No. 21-0909

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM 2022

IN RE TERRAPIN STATION, LLC, DEBTOR

TOUCH OF GREY ROASTERS, INC., PETITIONER

V.

CASEY JONES, CHAPTER 7 TRUSTEE, RESPONDENT

On Writ of Certiorari to
United States Court of Appeals for the Thirteenth Circuit

Brief for Respondent

Team 34
Counsel for Respondent

QUESTIONS PRESENTED

1. Whether a creditor may reduce its preference exposure by applying the subsequent new value defense under 11 U.S.C. § 547(c)(4) even though such new value was paid for in full post-petition under 11 U.S.C. § 503(b)(9).

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

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Respondent has consecutively prevailed on both issues before this Court three times. Initially, the bankruptcy court held that the Bankruptcy Code prohibited Petitioner from utilizing the new value of the goods to reduce its preference exposure. Additionally, the bankruptcy court rejected Petitioner's attempt to recover a full month's rent payment. Rather, the bankruptcy court found that Petitioner was only entitled to $4,032.26 – the prorated calculation due to the Debtor only occupying the warehouse for the first five days of the month before completely vacating the premises. Trustee received a second victory on the issues' merits when the United States District Court for the Court of Moot affirmed the bankruptcy court on both holdings. The Thirteenth Circuit heard the issues on the case's second appeal in which it agreed with the analyses and holdings of the lower courts. Consequently, the Thirteenth Circuit granted Respondent its third favorable ruling.

STATEMENT OF JURISDICTION

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

STATUTORY PROVISIONS

Relevant provisions from 11 U.S.C. § 96 (1976) (repealed and replaced by 11 U.S.C. § 747(c)(4)):

(c) If a creditor has been preferred, and afterward in good faith gives the debtor further credit without security of any kind for property which becomes a part of the debtor's estate, the amount of such new credit remaining unpaid at the time of the adjudication in bankruptcy may be set off against the amount which would otherwise be recoverable from him.

Relevant provisions from 11 U.S.C. § 303:

(f) Notwithstanding section 363 of this title, except to the extent that the court orders otherwise, and until an order for relief in the case, any business of the debtor may continue to operate, and the debtor may continue to use, acquire, or dispose of property as if an involuntary case concerning the debtor had not been commenced.

Relevant provisions from 11. U.S.C. § 503:

(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.

Relevant provisions from 11 U.S.C. § 542. Turnover of property to the estate

(c) Except as provided in section 362(a)(7) of this title, an entity that has neither actual notice nor actual knowledge of the commencement of the case concerning the debtor may transfer property of the estate, or pay a debt owing to the debtor, in good faith and other than in the manner specified in subsection (d) of this section, to an entity other than the trustee, with the same effect as to the entity making such transfer or payment as if the case under this title concerning the debtor had not been commenced.

Relevant provisions from 11. U.S.C. § 547:

(b) Except as provided in subsections (c), (i), and (j) of this section, the trustee may, based on reasonable due diligence in the circumstances of the case and taking into account a party's known or reasonably knowable affirmative defenses under subsection (c), avoid any transfer of an interest of the debtor in property—

(5) that enables such creditor to receive more than such creditor would receive if--
(A) the case were a case under chapter 7 of this title;
(B) the transfer had not been made; and
(C) such creditor received payment of such debt to the extent provided by the provisions of this title.

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

Relevant provisions from 11 U.S.C. § 549:

(a) Except as provided in subsection (b) or (c) of this section, the trustee may avoid a transfer of property of the estate--
(1) that occurs after the commencement of the case; and
(2)(A) that is authorized only under section 303(f) or 542(c) of this title; or
(B) that is not authorized under this title or by the court.

Relevant provisions from 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.

(B) In a case under subchapter V of chapter 11, the time for performance of an obligation described in subparagraph (A) arising under any unexpired lease of nonresidential real property may be extended by the court if the debtor is experiencing or has experienced a material financial hardship due, directly or indirectly, to the coronavirus disease 2019 (COVID-19) pandemic until the earlier of--

(i) the date that is 60 days after the date of the order for relief, which may be extended by the court for an additional period of 60 days if the court determines that the debtor is continuing to experience a material financial hardship due, directly or indirectly, to the coronavirus disease 2019 (COVID-19) pandemic; or

(ii) the date on which the lease is assumed or rejected under this section.

(C) An obligation described in subparagraph (A) for which an extension is granted under subparagraph (B) shall be treated as an administrative expense described in section 507(a)(2) for the purpose of section 1191(e).

Relevant statute provisions from 11 U.S.C. § 503(b):

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

(7) with respect to a nonresidential real property lease previously assumed under section 365, and subsequently rejected, a sum equal to all monetary obligations due, excluding those arising from or relating to a failure to operate or a penalty provision, for the period of 2 years following the later of the rejection date or the date of actual turnover of the premises, without reduction or setoff for any reason whatsoever except for sums actually received or to be received from an entity other than the debtor, and the claim for remaining sums due for the balance of the term of the lease shall be a claim under section 502(b)(6);

(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.

Relevant Provisions from 11 U.S.C. § 365(g):

Except as provided in subsections (h)(2) and (i)(2) of this section, the rejection of an executory contract or unexpired lease of the debtor constitutes a breach of such contract or lease--

(1) if such contract or lease has not been assumed under this section or under a plan confirmed under chapter 9, 11, 12, or 13 of this title, immediately before the date of the filing of the petition; or

(2) if such contract or lease has been assumed under this section or under a plan confirmed under chapter 9, 11, 12, or 13 of this title--

(A) if before such rejection the case has not been converted under section 1112, 1208, or 1307 of this title, at the time of such rejection; or

(B) if before such rejection the case has been converted under section 1112, 1208, or 1307 of this title--

(i) immediately before the date of such conversion, if such contract or lease was assumed before such conversion; or

(ii) at the time of such rejection, if such contract or lease was assumed after such conversion.

