplicity of this rule prevents delays and disputes caused by uncertainty over whether the provision applies to any given lease obligation. *In re Cukierman*, 265 F.3d at 851–52. If the trustee does not perform a lease obligation, the plain meaning of section 365(d)(3) serves to eliminate disputes over whether the claim arising from that nonperformance is entitled to administrative priority, and thus advances the interest of resolving bankruptcy cases expeditiously. *Id.*

Two decisions of the United States Courts of Appeal make this point in the context of rent payments. The Sixth Circuit found that the plain meaning of section 365(d)(3) required payment of a full month's rent because the lease provided that the tenant must pay the monthly rent in advance of the first day of the month. *See Koenig Sporting Goods*, 203 F.3d at 988–90. In *Koenig*, the rejection of the lease did not occur until one day *after* the rental payment was due under the lease. *Id.* Nonetheless, based on section 365(d)(3)'s clear mandate the Sixth Circuit held that a full month's payment was due. *Id.* at 990.

Similarly, the Seventh Circuit declined the debtor's invitation to consider the estate's use of the property post-rejection in *HA-LO Indus. v. CenterPoint Props. Tr.*, 342 F.3d 794, 798–99 (7th Cir. 2003). That debtor challenged paying rent that was due and payable "in advance, in twelve (12) equal monthly installments . . . on the first (1st) day of each month." *Id.* at 798. The *HA-LO* debtor rejected the lease on the second day of the month and moved out on the fourth day. *Id.* at 797. Examining the terms of the lease, the court found the debtor's obligation for the rent arose on the first day of the month in which the debtor rejected the lease. *Id.* Though the obligation covered

in part days that extended beyond rejection of the lease, that court nonetheless held that a full month's payment was due. *Id.*

Here, the lease between the estate and Touch of Grey provides that rent is payable on the first day of the month. Just as the rent in *Koenig* and *HA-LO* arose on the first day of the month, here, too, did the Debtor's obligation arise on May 1st. And the Debtor similarly waited to reject the lease until May 5th. This Court should apply the reasoning in *Koenig* and *HA-LO* and require the Trustee to pay $25,000 for the May 1st rent. The plain language of the section does not permit partial payment of rental payments that are due under an un-rejected lease. Nor does the plain language permit a trustee to stand in the post-rejection period and look back to the pre-rejection period for payments to avoid. The plain language simply does not support a finding that a trustee may partially pay rent, with such reduction being determined by a day-by-day examination of the how the estate used the property in the post-rejection period.

2. The plain meaning of section 365(d)(3) ensures predictable outcomes.

The Court of Appeals' decision incorrectly rejected the billing date approach out of concern that it would result in a windfall to the landlord, to the detriment of the estate and other creditors, thus violating principles of equity. R. at 20–21.

Even though the application of section 365(d)(3) may result in apparent unfairness to one of the parties to a commercial lease, its plain and unambiguous language enables a debtor to make an informed decision with all the facts. The court need not fabricate a mechanism to help debtors avoid full, on-time payment of rent where one already exists in the statute. The choice to end its obligations is already in the debtor's control because it alone chooses the date of rejection. A debtor need only compare the terms of the lease with the mandatory performance obligation to decide the best day of the month to reject the lease.

The decisions of the Sixth, Seventh, and Eighth Circuits saw no arbitrariness in enforcing section 365(d)(3) to protect a landlord from the bankruptcy court's attempt to split the baby. *Koenig Sporting Goods*, 203 F.3d at 989 (debtor must pay full month's rent because it waited until after rent was due to reject lease); *HA-LO Indus.*, 342 F.3d at 798–99 (same); *Burival v. Roehrich* (*In re Burival*), 613 F.3d 810, 812 (8th Cir. 2010) ("Rent obligations in [unexpired] leases must be performed when they arise after filing and before rejection; any reduction based on subsection 503(b)(1) would violate the specific language of § 365(d)(3)."). *Cf. In re Loves Furniture Inc.*, 626 B.R. 291, 295–96 (Bankr. E.D. Mich. 2021) (applying *Koenig* to find a debtor was not obligated to pay rent under sections 365(d)(3) or 503(b)(1) for post-petition occupancy because payment arose five days *before filing*).

Section 365(d)(3) decreased the Debtor's advantage over Touch of Grey—but not unfairly so. This Court should not save the Debtor from its original bargain or from its failure to properly plan the bankruptcy filing and proceedings. *See Koenig Sporting Goods*, 203 F.3d at 989 (debtor should have rejected lease sooner to avoid rent obligation under section 365(d)(3)). Had the Debtor filed a motion to reject the Lease six days sooner, this obligation would not be protected under section 365(d)(3). The Debtor, which picked its filing date, wasted its strategic opportunity to minimize its post-petition obligation under section 365(d)(3*). See Koenig Sporting Goods*, 203 F.3d at 989.

B. Proration would render meaningless section 365(d)(3)'s express exemption from compliance with section 503(b)(1).

The proration approach adopted by Court of Appeals finds ambiguity where there is none and improperly makes superfluous Congress's express determination that the landlord need not prove that it has an administrative priority claim within the meaning of section 503(b)(1) to claim the benefits of section 365(d)(3).

