No. 21-0909

In the Supreme Court of the United States

IN RE TERRAPIN STATION, LLC, DEBTOR,

TOUCH OF GREY ROASTERS, INC.,
Petitioner,

V.

CASEY JONES, CHAPTER 7 TRUSTEE,
Respondent.

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

BRIEF FOR PETITIONER

TEAM 33
Counsel for Petitioner

QUESTIONS PRESENTED

1. Whether a seller of goods may reduce its preference exposure according to 11 U.S.C. § 547(c)(4) by the new value conveyed to the debtor, after the debtor paid for the goods in full as an administrative expense under 11 U.S.C. § 503(b)(9).

2. Whether the text of 11 U.S.C. § 365(d)(3) compels a trustee to perform the obligations of the debtor by paying rent due prior to the rejection of an unexpired non-residential real property lease when such rent is allocable in part to the period after the effective date of rejection.

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OPINIONS BELOW

The opinion of the Bankruptcy Court for the District of Moot is unreported. The opinion of the District Court for the District of Moot is unreported. The opinion of the Court of Appeals for the Thirteenth Circuit, No. 20-0803, has not been reported, but is reproduced in the Record on pages 2–33.

STATEMENT OF JURISDICTION

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

STATUTORY PROVISIONS

The pertinent provisions of the Bankruptcy Code are reprinted in the appendix to this brief.

STATEMENT OF FACTS

This case arises from a business venture of Terrapin Station, LLC ("Terrapin"), and Touch of Grey Roasters, Inc. ("Touch of Grey"), in which Terrapin became a franchisee of Touch of Grey. On July 1, 2018, the parties agreed to a twenty-year, triple-net lease for premises located at 5877 Shakedown Street, under which Terrapin would pay $25,000 per month to Touch of Grey, the owner of the premises. (R. at 4.) The lease expressly stated that monthly rent would be "due in advance on the first day of each month." *Id.* The same day, the parties also executed a franchise agreement, which required Terrapin to purchase its coffee products from Touch of Grey, and to sell only those products at the shop. *Id.*

The shop opened on December 1, 2018, and quickly encountered financial difficulty. (R. at 5.) On December 5, 2019, with Terrapin owing Touch of Grey at least $700,000 for previously purchased product, Touch of Grey sent Terrapin a notice of default. *Id.* On December 7, 2019, the parties executed a forbearance agreement. *Id.* Touch of Grey agreed to forbear from terminating the franchise, and in exchange Terrapin reaffirmed its obligations under the lease, (confirming its understanding of the requirements with respect to monthly rent), released any and all claims or causes of action against Touch of Grey, and immediately paid Touch of Grey $250,000 to offset some of its outstanding invoices. *Id.* After the forbearance agreement took effect on December 18, 2019, Touch of Grey sold Terrapin an additional $200,000 of Touch of Grey products on credit, with Terrapin's owner William Tell personally guaranteeing payment of the amount invoiced. (R. at 5-6.)

Terrapin filed for Chapter 11 bankruptcy on January 5, 2020. (R. at 6.) While Terrapin was current on its rent payments, it owed over a million dollars to its creditors, including $650,000 to Touch of Grey in unpaid orders. *Id.* On January 19, 2020, Terrapin filed a motion

requesting authority to pay $200,000 to Touch of Grey pursuant to the December 18 sale of goods. Terrapin needed to make this payment to stay in business and, in recognition of the essential role Touch of Grey played in Terrapin's reorganization efforts, the creditors committee supported the motion. (R. at 6-7.) The bankruptcy court allowed the immediate payment under 11 U.S.C. § 503(b)(9). (R. at 7.)

Despite Touch of Grey's efforts to keep Terrapin afloat, Terrapin permanently ceased operations on May 5, 2020. *Id.* Terrapin vacated the leased premises, and the next day moved to reject the lease and franchise agreements. *Id.* On May 8, 2020, Touch of Grey moved to compel payment of the May 2020 rent in its entirety under 11 U.S.C. § 365(d)(3). (R. at 7-8.) At a hearing on May 29, 2020, the bankruptcy court granted Terrapin's motion to recognize the franchise agreement and lease as rejected under § 365(a) as of May 5. (R. at 8.) At the same hearing, the Debtor converted their bankruptcy to a Chapter 7 case, leading to the appointment of trustee Casey Jones. *Id.*

The trustee not only objected to the motion to compel immediate payment of the May 2020 rent, but also brought an adversary proceeding to avoid and recover the $250,000 payment made by Terrapin to Touch of Grey under the December 7 forbearance agreement. *Id.* The bankruptcy court ultimately ruled that under § 365(d)(3), the May rent should be prorated such that Terrapin need only immediately pay for the portion of the month that accrued prior to the lease rejection. (R. at 9.) With respect to the preference issue, the bankruptcy court ruled that the $250,000 transfer to Touch of Grey should be avoided, and that Touch of Grey could not use the value of the goods sold to Terrapin on December 18 to reduce its preference exposure. *Id.*

The United States District Court for the District of Moot affirmed on both issues. The United States Court of Appeals for the Thirteenth Circuit likewise affirmed on both issues, and Touch of Grey petitioned for a writ of certiorari to obtain review on both questions. (R. at 3.)

STANDARD OF REVIEW

Both issues concern statutory interpretation, a matter of law to be reviewed de novo. *William F. Sandoval Irrevocable Tr. v. Taylor (In re Taylor)*, 899 F.3d 1126, 1120 (10th Cir. 2014). Under this standard, the reviewing court must decide each issue as if it were the original trial court. *Razavi v. Comm'r of Internal Revenue*, 74 F.3d 125, 127 (6th Cir. 1996).

SUMMARY OF THE ARGUMENT

Regarding Touch of Grey's affirmative defense against the trustee's preference action, the plain text of § 547(c)(4)(B) provides that an "otherwise unavoidable transfer" must be made "*on account of*" new value (emphasis added), establishing a causality element that the trustee has not demonstrated to defeat the defense under § 547(c)(4). Further indications in the text and surrounding statutory provisions demonstrate that the "otherwise unavoidable transfer" must be a *pre-petition* transfer, which § 503(b)(9) is not. First, the definition of "debtor" can only be read sensibly if it does not include debtors-in-possession. Finding otherwise would disallow preferences in some Chapter 11 bankruptcies that trustees in Chapter 7, 11, and 13 bankruptcies can perform without question, inexplicably separating the forms of bankruptcy for no discernable reason. Second, reading "otherwise unavoidable transfers" to include post-petition transfers would disrupt the statutory scheme designed by Congress which favors calculation of preference exposure at the petition date. These arguments are bolstered by a recognition that trade creditors must be incentivized to engage in riskier business relationships to secure the benefits provided by the Chapter 11 bankruptcy mechanism.

With respect to Touch of Grey's motion for full payment of the May 2020 rent, an analysis of the plain meaning of 11 U.S.C. § 365(d)(3) compels the conclusion that Terrapin must immediately pay the entire amount, rather than the amount prorated for the portion of the month that passed prior to rejection. The statute requires the trustee (or debtor-in-possession) to perform *all* obligations arising *under the lease*. This text explicitly directs a reader to use the terms of the specific lease at hand to define the trustee's obligations. In a case like this, where the lease states that all rent is due in advance on the first of the month, the tenant has a legal duty—an "obligation"—to pay the entire amount as of the first.

Where the plain meaning of a statute is clear from its text, the interpretive inquiry should extend no further. Every court of appeals to rule on this issue (besides the court of appeals in this case) has come to the same text-based conclusion, that the lease obligations in question must be paid in full, rather than prorated. Several courts, however, including the lower courts in this case, have declared the language of § 365(d)(3) to be ambiguous and, once freed from the constraints of the text as enacted, have gone on to adopt the proration approach for lease obligations. The reasons these courts have offered for why the statute is ambiguous are conclusory, unsupported, and inapplicable to post-petition, pre-rejection rent expenses. In addition, the "performance date" interpretation fits more harmoniously into the context of the rest of the Bankruptcy Code, and the legislative history and the agreed-upon purpose of § 365(d)(3) preclude an application of the proration interpretation in these circumstances. Finally, as a matter of policy, the performance date approach better satisfies the clear intent of the statute, which is to protect landlords whose tenants declare bankruptcy. As such, this Court should reverse the court of appeals ruling and require the tenant to pay in full the rent due for May 2020.