Relevant provisions from 11 U.S.C. § 502(b)(6):

(b) Except as provided in subsections (e)(2), (f), (g), (h) and (i) of this section, if such objection to a claim is made, the court, after notice and a hearing, shall determine the amount of such claim in lawful currency of the United States as of the date of the filing of the petition, and shall allow such claim in such amount, except to the extent that—

(6) if such claim is the claim of a lessor for damages resulting from the termination of a lease of real property, such claim exceeds--

(A) the rent reserved by such lease, without acceleration, for the greater of one year, or 15 percent, not to exceed three years, of the remaining term of such lease, following the earlier of--

(i) the date of the filing of the petition; and

(ii) the date on which such lessor repossessed, or the lessee surrendered, the leased property; plus

(B) any unpaid rent due under such lease, without acceleration, on the earlier of such dates;

Relevant Provisions from 11 U.S.C. § 502(g):

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

STATEMENT OF THE CASE

This case evolved from a series of unfortunate events to that of pure greed. The Trustee, Respondent-Appellee, has successfully prevented excess payments from the local neighborhood coffeehouse Terrapin Station (the "Debtor") to the corporate-owned chain of coffeehouses Touch of Grey, Petitioner-Appellant. The facts prefacing this appeal occurred as follows:

The Lease Agreement. The Petitioner and Debtor entered into a Lease Agreement (the "Lease") and a Franchise Agreement on July 1, 2018. R. at 4. Petitioner convinced Respondent to discreetly operate as one of its coffeehouses under a more "local neighborhood" name. *Id.* The terms included a twenty-year-triple-net lease. *Id.* For rent, the Debtor would pay $25,000 "in advance on the first day of each month." *Id.* Respondent also agreed to exclusively purchase its products from Petitioner. *Id.* By November 1, 2019, the Debtor's had accrued a noticeable debt to Petitioner from purchasing goods. *Id.* On December 5, 2019, Petitioner sent the Debtor a default notice despite the Debtor being current on its rent obligations under the Lease. R. at 5.

The Forbearance Agreement. Two days later, on December 7, 2019, the parties entered into a forbearance agreement in which Petitioner refrained from terminating the franchise agreement. *Id.* The forbearance agreement contained three requirements: (1) the Debtor's $700,000 debt would be relieved with a $250,00 payment for the purchased Dark Star products; (2) the Debtor would reaffirm its Lease obligations; and (3) the Debtor would release Petitioner from any liability. *Id.* That same day, December 7, 2019, the Debtor, without contest or complaint from Petitioner, paid Petitioner the reduced amount of $250,000. *Id.*

The Final Attempt. Later, on December 18, 2019, Petitioner extended credit to the Debtor and sold the Debtor $200,000 worth of goods *Id.* Petitioner recorded the sale on an invoice (the "Invoice"). *Id.* The Debtor received the goods on December 21, 2019. *Id.* However, the Debtor continued to struggle. R. at 6. The Debtor finally accepted that Petitioner's plan of disguise was deficient of success, and on January 5, 2020 (the "Petition Date"), the Debtor filed for Chapter 11 bankruptcy. *Id.* As of the Petition Date, the Debtor owed an overall amount of $650,000 to Petitioner for purchased goods and owed over $500,000 to other unsecured creditors. *Id.* Even still, the Debtor's rental obligations under the Lease remained current. *Id.*

The Administrative Expense. The Debtor filed for Chapter 11 bankruptcy and "first day" motions simultaneously. *Id.* The Debtor upheld its obligation under the Franchise Agreement to continue purchasing and selling Petitioner's product. *Id.* Regardless of Petitioner's skepticism of the Debtor's reorganization plan, Petitioner and the Debtor had positive, legitimate discussions about future endeavors. *Id.* The Debtor considered Petitioner a "critical vendor" and moved to pay Petitioner $200,000. *Id.* Regardless of the bankruptcy court's declination to approve the critical vendor payment, it granted the Debtor an administrative expense. R. at 7. Petitioner received the payment and resumed business with the Debtor. *Id.*

The Extended Vacancy. The COVID-19 pandemic forced the Debtor to permanently close its doors on May 5, 2020. R. at 7. As confirmation that the Debtor intended to permanently cease its business affairs, the Debtor vacated the premises. *Id.* The Debtor returned the keys to Petitioner that same day. *Id.* The record is devoid of any evidence that the Debtor continued or intended to resume occupying the premises after May 5, 2020. Hence, the following day, the Debtor requested that the bankruptcy court reject the parties' Lease and their Franchise

Agreements *Id.* Petitioner did not object to rejecting the Lease. R. at 8. Yet, Petitioner motioned for a full month's rent payment for May. *Id.* On May 29, 2020, the Debtor converted its Chapter 11 bankruptcy to a Chapter 7 without contest. *Id.* The bankruptcy court then granted the Debtor's motion to reject the lease and franchise agreement. *Id.*

The Trustee's Favor. Respondent sought recovery of the Debtor's $250,000 payment arising from the forbearance agreement. *Id.* Respondent considered the payment as preferential. R. at 8. Petitioner insisted that the statute supported the new value reduction. *Id.* Eventually, the parties agreed that the new value issue was one of fact; both parties filed cross-motions for summary judgment. R. at 9. The bankruptcy court granted both motions in favor of Respondent. *Id.* Petitioner filed a timely appeal to the United States District Court for the District of Moot. *Id.* The district court then affirmed both rulings. *Id.* Petitioner then sought another timely appeal to the United States Court of Appeals for the Thirteenth Circuit. *Id.* The Thirteenth Circuit affirmed. Petitioner then timely petitioned for review to the United States Supreme Court. *Id.*