The circuit court adopts the proration approach to interpret the term "obligations" in an abstract sense to mean "something that is continuing to accrue." R. at 17 (citing *In re GCP CT School Acquisition, LLC*, 443 B.R. 243, 254 n.70 (Bankr. D. Mass. 2010)). Through this looking glass, the Court of Appeals views rent as an obligation that arises anew each day, and, out of context, its ordinary meaning could include thirty small payments that are individually due each day. While this rationale might be useful in assigning priority payment for property taxes or distinguishing between pre-petition claims and post-petition claims entitled to priority, *see, e.g.*, *In re Handy Andy Home Improvement Ctrs., Inc.*, 144 F.3d 1125 (7th Cir. 1998); *In re Stone Barn Manhattan LLC*, 398 B.R. 359, 362 (Bankr. S.D.N.Y. 2008), Congress expressly rejected that tedious approach when it enacted section 365(d)(3), which compels the on-time payment of rent as required by the explicit terms in a bargained-for lease.

The Supreme Court directs that "every clause and word" used by Congress must be given effect. *United States v. Menasche*, 348 U.S. 528, 538–39 (1955); *see Lugo v. Paulsen*, 886 F.2d 602, 609 (3d Cir. 1989). Section 365(d)(3) expressly provides that "[t]he trustee shall timely perform all the obligations of the debtor . . . arising from and after the order for relief under any unexpired lease of nonresidential real property, until such lease is assumed or rejected, *notwithstanding section 503(b)(1) of this title*." 11 U.S.C. § 365(d)(3) (emphasis added).

The language "notwithstanding section 503(b)(1)" is made superfluous upon application of the concepts of accrual, proration, and allocation. Such concepts are necessary for distinguishing between prepetition debts and administrative expenses in the context of section 503(b)(1). *In re Krystal Co.*, 194 B.R. 161, 163–64 (Bankr. E.D. Tenn. 1996). Consequently, section 503(b)(1) requirements or limitations must be irrelevant and inapplicable under section 365(d)(3). *Id.* The Court of Appeals' imposition of proration principles should, therefore, be rejected.

C. The legislative history of section 365(d)(3) supports the billing date approach.

This Court also should not resort to an examination of section 365(d)(3)'s meager legislative history to subvert the plain language of section 365(d)(3). As the Supreme Court has noted, "the plain meaning of legislation should be conclusive, except in the rare cases [in which] the literal application of a statute will produce a result demonstrably at odds with the intention of its drafters.' *Ron Pair Enters*, 489 U.S. at 242 (internal quotation marks omitted). Referring specifically to the Bankruptcy Code, the Court further stated that "as long as the statutory scheme is coherent and consistent, there is generally no need for a court to inquire beyond the plain language of the statute." *Id.* at 240–41. Application of the statutory scheme of section 365(d)(3) plainly mandates that the Trustee pay Touch of Grey $25,000 rent for the entire month of May. This Court therefore need not turn to the legislative history for guidance.

Should this Court elect to consider section 365(d)(3)'s legislative history, however, it notably supports Touch of Grey's position that section 365(d)(3) requires a debtor to perform its lease obligations at the time specified. *Koenig*, 203 F.3d at 989; *HA-LO*, 342 F.3d at 798–99; *Burival*, 613 F.3d at 812. The scant legislative history of section 365(d)(3) consists of the floor remarks of Senator Orin Hatch, a conferee on the Bankruptcy Amendments and Federal Judgeship Act of 1984. Senator Hatch offered the following rationale for enacting section 365(d)(3):

> A second and related problem is that during the time the debtor has vacated space but has not yet decided whether to assume or reject the lease, the trustee [or debtor-in-possession] has stopped making payments due under the lease. . . . In this situation, the landlord is forced to provide current services—the use of its property, utilities, security, and other services—without current payment. No other creditor is put in this position. . . . 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*, . . . *on time* pending the trustee's assumption or rejection of the lease.

H.R. Rep. No. 882, 95th Cong., 2d Sess., reprinted in 1984 U.S.C.C.A.N. 576 (emphasis added). A careful examination of Senator Hatch's remarks shows that Congress intended for the prompt performance of a debtor's lease obligations arising in the post-petition period to be controlled by the terms of the lease alone.

1. The legislative history does not support reducing the payment of pre-rejection rent in consideration of post-rejection benefit to the estate.

Senator Hatch stated that a trustee (or debtor-in-possession) is bound to perform all of the obligations of the debtor under a lease of nonresidential real property "at the time required in the lease." *Id.* Congress's intent to have the lease terms control could not have been more clearly stated. Neither Senator Hatch nor any other official made any "mention of the concepts of accrual or proration of charges" in debating the mechanics of section 365(d)(3). *In re Krystal Co.*, 194 B.R. at 164. The floor remarks also include no mention of "actual or necessary" expenses as might be expected if section 503(b)(1) were still operative. *Id.* The inescapable conclusion, therefore, is that Congress "leveled the playing field" by providing added protection for commercial landlords by enforcing their leases for the amount and timing of the debtor's obligations. *In re Stone Barn Manhattan LLC*, 398 B.R. at 362.