ARGUMENT

I. A PREFERENCE PROTECTED UNDER 11 U.S.C. § 547(c)(4) BY THE PROVISION OF NEW VALUE REMAINS PROTECTED EVEN IF THE DEBTOR PAID FOR THE GOODS IN FULL UNDER 11 U.S.C. § 503(b)(9)

Under § 547(b)(4)(A), trustees may avoid preferential transfers which are made "on or within 90 days before the date of the filing of the petition." 11 U.S.C. § 547(b)(4)(A). However, the Bankruptcy Code provides several restrictions on the avoidance power of trustees through § 547(c), among them § 547(c)(4), which protects transfers to creditors who have provided "new value" to the debtor's benefit. *Id.* § 547(c). In response to Touch of Grey's affirmative defense under § 547(c)(4) for the preference claim regarding the $250,000 transfer made on December 7, the lower court determined that the defense was unavailable under § 547(c)(4)(B). (R. at 13.) That section restricts creditors from using the defense if the debtor made "an otherwise unavoidable transfer to or for the benefit of such creditor" on account of the new value provided. § 547(c)(4)(B); (R. at 5, 8.) Specifically, the lower court determined that the payment made under § 503(b)(9) was an "otherwise unavoidable transfer," thus invalidating the §547(c)(4) defense. (R. at 13.) The lower court also expressed fear that deciding otherwise would allow "double dipping" by receiving payment under § 503(b)(9) in addition to a reduction in preference exposure, which the court felt further validated the decision. (R. at 15.)

This Court should reverse the lower court's decision on the grounds that key elements of § 547(c)(4)(B) have not been met, and that § 503(b)(9) does not constitute an "otherwise unavoidable transfer" upon closer investigation of the statutory scheme as a whole. Specifically, § 547(c)(4)(B) requires a demonstration that the new value *caused* the otherwise avoidable transfer, an element which the trustee has failed to show, and the text and context surrounding § 547(c)(4)(B) demonstrate that an otherwise avoidable transfer must be one made pre-petition. The Court should also not be swayed by concerns of double dipping, as the favorable treatment

of creditors who replenish the estate during troubled times represents sound policy that benefits all creditors, debtors, and communities in allowing for reorganization in place of liquidation and avoiding unnecessary economic loss.

A. The Statutory Text of § 547(c)(4) Permits Reducing Preference Exposure by the Value of Goods Sold, Even if the Debtor Paid for Such Goods Under § 503(b)(9)

1. The Only Statutory Mechanism for Removing the § 547(c)(4) Restriction on Trustees is § 547(c)(4)(B), Which Only Applies Under Specific Circumstances Not Present in this Case

Generally, the only way to avoid a preference under § 547(b) in the face of a § 547(c)(4) defense is if the debtor's actions run afoul of § 547(c)(4)(B). *See Beaulieu Liquidating Tr. v. Fabric Sources, Inc. (In re Beaulieu Grp.)*, 616 B.R. 857, 866 (Bankr. N.D. Ga. 2020); (R. at 10-11.) Section 547(c)(4)(B) prohibits avoiding transfers due to new value if ". . . the debtor[, on account of the new value,] did not make an otherwise unavoidable transfer to or for the benefit of [the] creditor."[1] 11 U.S.C. § 547(c)(4)(B). Note, however, that if the debtor did make an otherwise unavoidable transfer, the trustee would then still be able to avoid the transfer. As this statute offers the only method of blocking Touch of Grey's affirmative defense, it is important that its textual elements are broken down and well understood.

Courts have often remarked on the complicated nature of this clause, including the lower court in this case. (R. at 12.) It is not clear that any court has done a thorough vetting of *all* the elements of § 547(c)(4)(B), but lack of consideration by lower courts in the past cannot preclude a proper textual analysis by the Court. "It is our duty 'to give effect, if possible, to every clause and word of a statute.'" *Duncan v. Walker*, 533 U.S. 167, 173 (2001) (citations omitted). While the Court's "preference for avoiding surplusage is not absolute," *Lamie v. United States Tr.,* 540

[1] The first section of the clause, "on account of which new value," is repositioned to make the clause easier to read.

U.S. 526, 536 (2004), the Court generally shows a "'reluctan[ce] to treat statutory terms as surplusage' in any setting," *Duncan*, 533 U.S. at 173 (citations omitted).

The text of § 547(c)(4)(B) has four distinct elements that must be in play for a preference to fall within its exception, rendering the affirmative defense of § 547(c)(4) moot: (1) The debtor must make (2) an otherwise unavoidable transfer (3) to or for the benefit of such creditor (4) on account of new value. Only if all four of these requirements are fulfilled can a transfer be prevented by the trustee.

While the transfer of $200,000 made around January 19th was clearly for the benefit of the creditor, the trustee has failed to prove that it was made "on account of" new value. (R. at 6.)[2] Beyond that, the transfer must have been made by the debtor acting as the debtor, rather than in the role of debtor in possession, given the stark differences between their duties in pre- and post-petition proceedings. And finally, several courts have clarified that, based on statutory context, an "otherwise unavoidable transfer" must have been made before the filing of a petition, lest the determination of preference liability fluctuate and cause absurdity in the statutory scheme.

a. Section 547(c)(4)(B) Requires that the "Otherwise Unavoidable Transfer" be "on Account of" New Value, Implying Causality, Which Trustee has Not Proven

There is no question that § 547(c)(4)(B) goes unfulfilled if the debtor makes an otherwise unavoidable transfer *on account of* new value. But the phrasing of the statute implies an alternative: what if the debtor made the transfer *not* on account of the new value? To determine whether such a situation can occur requires analyzing the meaning of "on account of." In *Rousey v. Jacoway*, this Court stated that, "[w]e have interpreted the phrase 'on account of' elsewhere within the Bankruptcy Code to mean 'because of,' thereby requiring a *causal connection*." 544

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[2] January 19th is the approximate date of payment. The Record only specifies "two weeks later" as the payment date.

U.S. 320, 326 (2005) (emphasis added) (citing *Bank of America Nat'l Tr. and Sav. Ass'n v. 203 North LaSalle St. P'ship*, 526 U.S. 434, 450-451 (1999)). One such area where the Court has made such an interpretation: § 547(c)(4)(B). *Bank of America Nat'l Tr. and Sav. Ass'n*, 526 U.S. at 450-451 ("This is certainly the usage meant for the phrase at other places in the statute, see . . . § 547(c)(4)(B) . . . ."). This Court's own interpretation of the statute thus strongly leans towards reading in a causal requirement, whereby the new value must cause the debtor to make the "otherwise unavoidable transfer" to fall afoul of this provision.

But if the Court's own words are not by themselves convincing, consider a pure textual analysis. Thus far, the lower court's interpretation of § 547(c)(4)(B) implies that there is no causality requirement. *See* (R. at 10) (Judge Garcia, in writing that "the creditor can still assert a new value defense . . . provided that such payment is avoidable," showed no sign of entertaining a causality defense, and mentions no such presumption throughout the opinion.). But under Judge Garcia's reading, "on account of," has no meaning. If Congress wished to remove the § 547(c)(4) defense from those who merely made a transfer *after* new value was provided, it could have written the section to reflect that. Such language might read, "unless the debtor made an otherwise unavoidable transfer *after* the new value was provided." This realizes the canon against surplusage expressed in *Duncan*. 533 U.S. at 173. But it is also in line with the general rule that, "[g]oing beyond the plain language of a statute in search of a possible contrary congressional intent is 'a step to be taken cautiously' even under the best of circumstances." *United States v. Locke*, 471 U.S. 84, 95-96 (1985) (citations omitted).