SUMMARY OF ARGUMENT

This Court should affirm the Thirteenth Circuit's holding that the subsequent new value defense put forth in 11 U.S.C. § 547(c)(4) does not apply to these facts. Touch of Grey cannot reduce its preference exposure because the payment of administrative expenses, which was authorized by the Bankruptcy Court, was an otherwise unavoidable transfer. The plain meaning of section 547(c)(4) permits the use of post-petition payments such as the 503(b)(9) payment in the case before the Court. *See In re Beaulieu Group, LLC*, 616 B.R. 857, 973 (Bankr. N.D. Ga. 2020); *see also In re BFW Liquidation, LLC*, 899 F.3d 1178, 1189-90 (11th Cir. 2018). The plain language in section 547(c)(4), while perhaps complicated, is unambiguous. *See Boyd v. The Water Doctor (In re Check Reporting Servs., Inc.)*, 140 B.R. 425, 434 (Bankr. W.D. Mich. 1992). Section

547(c)(4) contains no temporal limitation or cut-off date on the analysis of the subsequent new value defense so it would be improper to retroactively impose one given section 547(c)(4)'s lack of ambiguity.

This Court should reject the Third Circuit's analysis in *In re Friedman* because it is not consistent with the plain meaning of section 547(c)(4). The lack of temporal limit in section 547(c)(4) was intentional and cannot be overcome by references to the title of Section 547(c). *See Mine Works of Am. Combined Benefit Fund v. Toffel (In re Walter Energy, Inc.)*, 911 F.3d 1121, 1154 n.38 (11th Cir. 2018). This intentionality is evidenced by the fact that the predecessor statute to section 547(c)(4) actually contained a temporal limitation identical to that argued by the Petitioner today, but this language was removed when Congress adopted section 547(c)(4). *See* 11 U.S.C. § 96(c) (1976). Additionally, the timing of the hypothetical liquidation test and concerns about establishing an easily identifiable cutoff-date for purposes of the statute of limitations does not show that Congress intended the petition date to be the cut-off point because an accurate preference analysis cannot always be done at the time the petition is filed due to certain unknowns at that point in time.

Lastly, the overarching public policy of equality of distribution among creditors requires that creditors such as Petitioner not be allowed to "double dip" and reduce their preference exposure when they have already been compensated post-petition by receiving administrative expense payments. To allow such double dipping would prejudice other creditors because the pool of funds to be distributed amongst unsecured creditors would be depleted, but only the windfall creditor would receive a benefit. The other creditors would simply be prejudiced with a smaller pool of funds. Therefore, the Thirteenth Circuit correctly held that Touch of Grey should not be allowed to engage in this sort of double dipping.

Regarding the second issue, this Court should affirm the Thirteenth Circuit's holding that 11 U.S.C. § 365(d)(3) requires prorating the rent due prior to the rejection of an unexpired non-residential lease but allocable to the period after the effective date of rejection. The determination of this issue requires this Court to examine whether the proration approach or the billing date approach should be adopted to correctly determine the computation "stub rent" under section 365(d)(3). A substantial majority of courts addressing this issue have adopted the proration method because it best comports with the canons of statutory interpretation. *See In re Child World*, 161 B.R. 571, 576 (S.D.N.Y. 1993).

When engaging in statutory interpretation, courts begin with the plain language of the statute. *See generally Pa. Dep't of Pub. Welfare v. Davenport*, 495 U.S. 552, 557 (1990). When the plain language of the statute is ambiguous, courts are permitted to employ other canons of statutory interpretation to determine the meaning of the statute. *See United States v. Colasuonno*, 697 F.3d 164, 173 (2d Cir. 2012). The plain language of section 365(d)(3) is ambiguous because several terms and phrases within the statute can be reasonably construed multiple ways. *See In re Lucarelli*, 517 B.R. 42, 49 (Bankr. D. Conn. 2014) (*quoting Natural Res. Def. Council, Inc. v. Muszynski*, 268 F.3d 91, 98 (2d Cir. 2001)).

Because several sources of ambiguity exist within the plain language of section 365(d)(3), this Court is permitted to look to other canons of statutory interpretation to resolve this ambiguity. When considering the statute in its broader context, looking to pre-amendment practices, and analyzing the legislative history, the legislative intent elucidates the continuation of the proration method. Finally, public policy underscores the adoption of the proration approach because this approach is the only way to ensure equitable and consistent results with a rule that is simple to

apply. Therefore, this Court should affirm the Thirteenth Circuit's holding that section 365(d)(3) requires the adoption of the proration approach.

STANDARD OF REVIEW

"An appeal from a district court's review of a bankruptcy court ruling is subject to plenary review." *Warex Terminals Inc. v. Halstead Energy (In re Halstead Energy Corp.),* 367 F.3d 110, 113 (2d Cir.2004). Courts review a bankruptcy court's conclusions of law *de novo* and its findings of fact under the clearly erroneous standard. *In re Fairfield Sentry Ltd.*, 768 F.3d 239, 243 (2d Cir. 2014).

ARGUMENT

I. This Court should find that Petitioner cannot reduce its preference exposure because, for a new value defense, section 547(c)(4)'s plain meaning permits post-petition administrative payments pursuant to section 503(b)(9).

The Thirteenth Circuit correctly found that Touch of Grey cannot reduce its preference exposure by $200,000 for the new value extended to the Debtor on December 18, 2019. This issue requires the Court to interpret section 547(c)(4) and determine whether post-petition transfers can be applied in its analysis. Under this section, known as the subsequent new value defense, if the debtor makes a preferential payment to the creditor and thereafter provides the debtor with new value, that new value is a defense to a preference claim so long as the debtor does not make an "otherwise unavoidable transfer. *In re Beaulieu Group, LLC*, 616 B.R. 857, 866 (Bankr. N.D. Ga. 2020). While some circuits restrict new value credit to invoices that were unpaid at the petition date, more recent decisions permit new value credit to "paid" invoices, to the extent that the later transfers paying the invoices were "avoidable." Joseph L. Steinfeld, Jr. & Kara E. Casteel, *Friedman's Improperly Adds Requirement That New-Value Analysis Closes at Petition Date*, 31 Am. Bankr. Inst. J. 42, 42 (March 2012). Here, the later transfer was the

payment of administrative expenses, and it was unavoidable because it was authorized by the bankruptcy court.