The Thirteenth Circuit is not alone in misreading Senator Hatch's remarks to support—rather than prohibit—proration of lease obligations under section 365(d)(3). *See, e.g.*, *In re Furr's Supermarkets, Inc.*, 283 B.R. 60, 66 (B.A.P. 10th Cir. 2002); *In re Child World*, 161 B.R. 571, 573–74 (S.D.N.Y. 1993); *In re Ames Dep't Store, Inc.*, 306 B.R. 43, 65–68 (Bankr. S.D.N.Y. 2004); *In re NETtel Corp., Inc.*, 289 B.R. 486, 489–90 (Bankr. D. Col. 2002).

These courts have ignored the language directing that performance of the debtor's lease obligations will occur "at the time required in the lease," however, and focused instead on Senator Hatch's discussion of the failure of the prior law to protect those landlords who were providing

"current services" without receiving "current payment" from bankrupt tenants. *See* R. at 21; *Child World*, 161 B.R. at 575–76. They concluded that Congress only intended for section 365(d)(3) to ensure that the landlord was compensated for those services it performed on behalf of the debtor in the post-petition, pre-rejection period. *Id.*

This out-of-context interpretation of Senator Hatch's comments fails because it contradicts the plain meaning of the statute and goes beyond its stated purpose. Senator Hatch's remarks regarding "current payment" for "current services" should be viewed as illustrative of the problems facing commercial landlords *before* section 365(d)(3) was enacted, not a comprehensive statement of them. These phrases do not address the legislature's intended evolution or operation of the section 365(d)(3) amendment. *See* R. at 19–20. Under the proration approach, to determine if the debtor's use and occupancy of the rental property were necessary and beneficial to the estate each day of the month, a court must search the post-rejection period, evaluating whether the property provided services that were necessary and beneficial to the estate. Such activity is explicitly foreclosed by 365(d)(3)'s mandate to reject 503(b)(1). *See Koenig Sporting Goods*, 303 F.3d at 989 (rejecting the use of this legislative history to support a proration of rent); *In re Krystal Co.*, 194 B.R. at 163–64 (refusing to expand section 365(d)(3) to include 503(b)(1) principles).

D. COVID-19 shows strict construction of section 365(d)(3) is the sounder approach.

An attempt to rationalize a broad reading of section 365(d)(3) by relying on similar principles of equity was rejected in recent decisions in cases where COVID-19 impacted the debtors' ability to timely pay rent. A debtor in Texas petitioned the bankruptcy court for relief from rental obligations arguing that COVID-19 curtailed its ability to make payments that arose from commercial leases for a nationwide chain of Chuck E. Cheese venues. *In re CEC Entm't, Inc.*, 625 B.R. at 353. The court denied the debtor's plea for abatement under the court's equity

powers. *Id.*; *In re Pier 1 Imports, Inc.*, 615 B.R. 196 (Bankr. E.D. Va. 2020) (exercising its "broad equitable powers" under section 105(a) to grant debtors a "breathing spell" and defer rental payments).

The court disagreed with *Pier 1 Imports*, explaining that it could not override section 365(d)(3)'s unambiguous requirement of timely performance of obligations under commercial leases. *In re CEC Entm't, Inc.*, 625 B.R. at 353. The court relied on the United States Supreme Court's opinion in *Law v. Siegel* to find that a bankruptcy court's equitable powers under section 105(a) are limited by the express provisions of the bankruptcy code, and section 365(d)(3) expressly prohibits delays of pre-rejection rent payments due under commercial leases. *Id.*; *Law v. Siegel*, 571 U.S. 415, 421 (2014) (noting that section 105(a) "does not allow the bankruptcy court to override explicit mandates of other sections of the Bankruptcy Code").

Here, Touch of Grey is entitled to full payment for May 2020 rent. On July 1, 2018, the Debtor as tenant and Touch of Grey as landlord entered the Lease for the Premises. The Lease was a twenty-year triple-net lease that required the Debtor to pay monthly rent for $25,000 with such rent due in advance on the first day of each month. R. at 4. There is nothing in the code standing in the way of full rent being paid to Touch of Grey. The Debtor occupied the Premises on the first day of May, rejecting the Lease five days later. We ask the Court to apply the statute as written and find the Trustee to must satisfy the $25,000 rent obligation. Touch of Grey persists in its support of the estate's financial health, as shown by its willingness to accept the burden of being classified as a critical vendor and the undisputed loss of the broken twenty-year Lease with no breakage fee. We only ask for the full month's rent so that Touch of Grey can recover and use it to find a new tenant.

CONCLUSION

The Court of Appeals erred when it concluded Touch of Grey could not reduce its preference exposure by the new value it provided to the replenish the estate when the estate will end up with both the new goods and the value of those goods. It also erred when it concluded the Trustee could avoid fully paying rent that was due before the Debtor rejected the Lease. The Order affirming Summary Judgment impermissibly blurs the terms of the Bankruptcy Code and confers greater power to the Trustee than allowed by the Act.