As such, the Court should refuse to entertain any claim that a transfer under § 503(b)(9) precludes this affirmative defense without performing an analysis of whether the new value caused the "otherwise unavoidable transfer." To do so would be to ignore the plain,

straightforward meaning of the text, remove any semblance of meaning from the phrase "on account of," and upend Supreme Court precedent on similarly situated language.

b. The "Otherwise Unavoidable Transfer" Text in § 547(c)(4)(B) Concerns Only Transfers Made Before the Filing of the Petition

Courts addressing this issue have often recognized restrictions on the phrase "otherwise unavoidable transfer," restraining the analysis to only those transfers made *before* the filing of the bankruptcy petition. (R. at 22.) They do this with good reason. First, the text's use of the "debtor" as the one who did not make the transfer, rather than the "debtor-in-possession" or "trustee," suggests that the statute only concerns pre-petition transfers. Second, a reading otherwise would lead to a number of absurdities in the calculation of preference liability which together derail any attempt to so structure the analysis. In the face of these clear textual and contextual indicators, a reading which prohibits consideration of post-petition transfers prevails.

i. The Transfer Must be Performed by the Debtor Qua Debtor, Rather than the Debtor-in-Possession, to Defeat a § 547(c)(4) Defense

Section 547(c)(4)(B) envisions a transfer made or not made by the "debtor," specifically. Several factors indicate that the meaning of debtor refers only to the actions of the debtor while acting in the capacity of themselves, rather than as the debtor-in-possession. While the Court undoubtedly has a duty to enforce the plain meaning of a statute, it has also recognized that "oftentimes the 'meaning–or ambiguity–of certain words or phrases may only become evident when placed in context." *King v. Burwell*, 576 U.S. 473, 486 (2015). Here, that ambiguity becomes evident on a closer look at the text of the statute, revealing that the debtor-in-possession does not qualify as the debtor for purposes of this statute.

Debtor, if read throughout § 547(c) in the same way, must be read as a pre-petition entity. Section 547(c)(4) references the debtor in a context that can only occur in an exclusively pre-

petition environment, implying that the debtor in § 547(c)(4)(B) would operate in a similar environment. (R. at 23.) The provision requires that new value must be given, "to or for the benefit of the debtor," which can only occur pre-petition, since the post-petition payments would only be for the benefit of the estate. *Bergquist v. Anderson-Greenword Aviation Corp. (In re Bellanca Aircraft Corp.)*, 850 F.2d 1275, 1284 (8th Cir. 1988). Because this clause, which precedes § 547(c)(4)(B), references *the same debtor*, reading the debtor as only a pre-petition debtor, and not a debtor-in-possession, follows naturally from the full statute. *Phoenix Rest. Grp. v. Ajilon Pro. Staffing LLC (In re Phoenix Rest. Grp.)*, 317 B.R. 491, 496 (Tenn. M. Bankr. 2004) ("Throughout § 547, 'the debtor' refers to the *prepetition* entity that transferred property . . . .").

But beyond the textual, the similarities between the trustee, who cannot violate § 547(c)(4)(B) in making the exact same payment, and the debtor-in-possession also provide contextual clues that "debtor" should be read narrowly. Section 1107(a) imbues the debtor-in-possession with all the rights, powers, duties, and functions that a trustee would have, with some exceptions outlined in the statute. 11 U.S.C. § 1107(a). Functionally, then, the two serve the same role. *See In re Ionosphere Clubs, Inc.*, 113 B.R. 164, 169 (Bankr. S.D.N.Y. 1990) (Explaining the debtor-in-possession's role as a fiduciary of creditors, whose "'. . . [job] . . . remains under the Code as that described by Judge Friendly – to get the creditors paid.'") (citations omitted). Yet in fulfilling that same role, if these two entities—the debtor-in-possession and the trustee—take the same action to fulfill the same duties, their actions would be treated differently by the same court under a broad reading of the word "debtor." Thus, a reading of § 547(c)(4)(B) that included debtors-in-possession would incentivize two individuals acting in virtually the same role to take *two opposite actions*.

Furthermore, in Chapter 7 and Chapter 13 bankruptcies, where only a trustee can bear responsibility for the estate, there would be no question that post-petition payments would not be considered under § 547(c)(4)(B) because that section does not address transfers made by trustees. Even in certain Chapter 11 bankruptcies, a trustee may be appointed to remove the debtor-in-possession entirely from the equation. 11 U.S.C § 1104(a)(2). Thus, we arrive at a heavily inconsistent situation if § 547(c)(4)(B) is read to include debtors-in-possession: payments under § 503(b)(9) for new value would not violate § 547(c)(4)(B) in Chapter 7, 13, and 11 bankruptcies where a trustee was appointed under § 1104(a). But in a subset of bankruptcies, the remainder under Chapter 11, identical payments would open the estate up to increased preference liability even though an entity operating under the same fiduciary role, who bears the same responsibility to creditors, comes to the decision that such action is in the best interest *of* the creditors. This is especially egregious in considering that in Chapter 11 bankruptcies with a trustee, the trustee fills the *exact same purpose* as the debtor-in-possession yet *would not be regulated as such*.

Though *Friedman's Liquidating Tr. v. Roth Staffing Cos. (In re Friedman's Inc.)* criticizes this argument by pointing to post-petition references to debtors in the Code, the Third Circuit's analysis misses key differences between § 547(c)(4)(B) and the provisions it cites. 738 F.3d 547 (3d Cir. 2013). Specifically, the court references § 329, a provision designed to ensure the estate's or debtor's finances are not being depleted to an excessive degree, and § 521, which generally describes the duties of the debtor post-petition. 11 U.S.C. § 329, § 521. Yet these sections only refer to (1) the debtor acting on their own, rather than as the debtor-in-possession, and (2) to actions or duties only relevant to the post-petition context. Section 547(c)(4)(B) requires a closer reading precisely because it *could* refer to pre-petition and post-petition claims, and debtor *could* refer to the debtor or debtor-in-possession, two issues nowhere present in the

statutes cited by the Third Circuit. *See Burwell*, 576 U.S. at 486 ("[O]ftentimes the 'meaning–or ambiguity–of certain words or phrases may only become evident when placed in context."). This seems a particularly egregious oversight for a court that only a few paragraphs before observed, "'in interpreting the Bankruptcy Code, the Supreme Court . . . [has] urg[ed] courts to "not be guided by a single sentence or member of a sentence, but look to the provisions of the whole law, and to its object and policy."'" *Friedman's*, 738 F.3d at 554.

On those grounds, it is hard to defend the Third Circuit's other argument that § 101(13) of the Code, the general definition of "debtor," does not make any pre-petition or post-petition distinction. *Id.* at 555. The statement is unabashedly true; it just misses the point that in the face of overwhelming contextual clues, e.g., significant differences in actions allowed depending on the fiduciary in question, and Supreme Court guidance to avoid laser-focusing on a single sentence, a general definition section in a far-off provision does not necessarily have much relevance.

This Court should not make the same mistake, nor should it turn to the definition of "debtor-in-possession" laid out in § 1101(1), as that definition is specific to Chapter 11 only. 11 U.S.C. § 1101(1). While that definition does say that "'debtor in possession' means debtor," the title of the section is, "[d]efinitions for this chapter," specifically Chapter 11. *Id.* So the synonymity of the two words does not apply to § 547(c)(4)(B), which is not in the same chapter. More importantly, Congress's decision to make such a definition within the chapter demonstrates that the equivalence between the two phrases was not facially evident.

And furthermore, the Court should not be fooled by precedent which equates the debtor to the debtor-in-possession in irrelevant contexts. The lower court falls prey to this, dismissing any distinction between the two in part based on a discussion in *NLRB v. Bildisco & Bildisco*.

465 U.S. 513, 528 (1984). While the Court therein finds no distinction between the debtor and debtor-in-possession, the Court's stance is taken "for [its] purposes," and in this case the Court's purposes fall far afield from the question before the Court today. *Id. Bildisco* concerned whether a debtor-in-possession could reject a collective-bargaining agreement, and the definitional dispute centered around whether a debtor-in-possession was an "'alter ego' or 'successor employer' . . . as those terms have been used in [the Court's] *labor* decisions." *Id.* (emphasis added). And while the case discusses § 365 of the Bankruptcy Code, § 547 and preferences never come up. The equivalence between the debtor and debtor-in-possession in that case is thus wholly divorced from the situation facing the Court at present.