Section 547 of the Bankruptcy Code enables a trustee or debtor-in possession to avoid and recover certain payments deemed to be "preferences." Michael A. Rosenthal et. al., *The Impact of Post-Petition Events on Preference Liability*, 24 Am. Bankr. Inst. J. 28, 28 (February 2005). A preference is any transfer of the debtor's interest in property to or for the benefit of another creditor on account of a debt owed by the debtor before the transfer was made on or within 90 days before the filing of the bankruptcy date that enables the creditor to receive more than the creditor would have received in a liquidation case if the transfer had not been made and the creditor received payment on its debt as provided by the Bankruptcy Code. *Id*. (*citing* 11 U.S.C. § 547(b)). Here, the preferential payment was the December 7, 2019, payment made pursuant to the forbearance agreement. This is the payment the estate is seeking to claw back under preference law as well as the preference exposure Petitioner is seeking to have reduced pursuant to section 547(c)(4).

The Thirteenth Circuit correctly found that the plain meaning of section 547(c)(4) prevents Touch of Grey from asserting a new value defense under the facts before the Court. The language of section 547(c)(4) is not ambiguous, and the bankruptcy court's authorization of payment made the administrative expense otherwise unavoidable. Moreover, the plain language of the statute does not limit this Court's ability to look at post-petition activity when determining whether to claw back a preferential transfer.

In a decision that is devoid of sound logic, the Third Circuit adopted an approach that is wholly inconsistent with the plain meaning of section 547(c)(4). In *In re Friedman*, the Third Circuit foreclosed the analysis of the new value defense at the date of petition. This was

improper because the lack of temporal limitation was intentional The Court should reject the Third Circuit's analysis in *In re Friedman* because it improperly construed the statute to achieve a goal inconsistent with both law and policy.

Finally, public policy supports disallowing creditors to reduce their preference exposure. The policy of equality of distribution among creditors is wholly inconsistent with the Petitioner's argument. Touch of Grey should not be allowed to "double dip" and reduce its preference exposure when it has already been compensated by receiving administrative expenses. For these reasons, this Court should affirm the Thirteenth Circuit's holding.

A. The plain meaning of section 547(c) prevents Touch of Grey from asserting a new value defense because the payment of 503(b)(9) administrative expenses was otherwise unavoidable.

A majority of courts have held that section 547(c)(4) is unambiguous and does not impose a pre-petition temporal limit on the analysis of the new value defense. *In re Beaulieu Group, LLC*, 616 B.R. 857, 973 (Bankr. N.D. Ga. 2020); *see also In re BFW Liquidation, LLC*, 899 F.3d 1178; *In re TI Acquisition, LLC*, 429 B.R. 377*; In re Circuit City Stores, Inc.* 2010 WL 4956022. Admittedly, section 547(c)(4) can be quite cumbersome because it contains a double negative. However, while the use of a double negative might make the statute complicated, it does not make the statute ambiguous. *In re Check Reporting Services, Inc.*, 140 B.R. at 434. "A mathematical calculation may be exceedingly complex, yet at the end of the exercise there is but one right answer. The same is true of [section] 547(c)(4)." *Id*.

1. Section 547(c)(4)'s unambiguous language supports that court-ordered administrative expense payments are otherwise unavoidable.

The Thirteenth Circuit correctly held that the language of section 547(c)(4) is unambiguous. When courts engage in statutory interpretation, they begin with the plain meaning

of the statute. *See Lamie v. U.S. Tr.*, 540 U.S. 526 (2004). When a statute is unambiguous, courts soley function to enforce it *according to its terms*. *Id*. Section 547(c)(4) provides as follows:

> (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[.]

11 U.S.C. § 547(c)(4). Here, the text is plain and unambiguous. It does not include any requirements regarding the timing of a debtor's payment of new value for defensive purposes. While section 547(c)(4) is not user friendly, it is not ambiguous. *See Boyd v. The Water Doctor (In re Check Reporting Servs., Inc.)*, 140 B.R. at 434. Therefore, any argument that bends over backwards to impose a petition-date-cutoff-point for purposes of the analysis of the new value defense must be rejected.

Additionally, the Thirteenth Circuit correctly held that Touch of Grey cannot reduce its preference exposure for the value of goods given in the Invoice because the payment of administrative expenses post-petition was otherwise unavoidable. As noted by the Thirteenth Circuit in its appellate opinion, "[b]ecause an administrative expense, even one under section 503(b)(9), is paid post-petition, we turn to section 549, which is the only avoidance power that could apply based on the facts in this case." R. at 13 (*comparing* 11 U.S.C. §§ 544, 545, 547, 548, 553, 724(a); *see also In re Circuit City Stores, Inc.*, at *8 2010 WL 4956022)). Section 549(a) provides that

> [e]xcept as provided in subsection (b) or (c) of this section, the trustee may avoid a transfer of property of the estate—
>
> (1) that occurs after the commencement of the case; and
>
> (2)(A) that is authorized only under section 303(f) or 542(c) of this title; or

(B) that is not authorized under this title or by the court.

11 U.S.C. § 549(a). In this case, Debtor was authorized by the bankruptcy court to pay Petitioner's administrative expense. The payment was therefore "otherwise unavoidable" because the transfer was not avoidable by other sections of the bankruptcy code and because the bankruptcy court authorized the payment. *See In re Circuit City Stores, Inc.*, at *8 2010 WL 4956022; *see also In re MMR Holding Corp.*, 203 B.R. 605, 609-611 (Bankr. M.D. La. 1996). Therefore, because the payment of administrative expenses was otherwise unavoidable, Petitioner, this Court should affirm the Thirteenth Circuit.