The textual and contextual indications that debtor refers to a pre-petition entity should demonstrate on their own that post-petition transfers are out of the question for § 547(c)(4)(B). The alternative invites a truly odd reading of debtor in all parts of the statute and eliminates an otherwise acceptable practice from only one form of bankruptcy proceeding without any discernable reason.

ii. Calculation of Preference Liability has been Tied to the Petition Date by Statute, so Adjusting for Post-Petition Transfers Would Transform the Statutory Scheme Beyond Congress's Wishes

Extending the calculation of preference liability beyond the petition date would also destroy or otherwise mutilate the statutory scheme envisioned by Congress for preferences overall. This Court has recognized that "when deciding whether the language is plain, we must read the words 'in their context and with a view to their place in the overall statutory scheme." *Burwell*, 576 U.S. at 486. In that vein, various other elements of the statute collectively indicate a singular point of preference calculation envisioned by the statutory scheme. (R. at 24-25.) Including post-petition transfers in § 547(b)(4)(A) would effectively abandon that scheme.

The initial indication that Congress intended for § 547(c)(4)(B) to only concern prepetition transfers comes straight from the legislative history, as the court in *Beaulieu* indicates. *Beaulieu*, 616 B.R. at 872 ("The legislative history states: 'the fourth exception codifies the net result rule . . . of current law. If the creditor and debtor have more than one exchange *during the 90-day period*, the exchanges are netted out . . . ."). But that court feels that the language is so clearly plain, legislative history should not triumph. *Id.* That may be fine if legislative history spoke alone, but other contextual indicators sing harmonies like those envisioned by the Court in *Burwell*.

Section 547(b)(4)(A) restricts preferences to those transfers made in the 90 days on or before *the petition date*. 11 U.S.C. § 547(b)(4)(A). Naturally, then, without any factors to offset the total preference exposure, the calculation begins and ends at the petition date. Beyond that, the statute of limitations starts running on the petition date, a further sign that the calculation naturally falls on the petition date. *Friedman's*, 738 F.3d at 556 ("the fact . . . suggests that the calculation of preference liability should remain constant post-petition."). *Friedman's* further postulates that if Congress had envisioned such a result, it probably would have implemented a different statute of limitations to account for this variability. *Id.* And intuitively, this makes sense. As § 546(a)(1)(A) restricts actions for preference recovery to two years after the petition date, an enterprising creditor may try to game the system, waiting until the day before the statute of limitations runs out to provide new value. 11 U.S.C. § 546(a)(1)(A). Alternatively, they may try to encourage the appointment of a trustee to decrease this statute of limitations to one year under § 546(a)(1)(B). *Id.* In discouraging creditors from engaging in business early on in Chapter 11 bankruptcies and encouraging them to get rid of the debtor-in-possession, such a ruling would

undermine the fundamental idea of Chapter 11 bankruptcies that the debtor can reorganize and make good on their payments to their other creditors.

The court in *Beaulieu* criticizes the statute of limitations rationale on the grounds that " . . . generally, the preference analysis cannot be done at the petition date . . . because of many unknowns with respect to the exact amount of payments, when payments cleared, and when checks or other payments were initiated." *Beaulieu*, 616 B.R. at 875. Yet this is an *evidentiary* concern; *Friedman's* concerns only *calculation* of preference liability in discussing the statute of limitations. *Friedman's*, 738 F.3d at 556. It does not matter when the *calculation* is done; it matters *what date* the calculation represents.

Calculations of preference exposure contained in other provisions within the section further elucidate a statutory scheme structured around the petition date. Similarly situated tests, like the "improvement-in-position" test under § 547(c)(5) that provides a defense for floating liens which have not increased in size, are explicitly calculated at the date of petition. *Friedman's*, 738 F.3d at 556 ("Notably, the provision includes the phrase, 'as of the date of the filing of the petition.'"). And preferences demonstrated under the hypothetical liquidation test, a test which allows for claw backs of any excess transfers that would not occur under a Chapter 7 liquidation, are calculated by courts based on the petition date. *See Id.* at 555-556 ("Courts have held that this test should be performed as of the petition date even though the statute does not specify the date to be used."); 11 U.S.C. § 547(b)(5). A similar ruling by this Court regarding § 547(c)(4)(B) would preserve a widespread trend grounded in the fundamental recognition that § 547 generally envisions preferences calculated at the petition date.

One indication pointing towards such a calculation might be written off as mere chance, but in the face of many provisions creating a comprehensive statutory scheme, it is hard to give

credence to the lower court's fear that "'Congress "does not, one might say, hide elephants in mouseholes."'" (R. at 14) (quoting *Whitman v. American Trucking Ass'ns*, 531 U.S. 457, 468 (2001) (citations omitted)). While § 547(c)(4)(B) does lack an explicit temporal component seen in § 547(c)(5) and other provisions, the many context clues that point towards a pre-petition reading function more like a series of flashing neon signs: elephants welcome, elephant crossing, there be elephants here. One could ignore the signs that the provision functions better and more in line with neighboring statutes, but why would anyone do this? They at the very least merit serious consideration, but their numerosity seems better suited to judicial deference. *Burwell*, 576 U.S. at 486. ("When deciding whether the language is plain, we must read the words 'in their context and with a view to their place in the overall statutory scheme.").

B. <u>The Dependence of Debtors on Continued Dealing with Commercial Creditors Merits a Reduction in Preference Exposure Under § 547(c)(4), Regardless of Payment Under § 503(b)(9)</u>

The feasibility of Chapter 11 bankruptcies rests on trade creditors who are willing to come in, take on risk, and "replenish the estate when it is in extreme financial distress." (R. at 26) (Weir, J., dissenting). If these trade creditors withdraw, afraid of the consequences of continued dealing with nearly insolvent corporations, the central conceit of Chapter 11, that a bankrupt can pay back its debts given a good faith effort to reorganize, would falter. The myriad benefits of this important legal structure would be lost: the "maximizing [of] the value of the bankruptcy estate," the "preserv[ation of] jobs and protect[ion of] investors" would all be lost to the ravages of fear. *Toibb v. Radloff*, 501 U.S. 157, 163 (1991) (expressing that Congress had many purposes, not just one, in creating the Chapter 11 framework).[3] It follows, then, that certain incentives may be necessary to preserve this useful mechanism. *See Phoenix Rest. Grp.*, 317

[3] Note that *Toibb* does not reject that the benefits of Chapter 11 include preserving jobs and protection; it merely rejects that these are the *only* benefits.

B.R. at 497 ("At its heart, the preference power in § 547 levels the playing field for creditors that do business with a debtor during the slide into bankruptcy."). Section 547(c)(4) is one such provision which levels the playing field and allows for the benefits of Chapter 11 to arise. From a pure policy perspective, the more sensible reading of this section gives creditors a reason to *maintain* relationships with their debtors, rather than merely give up on them.

2. Section 547(c)(4) Should Incentivize Trade Creditors to Maintain Their Business by Offsetting Heightened Risk, Promoting Chapter 11 Bankruptcies Which Preserve Ongoing Payments for Other Creditors

Creditors require an extra incentive to remain in business relationships with soon-to-be bankrupt debtors. When faced with a debtor approaching insolvency, creditors rightfully begin to wonder whether it may be time to abandon ship. Faced with a company approaching insolvency and one that remains perfectly solvent, the creditor should prefer doing business with the solvent company. In switching business from the debtor to this new, more stable company, the creditor avoids any more money getting wound up in the soon-to-be bankrupt enterprise and protects itself from further losses. Perhaps, in special circumstances, the creditor believes the debtor is worth more to them alive than dead, but those cases are few and far between. In the Hobbesian state of nature that is our capitalist system, the soon-to-be bankrupt usually offers more risk than a solvent company. To maintain that relationship and achieve the benefits of Chapter 11 bankruptcy, creditors require incentives which make the relationship worth their while again in the nasty, brutish, and short-lived/fast-paced business environment that society inhabits. In other words, they require a reward. *See Phoenix Rest. Grp.*, 317 B.R. at 497 ("Creditors who continue to supply the debtor-in-possession with goods and services post-petition are provided special priority for payment from the bankruptcy estate.").

a. Section 547(c)(4) Encourages Maintaining Business with Debtors in Order that Debtors May Continue Paying Their Debts

A reduction in preference exposure under § 547(c)(4) after reimbursement under § 503(b)(9) provides an incentive that can maintain the fractured relationship between the creditor and bankrupt debtor. On its own, repayment for new value by the debtor offers no value that the creditor cannot receive elsewhere from selling to a solvent company. However, repayment for that new value together with a reduction in preference exposure provides the creditor with something they cannot receive from any other company. In other words, the bankrupt debtor now has a shot at winning back the otherwise lost business of the rational creditor. Such a mechanism allows for the benefits of Chapter 11 bankruptcy to accrue, and those benefits are multitudinous.

b. Because All Creditors and Debtors Share an Interest in Debtors Continuing to Pay Their Debts, Preserving the Power of § 547(c)(4) in the Face of § 503(b)(9) Promotes the Underlying Goals of Bankruptcy

Toibb discusses how Chapter 11 bankruptcy "maximiz[es] the value of the bankruptcy estate." 501 U.S. at 163. That maximization of value accrues to *all* creditors, benefitting them equally. While a preference protected under § 547(c)(4) *could* negate that effect, § 547(b)(5) ensures that such an effect *will not occur*. 11 U.S.C. § 547(c)(4); § 547(b)(5). Preferences calculated under the hypothetical liquidation test ensure that the value accruing to any trade creditor that reduces its preference exposure using any other mechanism does not otherwise deplete the rightful pro rata distributions of other creditors beyond what would be expected under a Chapter 7 liquidation. And the benefits do not stop at the excess value provided to creditors. Continued relations with trade creditors allow for debtors to maintain their business, preserving community jobs and creating equity which previously would have been lost. *Toibb*, 501 U.S. at 163. These benefits on their own are not small; indeed, the protection of communities dependent

on bankrupt businesses, investors whose retirement funds depend on the preservation of equity, and creditors who have bottom lines to meet, all provide important value to the community; but such benefits also prevent bankruptcy from *spreading* throughout society. After all, unemployed people, underfunded retirement funds, and unpaid creditors are at risk of bankruptcy too. Providing trade creditors with minimized preference exposure for maintaining relations with bankrupt companies is a small but underappreciated price to pay for some important benefits.

II. 11 U.S.C. § 365(d)(3) REQUIRES THE TRUSTEE TO PAY ALL RENT COMING DUE PRIOR TO REJECTION OF THE UNEXPIRED LEASE

11 U.S.C. § 365(d)(3) states: "The trustee[4] 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." In this case, Respondent argues that their obligation to pay rent for the entirety of the month of May 2020 had not arisen by May 5, 2020, the date on which the debtor rejected the lease. (R. at 8.) In support, Respondent points to what courts have called the "proration approach", under which the debtor is only required to pay "sums coming due under a lease during the post-petition, pre-rejection period that pertain to benefits realized by the estate during that period." *Koenig Sporting Goods, Inc. v. Morse Road Co. (In re Koenig Sporting Goods, Inc.)*, 229 B.R. 388, 391 (B.A.P. 6th Cir. 1999), *aff'd*, 203 F.3d 986 (6th Cir. 2000). Conversely, many other courts apply the "performance date approach", which requires that "any amount coming due under a lease in the post-petition, pre-rejection period must be paid in full by the debtor without regard to whether the payment pertains to a pre-petition or post-rejection benefit." *Id.* at 390.

[4] This statute also applies to debtors-in-possession, such as the Debtor in the instant case was during the relevant post-petition, pre-rejection time period. 11 U.S.C. § 1107(a).

Only the performance date approach is faithful to the plain text of the statute. The case can and should be decided on this ground alone. *See Lamie*, 540 U.S. at 528 ("[W]hen the statute's language is plain, the 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."). While plain meaning is dispositive, the language of the lease itself, purpose of the statute, legislative history, and precedent also embrace the performance date approach. None of these support proration in the context of this case, where the disputed charge is for rent due under the lease during the post-petition, pre-rejection period but allocable in part to the post-rejection period.

A. The Plain Meaning of § 365(d)(3) Justifies the Performance Date Approach

The preference for interpreting statutes based on their plain meaning is central to modern American jurisprudence. *See, e.g.*, *Caminetti v. United States*, 242 U.S. 470, 485 (1917). In this case, the language of the statute and the parties' lease agreement is more than satisfactory to settle the legal question. Given that "obligation" is not defined in the Bankruptcy Code, it is presumably used in its most common sense relevant to this situation. *Centerpoint Props. v. Montgomery Ward Holding Corp. (In re Montgomery Ward Holding Corp.)*, 268 F.3d 205, 209 (3d Cir. 2001). This can be stated as "a legal or moral duty" or "a formal, binding agreement or acknowledgement of a liability" to pay or do something, "*especially a duty arising by contract*." *Obligation,* Black's Law Dictionary (11th ed. 2019) (emphasis added). The lease in this case states that rent is "due in advance on the first day of each month." (R. at 4.) The debtor-in-possession did not reject the lease until May 5, 2020. (R. at 7.) Thus, "the requirement to pay one month's rent on [May] 1 was an 'obligation of the debtor' that arose after the order for relief" and (four days) before rejection. *Koenig Sporting Goods*, 229 B.R. at 390.

While several courts have reached a different conclusion by arguing that, under a particular reading of the Code, § 365(d)(3) is ambiguous, these courts “elide the unmistakable language of the statute, or ignore operative terms of the lease before them.” *Geonex Corp. v. Norritech (In re Geonex Corp.)*, 258 B.R. 336, 342 (Bankr. D. Md. 2001). Since the statute requires performance of all obligations arising from the lease, “any interpretation must look to the terms of the lease to determine both the nature of the ‘obligation’ and when it ‘arises.’” *In re Montgomery Ward Holding Corp.*, 268 F.3d at 209. As such, where the lease creates a duty prior to rejection, “it is difficult to find a textual basis for a proration approach.” *Id.*

Indeed, every court of appeals to address this issue, besides the court below in this case, has looked to the applicable texts and consequently adopted the performance date approach. *See Burival v. Roehrich (In re Burival)*, 613 F.3d 810, 812 (8th Cir. 2010) (“This court agrees . . . that § 365(d)(3) is not ambiguous. . . . Rent obligations in such leases must be performed when they arise after filing and before rejection.”); *HA-LO Indus., Inc. v. Centerpoint Props. Tr.*, 342 F.3d 794, 798 (7th Cir. 2003) (“Under the prescriptions of § 365(d)(3), HA–LO is required to timely perform all lease obligations that arise after [the petition date], until the lease is rejected.”); *In re Montgomery Ward Holding Corp.*, 268 F.3d at 210 (“finding a straightforward interpretation that produces a rational result and no other reasonable interpretation consistent with the text, we are constrained to hold that § 365(d)(3) is not ambiguous.”); *In re Koenig Sporting Goods, Inc.*, 203 F.3d at 989 (“The specific obligation to pay rent . . . arose . . . during the post-petition, pre-rejection period. Under these circumstances, § 365(d)(3) is unambiguous as to the debtor's rent obligation and requires payment of the full month's rent.”). Respondent can offer no compelling reasons for this Court to abandon this weighty precedent.

B. Interpretations of § 365(d)(3) Which Favor the Proration Approach Lack Support in the Context of Post-Petition, Pre-Rejection Rent Charges

Despite the self-evident message of the text, some courts have made contextual and purposive arguments to conclude that § 365(d)(3) is ambiguous and taken advantage of that nominal ambiguity to read the proration approach into the law. The reasoning given in support of this conclusion, however, is inaccurate, unsupported, and wholly inapplicable to a case involving post-petition, pre-rejection rent charges.

1. The Text of § 365(d)(3) is Not Ambiguous in its Support for the Performance Date Approach

Preliminarily, the fact that multiple constructions of a statute have been recognized does not mean that the language is ambiguous. "Our Supreme Court cautions that while courts may disagree on whether a statute is ambiguous, judicial disagreement does not itself create ambiguity." *In re Gibas*, 543 B.R. 570, 588 (Bankr. E.D. Wis. 2016) (citing *Moskal v. United States*, 498 U.S. 103, 108 (1990)).

Some interpreters have stated that "arising" is ambiguous, as an obligation "may arise as it is accrued, or it may arise when the landlord submits the bill." *In re Phar-Mor, Inc.*, 290 B.R. 319, 324 (Bankr. N.D. Ohio 2003); *see also Heathcon Holdings, LLC v. Dunn Industries, LLC (In re Dunn Industries, LLC)*, 320 B.R. 86, 90 (Bankr. D. Md. 2005); *In re Learningsmith, Inc.*, 253 B.R. 131, 134 (Bankr. D. Mass. 2000). While this statement may be true in principle, it does not mean that "arising" is ambiguous *when read in conjunction with an actual lease*. In almost any lease, for example, the obligation to pay rent unambiguously arises at a discrete time. "[T]he rent obligation 'arises' like anything else 'arises'—when it first originates, comes into being, or becomes operative. That most fairly and accurately describes rent for an entire month that

becomes due and payable in advance on the first of the month." *In re The ½ Off Card Shop, Inc.*, No. 00-48425-WS, 2001 WL 1822419, at *3 (Bankr. E.D. Mich. Mar. 7, 2001).