2. Section 547(c)(4)'s plain meaning expands beyond prepetition activity when determining whether to claw back a preferential transfer.

The Thirteenth Circuit correctly held that the plain meaning of section 547(c)(4) does not impose a temporal limitation on the analysis of the new value defense. Although the language "on account of which new value the debtor *did not make* an otherwise unavoidable transfer" uses the past tense, nothing in the statute explicitly designates the petition date as the cut-off point for the lookback period as opposed to the date at which preference liability is determined. As stated by the Eleventh Circuit in *In re BFW Liquidation, LLC*:

> Instead, the plain language of the statute requires only that (1) any new value given by the creditor must not be secured by an otherwise unavoidable security interest and (2) the debtor must not have made an otherwise unavoidable transfer to or for the benefit of the creditor on account of the new value given.
>
> By its plain terms, then, the statute only excludes "paid" new value that is paid for with "an otherwise unavoidable transfer." § 547(c)(4)(B). Therefore, so long as the transfer that pays for the new value is itself avoidable, that transfer is not a barrier to assertion of section 547(c)(4)'s subsequent-new-value defense.

899 F.3d at 1189.

Additionally, the Thirteenth Circuit properly rejected the argument that the use of the term "debtor" as opposed to "debtor in possession" somehow imposed a temporal limitation on the analysis of the new value defense. Petitioners argue that because "debtor" refers exclusively to a

pre-petition entity, section 547(c)(4) must exclusively deal with pre-petition activity. As noted by the court in *In re Friedman* – a court that ultimately adopted a temporal limitation for purposes of section 547(c)(4) for other, fallacious, reasons – such a fallacious assumption invalidates the argument. *In re Friedman's Inc.*, 2011 WL 5975283, at *4 (Bankr. D. Del. Nov. 30, 2011). It further recognized that "the 'debtor' is a corporate entity and exists both pre-petition and post-petition." *Id.* This Court should adopt this reasoning.

Lastly, the Thirteenth Circuit correctly held that payment of administrative expenses pursuant to 503(b)(9) qualifies as a "transfer" for purposes of section 547(c)(4). The Bankruptcy Code defines a transfer as "each mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or paying with – (i) property; or (ii) an interest in property." 11 U.S.C. § 101(54)(D). Nothing in this definition of "transfer" explicitly excludes distributions. As stated in *In re Beaulieu*, "while not all transfers are distributions, all distributions – or at least [section 503(b)(9) distributions] – are transfers. 616 B.R. at 870. The Debtor clearly satisfied this definition when it paid Petitioner an administrative expense because it voluntarily, with leave of the bankruptcy court, paid Touch of Grey $200,000 for the value reflected in the Invoice.

B. The intentional elimination of a temporal limit in section 547(c)(4) should prohibit a creditor from utilizing a post-petition administrative expense transfer to limit its preference exposure.

This Court should affirm the Thirteenth Circuit's decision because doing otherwise contradicts the plain meaning of the statute to the extent that looking section 547's title or other relevant statutory context cannot overcome the contradiction. When an issue calls statutory construction into question, the court's first step in analyzing congressional intent is analyzing the statute's plain language. *Midlantic Nat. Bank v. New Jersey Dep't of Env't Prot.*, 474 U.S. 494, 501 (1986). "If Congress intends for legislation to change the interpretation of a judicially created

concept, it makes that intent specific." *Edmonds v. Compagnie Generale Transatlantique,* 443 U.S. 256, 266–267 (1979). Courts have consistently adhered to construing a statute with "intensive care in construing the scope of bankruptcy codifications." *Midlantic Nat. Bank.*, 474 U.S. at 501. Thus, courts are bound by the plain, literal meaning of a statute where the statute lacks ambiguity. *In re McLean Indus., Inc.*, 184 B.R. 10, 15 (Bankr. S.D.N.Y. 1995) (citing *United States v. Ron Pair Enters., Inc.,* 489 U.S. 235, 242 (1989).

The Thirteenth Circuit correctly held that the plain language of section 547(c)(4) did not impose a temporal limitation on the analysis of the new value defense. The conclusion that 547(c)(4) does not impose a temporal limitation is further evidenced by the removal of *just such* a limitation from the statute that predated section 547(c)(4). The timing of the hypothetical liquidation test in section 547(b)(5) is consistent with allowing post-petition transfers to affect the analysis of the new value defense. Lastly, a complete and accurate preference analysis cannot always be done at the petition date because of many unknowns that may exist at this point in a case.

1. Section 547's title stating "preferences" does not oust the statutory text's plain meaning to impose a temporal limitation to the new value defense.

The Thirteenth Circuit correctly found that Section 547's word choice for its title did not trump the statute's textual plain meaning. While it is true that the title of the statute is "Preferences," this observation fails to triumph over the plain meaning of the statute itself. The Court may consider the title of a statute to resolve an ambiguity in the text of a statute, but the title of a statute "cannot trump the plain meaning of its text." *Mine Works of Am. Combined Benefit Fund v. Toffel (In re Walter Energy, Inc.)*, 911 F.3d at 1154 n.38 (citing *Brotherhood of R.R. Trainmen v. Baltimore & O.R. Co.*, 331 U.S. 519 (1947)). Section 547(c)(4) is unambiguous. The Third Circuit took an unnecessary approach. The statute's title can assist *resolving already existing*

ambiguities, not create them. The statute excludes *any* requirements regarding the timing of a debtor's new value payment for defense purposes.