The argument that "until such lease is assumed or rejected" is ambiguous is also misplaced. Theoretically, this clause could modify "perform," meaning the trustee has to make all payments under the lease until assumption or rejection occurs; or it could modify "obligations," meaning the trustee must meet their obligations until they reject. This interpretation could suggest that the moment the lease is rejected, the tenant has no further requirement to stay current on rent. *See, e.g.*, *In re Ames Dep't Stores, Inc.*, 306 B.R. 43, 67 (Bankr. S.D.N.Y. 2004). But like the one before it, this argument also ignores the import of the specific lease at hand, because whether "until such lease is assumed or rejected" modifies "perform" or "obligations", § 365(d)(3) compels full payment if the lease creates an obligation to pay the *entire month's* rent on a specific, pre-rejection, day. Such is the case here. The rent obligation in the lease "arise[s] once each month on the first of the month," rather than being "payable per diem." *In re Appletree Markets, Inc.*, 139 B.R. 417, 420 (Bankr. S.D. Tex. 1992).

ii. The Proration Approach is Illogical and Unsupported for Charges Allocable to Rent Obligations or Charges Which Arise During the Post-Petition, Pre-Rejection Period

Courts have been quick to reject § 365(d)(3) arguments from landlords seeking immediate payment of sums allocable to *pre-petition* events, because the text of the statute only applies to obligations arising "after the order for relief." *See Child World, Inc. v. The Campbell/Mass. Tr. (In re Child World, Inc.)*, 161 B.R. 571, 573-76 (S.D.N.Y. 1993) (adopting the proration approach in a case regarding real estate tax obligations allocable primarily to the pre-petition period, where the performance date approach would have required the debtor to immediately pay six months' worth of taxes which accrued entirely pre-petition). The logic of

Child World is persuasive, but it is inapplicable to this case, where the debtor is asked to pay only for rent coming due *post-petition*, an obligation fitting neatly within the statute's bounds.

Other arguments for the proration approach have been offered in cases involving debtors' tax obligations, but they are inapplicable to cases which concern rent obligations, such as this case, due to the differences in how these two expenses accrue. Real estate taxes, unlike rent, can be reasonably understood to accrue day by day. Thus, in situations where pre-petition taxes come due during the post-petition, pre-rejection period, it is fair to say the taxes allocable to the pre-petition period do not arise after the order for relief, as required for § 365(d)(3) to apply. *See In re Trak Auto Corp.*, 277 B.R. 655, 663 (Bankr. E.D. Va. 2002), *rev'd on other grounds*, 367 F.3d 237 (4th Cir. 2004); *Santa Ana Best Plaza, Ltd. v. Best Prods. Co. (In re Best Prods. Co.)*, 206 B.R. 404, 407 (Va. E. Bankr. 1997). Moreover, many leases do not set a firm date for tenants to pay tax obligations. As such, strict application of the performance date approach might allow a landlord to strategically select a post-petition date to bill a tenant for taxes that accrued primarily pre-petition and demand immediate payment in full under § 365(d)(3). *See In re Phar-Mor*, 290 B.R. at 326; *In re Handy Andy Home Improvement Ctrs., Inc.*, 144 F.3d 1125, 1128-29 (7th Cir. 1998). Rent charges, however, are better understood as accruing all at once (*see* discussion *supra* Section II.A of this Brief), on a specific date set by the lease, rather than whenever the landlord chooses to bill them. So these alleged flaws in the performance date approach are inapt here.

iii. Even if the Language of § 365(d)(3) is Deemed Ambiguous, Arguments for the Proration Approach do Not Explain Why Rent for the Post-Petition, Pre-Rejection Period Should be Prorated

"The plain language of the statute implies that the *lease* should dictate when an obligation must be performed." *In re Simbaki, Ltd.*, No. 13-36878, 2015 WL 1593888 at *5 (Tex. S. Bankr. 2015) (emphasis added). *See also In re Montgomery Ward Holding Corp.*, 268 F.3d at 209.

Given that the proration approach deviates from this textual command, a court should not adopt it unless the reasons in favor of proration are compelling. The caselaw simply does not clear this high bar. Specifically, while courts offer several reasons why § 365(d)(3) can be read as ambiguous, they have failed to explain why, under *any* reading, the obligation to pay rent for the entire period arises as the period elapses, rather than on the due date prescribed in the lease.

Supporters of the proration approach assert that where the trustee (or debtor-in-possession) rejects a lease in the middle of a rental period, § 365(d)(3) can plausibly be read to require the trustee to immediately pay only for the proportion of expenses that accrued in the period *prior to the date of rejection*. *See, e.g. In re Trak Auto Corp.*, 227 B.R. at 663-65. The problem is that the cases, including those cited by the court of appeals, do not adequately respond to the eminently reasonable proposition that where a tenant has agreed in their lease to pay rent in advance on the first day of the period, 100% of the rent charge has accrued as of that due date, prior to the lease being rejected.

There are cursory statements contending that rent accrues over the course of the period: *See In re Montgomery Ward*, 268 F.3d at 213 (Mansmann, J., dissenting) ("[A]n obligation that accrues over time may be said to 'arise' as it accrues, without doing violence to the statutory language."); *In re NETtel Corp.*, 289 B.R. 486, 490 (Bankr. D.D.C. 2002) ("The term 'arising' is susceptible of being used in an accrual sense: a rental obligation arises under the lease based on the corresponding period of occupancy under the lease."). But these cases give zero citations or reasoning in support of this reading (*Montgomery Ward*), or offer support from entirely inapplicable situations (The *NETtel* court quotes *In re Handy Andy Improvement Ctrs.*, 144 F.3d at 1127, for the proposition that the rent obligation "could realistically said to have arisen

piecemeal every day." *Handy Andy*, however, was about a *tax* obligation and thus does not support *NETtel*'s proposition (*see* discussion *supra* Section II.B.2 of this Brief).

Other courts that have adopted the proration approach actually endorse the performance date approach in the context of post-petition, pre-rejection rent obligations. *See In re Phar-Mor, Inc.*, 290 B.R. at 327-28 ("The difference is in the economic reality of the charges. Taxes are 'costs incurred in the past that have no present relevance to the operations of the debtor.' Monthly rental payments, on the other hand, are 'a charge for the consumption of a resource.'" (quoting *In re Comdisco, Inc.*, 272 B.R. 671, 674 (Bankr. N.D. Ill. 2002))). Similarly, in endeavoring to support the proration approach, premised on the fact of textual ambiguity, the court in *NETtel* had to admit that with respect to rent coming due post-petition and pre-rejection, the obligation to pay for the full period arises as of the due date. In other words, the text is *not* ambiguous in those circumstances: "Had the landlord been before the court on December 1, 2000, insisting that the Trustee pay the overdue December rent, the court would have taken steps to enforce § 365(d)(3): a trustee is not entitled to shirk timely performance of his *rent obligation* . . . ." *In re NETtel Corp.*, 289 B.R. at 496 (emphasis added).

These cases highlight a fatal flaw in the proration approach: it fails to consider the contractual language at hand, despite § 365(d)(3)'s emphasis on the terms of the lease. "The statute requires timely performance of lease obligations that arise from and after the petition date, as determined by the terms of the lease." *In re Oreck Corp.*, 506 B.R. 500, 506 (Bankr. M.D. Tenn. 2014). A lease is a contract, and "a contract is a promise . . . the performance of which the law in some way recognizes a duty." Restatement (Second) of Contracts § 1 (Am. L. Inst. 1981). The lease in this case was not unusual; it required the tenant to pay rent for the entirety of the month on the first. That term represents a duty to pay on the first (which can also

be labelled an "obligation" to pay) as a matter of contract law. It should not be read to mean something different in the bankruptcy context (as evidenced by Congress's choice not to create a special definition for "obligation" in the Bankruptcy Code).

C. Interpreting § 365(d)(3) in the Context of the Rest of the Bankruptcy Code Supports the Performance Date Approach and Refutes the Proration Approach in Cases Involving Post-Petition, Pre-Rejection Rent

While the plain meaning of the text takes precedence in statutory interpretation, courts may also look to "the specific context in which that language is used, and the broader context of the statute as a whole" to verify that their reading is correct. *Robinson v. Shell Oil Co.*, 519 U.S. 337, 341 (1997). The first contextual argument levied against the performance date approach is that it creates a conflict between the treatment of "obligations" under § 365(d)(3) and general unsecured "claims", defined at 11 U.S.C. § 101(5). The argument is outlined in *In re Learningsmith, Inc.*, 253 B.R. at 134: Step one is the premise that "arising from and after the order for relief" is ambiguous, and could modify "obligations" to suggest that only obligations arising from events which occurred after the order for relief fall under the purview of § 365(d)(3), even if those obligations are *billed* post-petition. Courts support this premise by noting that charges arising out of pre-petition events fall under the definition of "claims" by the terms of § 101(5) (claims include "unmatured" rights to payment), and that § 365(d)(3) does not recognize an exception to the normal treatment of claims. This conflation of "claims" and "obligations", the argument goes, can be avoided by pro-rating charges arising from the lease so that immediate payment under § 365(d)(3) is only due for amounts allocable to post-petition events. *See also In re Handy Andy*, 144 F.3d at 1128.

In *Montgomery Ward*, The Third Circuit effectively invalidated this argument while adopting the performance date approach: a reading which conflates § 365(d)(3) obligations with

claims cannot be correct, because it "would render § 365(d)(3) superfluous. Unmatured rights to payment under a lease exist from the date the lease is executed." No obligations, so defined, would ever arise after the order for relief; they would all have already existed as an unmatured right to payment. *In re Montgomery Ward Holding Corp.*, 268 F.3d at 209. The court concluded that the plain text of the statute and the lease itself are better sources of meaning than the speculative reading and textual gymnastics required to find support for proration. *Id.*

At its best, this argument does not apply to charges arising from events that are wholly post-petition, such as the case at hand. Charges covering only post-petition periods are different in kind from § 101(5) claims, and while post-petition expenses may overlap with administrative claims under 11 U.S.C. § 503, this potential conflict is dispatched with directly in the text of § 365(d)(3) ("notwithstanding section 503(b)(1)"). *See In re Burival*, 613 F.3d at 812. The basic distinction between charges allocable to the pre-petition period and those that relate only to post-petition periods is that pre-petition costs are more similar to regular claims, which do not receive priority under the Bankruptcy Code. If one sets aside the plain textual requirements of § 365(d)(3), as some courts have chosen to do, costs accruing pre-petition can be thought of as "sunk", payable only pursuant to a confirmed plan at the conclusion of the bankruptcy process, regardless of when they are billed by a landlord. *HA-LO Indus.*, 342 F.3d at 798-99. On the other hand, post-petition, pre-rejection rent charges are not a sunk cost, but rather charges related to the behavior and decisions of the trustee (or debtor-in-possession) during the administration of the case. And "costs of administration must be paid." *Id.* (citing *In re Comdisco, Inc.*, 272 B.R. at 675 (in turn citing 11 U.S.C. § 1129(a)(9)(A) for the proposition that a "plan may be confirmed only if holders of administrative claims are paid in full or agree otherwise.")).

The court of appeals below also argued that § 365(d)(3) does not support the performance date approach, because of the conflict such a reading would purportedly create with the code sections suggesting that obligations arising post-rejection should be "treated as general unsecured claims." (R. at 18) (citing 11 U.S.C. §§ 365(g), 502(b)(6), 502(g)). These sections, however, are either not relevant to the issue at hand or, once again, fail to explain why a post-petition, pre-rejection rent expense should be viewed as accruing post-rejection.

Section 365(g) states that a rejected lease should be considered breached as of the date the petition was filed, and as such, damages flowing from the rejection should be treated as pre-petition claims. *See Gwinnett Prado, L.P. v. Rhodes, Inc. (In re Rhodes, Inc.)*, 321 B.R. 80, 83 (Bankr. N.D. Ga. 2005). This section might be apt if there were any support provided for the contention that a rent expense coming due post-petition, pre-rejection rent is allocable to the post-rejection period (*see* discussion *supra* Section II.B.3 of this Brief). Section 365(g) does not impact this distinction, but rather informs trustees of how to collect damages for items that inarguably arose post-rejection, such as lost future rent or damage to the premises. *In re Ames Dep't Stores*, 306 B.R. at 59-60. Section 365(d)(3) expenses are different in kind from damages under section 365(g) which arise from the fallout of a breached lease. In fact, Congress passed § 365(d)(3) to assure that these obligations would *not* be grouped with obligations receiving pre-petition claim treatment. *In re Rhodes Inc.*, 321 B.R. at 83, 88.

Section 502(g) similarly categorizes damages claims "arising from the rejection, under section 365" of an unexpired lease as equivalent to a claim arising pre-petition. But once again, § 365(d)(3) supersedes the general treatment of claims relating to the rejection of leases. Section 365(d)(3) obligations are those which have already come *due* prior to rejection, while the purview of section 502(g) is amounts and expenses arising from the premature termination of

leases. And § 502(b)(6) lacks any descriptive dimension as to which obligations should be treated as pre-petition claims; it merely sets a cap on "damages resulting from the termination of a lease of real property." So, while rent coming due pre-rejection is specifically singled out for unique treatment under § 365(d)(3), § 502(g) operates to assure that other claims, like breach of an agreement to pay to use the premises post-rejection or failure to vacate the premises or remove property upon rejection are considered along with the claims of other unsecured creditors. *See In re NETtel Corp.*¸ 289 B.R. at 493, 495; *In re Trak Auto Corp.*, 277 B.R. at 660-61. To the same end, § 502 only mentions § 365 in general, rather than § 365(d)(3) specifically, so its scope covers any damages that might arise out of an executory contract or lease that is unexpired as of the order for relief. Given that § 365(d)(3) only covers leases of nonresidential real property, it is wrong to say that § 502 requires that § 365(d)(3) obligations applicable in part to post-rejection periods should always be considered the same as general, unsecured claims.

The court of appeals below also points to § 365(d)(4), a section enacted contemporary to § 365(d)(3), in support of the proration approach. In requiring the trustee (or debtor-in-possession) to "immediately surrender" the property upon rejection, § 365(d)(4) helps landlords recover quickly from a tenant's bankruptcy. *See In re Curio Shoppes, Inc.*, 55 B.R. 148, 153-54 (Bankr. D. Conn 1985). § 365(d)(4) affirms that tenants have no right to use the premises after rejection, but it does *not* imply that their rent obligations also cease to exist when that right expires, notwithstanding the manifest due date in the lease. As is becoming a familiar refrain, § 365(d)(4) simply has no impact on defining *which* obligations arise pre-rejection.

D. The Legislative History of § 365(d)(3) is Minimal and Supports the Priority Treatment Landlords Receive Under the Performance Date Approach

Section 365(d)(3) originated in the 1984 amendments to the Bankruptcy Code. Senator Hatch's statement during Senate discussion of the amendments represents the extent of the

relevant legislative record. Building off the erroneous conclusion that the statutory language is ambiguous, several courts have highlighted portions of this history as weighing toward the proration approach. Other passages, however, seem to clearly support the performance date approach in the context of post-petition, pre-rejection rent charges.

Senator Hatch noted that § 365(d)(3) would require the trustee to "perform all the obligations of the debtor. . . *at the time required in the lease*." 1984 U.S.C.C.A.N. 576, 599 (emphasis added). Endorsing the import of the specific language of the lease aligns with the performance date approach, rather than proration. *See In re Montgomery Ward*, 268 F.3d at 211.

However, some advocates have seized on another part of the Senator's remarks to reach the opposite conclusion. They argue that the goal of § 365(d)(3) is to ensure that landlords receive "current payment" for "current services" provided to tenants in bankruptcy. 1984 U.S.C.C.A.N. 576, 599. The courts take this to mean that once a tenant has rejected their lease, and thus no longer has a right to use the landlord's property, the landlord consequently loses any right to further payment. *See In re Ames Dep't Stores*, 306 B.R. at 68-70, *Newman v. McCrory Corp. (In re McCrory Corp.)*, 210 B.R. 934, 937 (S.D.N.Y. 1997).