In *In re Friedman*, the Third Circuit adopted a now minority view that post-petition payments may be used to limit preference exposure even if they would otherwise be subject to section 547(c)(4) if the same payments had been made prepetition. *In re Friedman*, 738 F.3d (3d Cir. 2013). *Friedman* provided three non-policy-based reasons for its determination that the statutory context supports a temporal limitation on the new value defense despite the omission of any such language from the statute. *Id*. at 555-56. First, the Third Circuit placed great importance on the fact that section 547 is titled "Preferences" and therefore, according to the Third Circuit, all calculations of liability relate to the pre-petition preference period. *Id*. at 555. Second, the hypothetical liquidation test in section 547(b)(5) is performed at the petition date and "[e]xtending preference analysis past the petition date would be inconsistent with [section] 547(b)(5)." *Id*. Third, the statute of limitations for a preference complaint begins on the petition date and the calculation of liability could change based on the date the complaint is filed if post-petition payments can defeat the new value defense. *Id*. at 556. This Court should refuse to uphold these determinations, as they are wholly devoid of statutory support.

Additionally, as noted by the court in *In re Beaulieu*, in *Barnhill v. Johnson*, the Supreme Court concluded that for purposes of a prima facie preference, the delivery date of a check applies to preference defenses under section 547(c). *In re Beaulieu*, 616 B.R. at 873 (*citing Barnhill v. Johnson*, 504 U.S. 393, 402 (1992)). This date of delivery rule has remained good law for preference defenses after *Barnhill*. *Id*. at 873-74 (referencing 5 Collier on Bankruptcy ¶ 547.04[4][b] (16th ed.); *see also Hall-Mark Elec. Corp. v. Sims (In re Lee)*, 108 F.3d 239, 240-41 (9th Cir. 1997) ("The Supreme Court has held that, for purposes of [section 547(b)], a transfer

accomplished by means of an ordinary check takes place ... on the day it is honored[.] ... A different rule for time of transfer applies, however, under the 'new value' exception of [section] 547(c)(4)")). While section 547(b) advances the bankruptcy policy of equality of distribution among creditors and depends on when funds are actually depleted, applying the date-of-delivery rule to transfers under section 547(c) encourages creditors to continue transacting business on ordinary terms with financially distressed creditors; "thus furthering the rehabilitative purpose of bankruptcy." *Id*. at 874 (*citing Brown v. Shell Canada Ltd. (In re Tennessee Chemical Co.)*, 112 F.3d 234, 238 (6th Cir. 1997).

2. Congress intentionally voided section 547(c)(4)'s temporal limitation as evidenced by removal of such language from the statute's predecessor.

While the statute is unambiguous on its face, the statutory history further supports the conclusion that Congress intentionally left out any temporal limitation in the analysis of new value preference defenses. Section 60(c) of the Bankruptcy Act of 1898 was the predecessor to section 547(c)(4) and provided as follows:

> If a creditor has been preferred, and afterward in good faith gives the debtor further credit without security of any kind for property which becomes a part of the debtor's estate, the amount of such new credit *remaining unpaid at the time of the adjudication* in bankruptcy may be set off against the amount which would otherwise be recoverable from him.

When congress repealed this section and replaced it with 547(c)(4), it replaced the "remain unpaid" language with the current "not make an otherwise unavoidable transfer" language. *In re BFW Liquidation*, 899 F.3d at 1191. This change shows that Congress intended to replace that old requirement with a substantively new one, and the same can be said about the "time of adjudication language." *Id*. Section 60(c) included a temporal limitation on payments made on account of new value, and any such limitation is absent in section 547(c)(4). This Court can reasonably infer that this change was intentional.

3. The hypothetical liquidation test's timing in section 547(b)(5) consists with allowing a debtor's post-petition payments offset the new value defense.

Post-petition facts may impact whether a trustee is able to make a prima facie case under section 547(b)(5). As pointed out in *In re TI Acquisition*, the preference period only involves transfers by the debtor that occur pre-petition, but the defense of section 547(c)(4) does not limit itself to the pre-petition period. 429 B.R. at 385.

> Indeed, the requirements for making out a *prima facie* case for preference recovery include a determination of the extent of payment a creditor would receive in a Chapter 7 case. Post-bankruptcy facts are thus required for proper consideration of section 547 recovery actions. The holder of an administrative claim in a Chapter 7 case—even one created post-petition by section 503(b)(9)—is treated differently than other unsecured creditors. That post-petition fact may impact whether a trustee is able to make out a *prima facie* case under 11 U.S.C. § 547(b)(5).

Id. Thus, post-petition facts can be relevant when evaluating a new value defense. Indeed, post-petition facts were relevant in the current case because Petitioner received an administrative expense payment pursuant to section 503(b)(9). Consequently, granting its request would allow Petitioner to be treated differently than other unsecured creditors. Therefore, any argument that courts must turn a blind eye to post-petition facts in evaluating a new value defense because the hypothetical liquidation test takes place at the time of filing the petition must be rejected because post-petition facts can still impact the analysis of section 547(b)(5).

Under a prima facie case for a preference, different time periods apply to different elements. The use of different time periods (some post-petition and some pre-petition) shows that the timing of the hypothetical liquidation test – which is done at the petition date – is not inconsistent with allowing post-petition payments by the debtor to offset the new value defense. Section 547(b)(5) codifies the Supreme Court's holding in *Palmer Clay Products v. Brown*. 5 Collier on Bankruptcy ¶ 547.03[7] (16th ed.). There, the Supreme Court held that whether a particular transfer is preferential is to be determined "not by what the situation would have been if

the debtor's assets had been liquidated and distributed among his creditors at the time the alleged preferential payment was made, but by the actual effect of the payment as determined when bankruptcy results." *Id*. (*quoting Palmer Clay Prod. Co. v. Brown*, 297 U.S. 227, 229 (1936)).[1] All other elements of a preference are determined at the time the transfer is made. Thus, different time periods must be applied to different elements to carry out the purpose of the preference statute.

4. A complete preference analysis cannot always be done at the petition date because of many unknowns that may exist at that point in time.

Lastly, the Thirteenth Circuit correctly discarded *Friedman's* statute of limitations argument because preference analysis cannot be done at the petition date. The *In re Beaulieu* court explained why the preference analysis cannot be done at the petition date, even when section 503(b)(9) claims are absent:

> [There are] many unknowns with respect to the exact amount of payments, when payments cleared, and when checks or other payments were initiated. This fact is part of the reasons why preference actions are rarely brought early on in a case such that from a practical standpoint, [concerns about having a fixed point for purposes of the statute of limitations] is of little effect.

In re Beaulieu, 616 B.R. at 875. While having a fixed point at which a preference amount can be determined and defenses anticipated might sound appealing, the reality is that this rule would be impracticable because a complete preference analysis cannot always be done at the petition date. Furthermore, Congress can, and even has, "imposed a different limitations period for some avoidance actions." *Id*. For example, section 549 has a separate statute of limitations that requires the claim to be brought either two years after the transfer sought to be avoided or at the time the bankruptcy case is closed or dismissed, whichever is earlier. *Id*. Thus, the statute of limitations argument must fail., and this Court should affirm the Thirteenth Circuit's ruling.

[1] The court in *Palmer Clay* was interpreting the predecessor statute to 547(c). The predecessor did not include a hypothetical liquidation test at that time.

C. Allowing Petitioner to reduce its preference exposure via a pre-petition new value defense when it has already received an administrative expense payment post-petition would disturb the equality of distribution's purpose.

The Thirteenth Circuit properly weighed the overarching policy consideration of equality of distribution of creditors when it did not allow Touch of Grey to "double dip" and reduce its preference exposure even though it had already been fully compensated with an administrative expense payment. This issue presents two policy considerations which must be balanced: the overarching goal of the Bankruptcy code to equally treat similarly situated creditors and the encouragement of creditors to extend lines of credit to struggling businesses. The overarching goal of equality of distribution must not be undercut.

While double-dipping may entice more creditors to extend lines of credit to failing businesses, it would ultimately result in extreme inequity among creditors. As noted by the court in *In re Beaulieu*, if the Court were to accept Petitioner's argument, Touch of Grey would be paid in full for its section 503(b)(9) claim, which would result in a smaller return to other unsecured creditors as the pool of funds to be divided would be decreased by $200,000. 616 B.R. at 877. Touch of Grey would have a smaller section 502(h) claim by virtue of its administrative expense claim, but this reduction "would not compensate other creditors as its real value is some percentage on the dollar that would be paid to general unsecured creditors[.]" *Id*. By contrast, any of the other unsecured creditors who may have provided goods during the preference period, but not during the last 20 days would receive payment on section 502(h) claims and their other general unsecured claims at a reduced rate because the recovery to the estate is now reduced by the use of a fully paid 503(b)(9) claim. *Id*. Thus, general unsecured creditors would be penalized by this aforementioned reduction. The overarching goal of equality of distribution would be

severely undercut in such a situation and the Thirteenth Circuit was therefore correct to not allow such a scenario.

Our proposed interpretation would not "cause harm" to trade creditors like Touch of Grey who support a struggling debtor. It would merely prevent them from getting multiple bites at the apple. This would be our course of action even if the administrative expense was never awarded because the two payments are entirely distinct. Touch of Grey has not been prejudiced or harmed by asserting a 503(b)(9) administrative expense. Denying creditors this windfall will not impact debtors desiring to obtain post-petition services from "critical" vendors. Joseph L. Steinfeld, Jr. & Kara E. Casteel, *Friedman's Improperly Adds Requirement That New-Value Analysis Closes at Petition Date*, 31 Am. Bankr. Inst. J. 42, 43 (March 2012). Reasonable creditors would still take the bargain of having pre-petition invoices paid in return for the mere possibility that they may not get new value credit should, for example, an avoidance action be filed two years hence. *Id*. If concerned about this, these creditors could seek a waiver of avoidance claim as part of critical-vendor negotiations. *Id*. Therefore, the overarching policy consideration of equality of distribution of creditors is not overcome by policy concerns that section 503(b)(9) was intended to accomplish. Touch of Grey must not be allowed to have its cake and eat it too.

II. This Court should affirm the Thirteenth Circuit's finding that 11 U.S.C. § 365(d)(3) requires the adoption of the proration approach.

The Thirteenth Circuit correctly found that 11 U.S.C. § 365(d)(3) only required the Debtor to pay for the rent that had accrued through the effective date of rejection. This issue requires this Court to determine the correct computation of "stub rent" under section 365(d)(3) and analyzes the benefits of the proration approach compared to the billing date approach. "Stub rent" is defined as the rent due between the filing of the petition and the rejection of the lease. Gary P. Spencer,

Jr., *A Simple Solution for Stub Rent? How Proposed Changes to the Treatment of Stub Rent Could Lead to Unforeseen Consequences*, 36 Rev. Banking & Fin. L. 915, 918 (2017). While courts generally agree that section 365(d)(3) is "designed to protect landlords and provide them with the ability to recover rent and other charges in a timely manner," courts are "sharply divided" when determining the statute's ambiguity and whether the proration approach is more consistent with the statute. Aaron H. Stulman, *Stub Rent Under Section 365(d)(3): A Call for a Unified Approach*, 36 Del. J. Corp. L. 655, 661-62 (2011) (hereinafter "Stulman Article").

Despite this sharp division, "a substantial majority of the courts that have considered this issue have concluded that under section 365(d)(3), rent should be *prorated* to cover only the post-petition, pre-rejection period, regardless of the fortuity of the billing date. *In re Child World*, 161 B.R. at. 576 (emphasis added); *See also In re Ames Dep't Stores, Inc.*, 150 B.R. 107 (Bankr. S.D.N.Y. 1993); *In re RB Furniture, Inc.*, 141 B.R. 706 (Bankr. C.D. Cal. 1992); *In re Duckwall-Alco Stores, Inc.*, 1992 WL 365362 (D. Kan. 1992); *In re Revco D.S., Inc.*, 111 B.R. 626 (Bankr. N.D. Ohio 1989); *In re S&F Conccession, Inc.*, 55 B.R. 689 (Bankr. E.D. Pa. 1985); *In re Barrister of Delaware, LTD.*, 49 B.R. 446 (Bankr. D. Del. 1985).