Some interpreters have used this inconclusive history to support the proration approach, arguing that proration was historically applied prior to the enactment of § 365(d)(3) and that this practice should continue as the norm under the canon that the Bankruptcy Code should not be "read . . . to erode past bankruptcy practice absent a clear indication that Congress intended such a departure." *Cohen v. De La Cruz*, 523 U.S. 213, 221 (1998) (internal quotations and citations omitted). Recognizing that the words "performance date approach" do not themselves appear in the statute or the legislative history, these courts jump to the conclusion that "Nothing in the legislative history indicates that Congress intended § 365(d)(3) to overturn the long-standing

practice under § 503(b)(1) of prorating debtor-tenants' rent to cover only the postpetition, prerejection period, regardless of billing date." *In re Child World, Inc.*, 161 B.R. at 575-76.

This argument ignores Senator Hatch's statement about requiring tenants to perform their obligations "at the time required in the lease," a nearly verbatim authorization of the performance date approach. More importantly, it ignores the text of the statute itself: "It seems clear . . . that Congress enacted § 365(d)(3) for the purpose of altering a pre-Code practice that had created a problem for landlords of non-residential property." *In re Montgomery Ward*, 268 F.3d at 211. If proration were still the preferred approach, then the old regime, which treated post-petition, pre-rejection obligations as administrative expenses and prorated them accordingly, could have remained in place.

The simplest conclusion is that the minimal legislative record does not militate in favor of one approach or the other. But both sides of the dispute can agree on one aspect of the legislative history: § 365(d)(3) was intended to benefit *landlords*, rather than debtors or other creditors. *In re Phar-Mor*, 290 B.R. at 323 (noting that "the purpose of § 365(d) is to prevent parties in contractual or lease relationships with the debtor from being left in doubt concerning their status vis-à-vis the estate" and adopting the proration approach); *In re Krystal Co.*, 194 B.R. 161, 164 (Bankr. E.D. Tenn. 1996) (adopting the performance date approach and holding "Congress intended § 365(d)(3) to shift the burden of indecision to the debtor . . . . [A] sensible adjustment of this particular debtor-creditor relationship."). Given this preference, the approach which grants greater practical benefits to landlords should receive greater solicitude.

In the case of post-petition, pre-rejection rent, the performance date approach better accommodates landlords. In fact, cases adopting the proration approach in other contexts

acknowledge that the purpose of the statute requires adherence to the performance date approach in the context of rent coming due pre-rejection:

> Congress passed § 365(d)(3) to relieve landlords of the uncertainty of collecting rent fixed in the lease 'in full, promptly, and without legal expense' . . . . We therefore find *Handy Andy* supports our conclusion that § 365(d)(3) requires HA-LO to pay its . . . rent in full on [the date] on which such payment was due . . . under the terms of the lease.

HA-LO Indus., Inc., 342 F.3d at 799 (quoting *In re Handy Andy*, 144 F.3d at 1128).

E. The Performance Date Approach Better Advances the Policy Decisions Embodied by § 365(d)(3)

1. Equal Treatment of All Creditors is Not the Goal of the Bankruptcy Code, and § 365(d)(3) Clearly Authorizes Preferential Treatment of Landlords

The court of appeals below concluded that the performance date approach was improper because, by allowing landlords to immediately collect rent expenses coming due post-petition and pre-rejection, it distorted the fundamental bankruptcy tenet of "equal distribution among creditors." (R. at 20) (quoting *Howard Delivery Serv., Inc. v. Zurich Am. Ins. Co.*, 547 U.S. 651, 655 (2006)). While creditor equality is a legitimate background value of the bankruptcy process, this contention oversimplifies the Code. Even the source quoted by the court of appeals, *Howard Delivery Services*, acknowledges the principle that preferential treatment of certain creditors is valid, as long as Congress clearly authorizes such treatment. 547 U.S. at 655. § 365(d)(3) is exactly such clear authorization: The performance date approach "may give a landlord priority over other creditors," but "[t]hat is exactly what Congress did when it enacted Section 365(d)(3)—it provided special treatment for non-residential landlords." *In re Burival*, 406 B.R. 548, 553 (B.A.P. 8th Cir. 2009), *aff'd* 613 F.3d 810 (8th Cir. 2010).

To the same end, the very concept of proration is meant to further an equitable distribution of the estate to creditors *in the absence of Congressional direction otherwise*, as it

distinguishes "between prepetition debts and administrative expenses." *In re Krystal Co.*, 194 B.R. at 163. But here, Congress has prescribed a substitute treatment for the types of obligations contemplated by § 365(d)(3) and specifically excepted them from regular administrative expense treatment under § 503(b). *Id.* Given this Congressional direction, the argument that proration is somehow more equitable as a matter of policy falls short.

ii. Section 365(d)(3) Does Not Create a Guaranteed Windfall for Landlords, but Rather Protects Them as Involuntary Creditors and Incentivizes Renting to Small Businesses

Another alleged "problem" with the performance date approach is that it creates a windfall for landlords, allowing them to collect rent allocable to the post-rejection immediately and in full, while other creditors must wait for confirmation of a plan. *In re Ames Dep't Stores*, 306 B.R. at 69-70. This is incorrect. § 365(d)(3) does not guarantee a windfall to landlords, and without the performance date approach, landlords would actually be subject to greater losses than other creditors. First, the landlord does not categorically enjoy a windfall gain, because the *trustee,* not the landlord, determines when to reject a lease. A trustee can easily reject at the end of the rent period and avoid any continuing expense post-rejection. *In re Koenig Sporting Goods*, 203 F.3d at 989. Also, the performance date approach is just as likely to work to the *benefit* of debtors: When rent comes due the day before the petition is filed, the entire rent expense will be treated as a pre-petition claim. *E.g.*, *In re The ½ Off Card Shop*, 2001 WL 1822419 at *3.

The solicitude granted to landlords by § 365(d)(3) and the performance date approach make practical sense. If tenants only pay prorated rent for the period in which they reject, landlords are left particularly vulnerable whenever a tenant experiences financial hardship. *In re Koenig Sporting Goods*, 229 B.R. at 392. Landlords are virtually guaranteed to lose money in these situations, despite being *involuntary* creditors, forced to allow a debtor to remain in the

premises throughout the pendency of the bankruptcy under 11 U.S.C. § 362(a)(3). Landlords must continue providing services to an insolvent tenant, while other creditors can choose to cease doing business, and will likely not receive the full payment for lost rent in the final plan.

Given these circumstances, it makes sense to grant landlords the final period's rent payment in full once a tenant rejects, to allow them time to find a new tenant, a task which takes time, especially during a global pandemic, as it is hard to predict when a debtor will choose to reject a lease. The proration approach, on the other hand, incentivizes landlords to rent only to large, highly solvent corporations. Renting to a small business always involves heightened risks, but the performance date interpretation of § 365(d)(3) eases the consequences of tenant insolvency for landlords, who are otherwise held in limbo by a tenant who may not be able to pay while they decide whether or not to assume their lease. *HA-LO Indus.*, 342 F.3d at 799.

Ultimately, § 365(d)(3) presents a situation where one party, debtor or landlord, will inescapably suffer greater consequences than the other. In such a case, the decision of which party deserves precedence is a subjective evaluation much more apt for the people's representatives in Congress than the judiciary. In passing the language of § 365(d)(3), Congress did just that. The proration approach disrespects this Congressional decision and the intent behind it. And while "one can disagree with this legislative classification as a political matter . . . when language as clear as 'all the obligations of the debtor . . . under any unexpired lease' is invoked by a landlord," a court's only role is to identify the obligations defined in that lease and enforce them accordingly. *In re Geonex Corp.*, 258 B.R. at 342.

CONCLUSION

For the foregoing reasons, this Court should reverse the judgment of the court of appeals on both issues.

APPENDIX

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

11 U.S.C. § 503(b)(9)
After notice and a hearing, there shall be allowed administrative expenses, other than claims allowed under section 502(f) of this title, including—

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

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

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