The adoption of the proration approach over the billing date approach can have substantial benefits for both debtors and tenants. To understand why, it is necessary to understand the difference between the two methods. Under the proration approach, "lease obligations relating to pre-petition, yet billed post-petition, or vice versa, are prorated per day in the month of the filing." Stulman Article at 670. Conversely, the billing date method provides that "the date on the lease acts 'as the operative date to determine whether rent is a pre-petition or post-petition expense.'" Stulman Article at 667 (*quoting* Michael J. Lichtenstein, The Payment of "Stub Rent" Under the

Bankruptcy Code, 36 Real. Est. L.J. 144, 144 (2007)). Thus, the current issue hinges not on an issue of fact, but rather on the construction of section 365(d)(3).

When courts engage in statutory interpretation and construction, the analysis begins with the plain meaning of the statute. *See generally Davenport*, 495 U.S. at 557. In determining plainness or ambiguity, courts are directed to look "to the language itself, the context in which that language is used, and the broader context of the statute as a whole." *Robinson v. Shell Oil Co.*, 519 U.S. 337, 341 (1997). As will be discussed below, the language of section 365(d)(3) is ambiguous, and this Court should consider extrinsic evidence to determine the statute's meaning, and thus, which method best comports with the meaning of the statute. When considering the context of the statute, the pre-amendment practices, and the legislative history, the proration approach is the only approach that can be read in accordance with section 365(d)(3). Finally, public policy also necessitates the proration approach to best achieve the goals of the Bankruptcy Code and avoid inequity. The proration approach is simple, equitable, and consistent. *See In re Stone Barn Manhattan*, 398 B.R. 359 (Bankr. S.D.N.Y 2008).

A. The Thirteenth Circuit correctly found that the plain language of 11 U.S.C. § 365(d)(3) is ambiguous because the language of the statute is capable of more than one reasonable construction.

When engaging in statutory interpretation, this Court should first look to the plain language of section 365(d)(3). "A fundamental canon of statutory interpretation is that a court 'begins with the language of the statute itself' when analyzing the statute's meaning." (Stulman at 662) (*quoting Pa. Dep't of Pub. Welfare*, 495 U.S. at 557). The threshold issue thus necessitates determining whether the plain language of section 365(d)(3) is ambiguous.

A statute is ambiguous where the language is capable of more than one reasonable construction. *See In re Lucarelli*, 517 B.R. at 49 (*quoting Natural Res. Def. Council, Inc. v.*

Muszynski, 268 F.3d at 98. ("A statute is ambiguous if 'susceptible to two or more reasonable meanings.'"). As the Thirteenth Circuit astutely observed, the statute is clear on *what* the trustee must do (*i.e.* perform), but courts are "sharply divided" with respect to *when* the obligation to do it arises. (R. at 16). The existence of a circuit split in the interpretation of section 365(d)(3) is *per se* evidence of the ambiguity of the language. *In re Furr's Supermarkets, Inc.*, 283 B.R. 60, ftn. 8 (10th Cir. BAP 2002) (*citing In re Southern Star Foods, Inc.*, 144 F.3d 712, 715 (10th Cir. 1998)). Indeed, even courts adopting the billing date approach have noted ambiguity in the plain language. *See, e.g., In re Montgomery Ward Holding Corp.*, 268 F.3d 205, 208 (3d Cir. 2001) ("There is, of course, syntactical ambiguity in this text."). Each of the ambiguities in the language will be discussed in turn, evincing the need to consider extrinsic evidence to determine the meaning of section 365(d)(3).

1. The term "arises" is ambiguous because the term is not defined in the Code and has been interpreted differently by courts.

The term "arising from and after the order for relief…" (11 U.S.C. § 365(d)(3)) should be considered ambiguous because it has been applied differently by courts. One main issue is that the term "arises" is not defined in the Bankruptcy Code. (R. at 17). Courts are left to determine when the obligation arises. Specifically, "courts are confused as to whether an obligation 'arises' every day on a pro rata basis or 'arises' when billed." *In re Montgomery Ward Holding Corp.*, 268 F.3d at 209.

For example, in *Handy Andy*, the Seventh Circuit had to determine when the obligation was said to have "arisen". *In re Handy Andy Home Improvement Centers, Inc.*, 144 F.3d 1125, 1127 (7th Cir. 1998). The dispute was whether the tenant's obligation to reimburse the landlord for taxes under the lease was a post-petition debt entirely or should be prorated between the pre-petition and post-petition period of occupancy. *Id.* at 1126. Under the terms of the lease, the

landlord would pay the taxes assessed and bill Handy Andy for the reimbursement, which would be due with the next rental payment. *Id.* The landlord argued Handy Andy's obligation under the lease could *not* arise before Handy Andy was contractually obligated to reimburse the landlord, thus advocating for the billing date approach. *Id.* at 1127 (emphasis added). The court, however, noted that this reading of the statute was "neither inevitable nor sensible." *Id.*

Although the court noted that Handy Andy's obligation did not *crystallize* until the rental due date after the taxes were paid, the obligation to pay *arose* piecemeal every day that Handy Andy occupied the premises and became irrevocably fixed on the last day of the year. *Id.* The court reasoned that the proration approach is more sensible because the taxes were billed after the period for which the taxes have been assessed. *Id.* at 1126.

Like the Seventh Circuit in *Handy Andy*, the Thirteenth Circuit clearly articulated the ambiguity in the case at bar:

> The statute says nothing about how to determine when the obligation arises. Nothing in the text is inconsistent with the common-sense view that when an obligation arises may be fixed by its intrinsic nature and/or by the extrinsic circumstances of its accrual. An obligation attributable to a particular time may well be said to "arise" at that time, and an obligation that accrues over time may be said to "arise" as it accrues, without doing violence to the statutory language.

(R. at 18) *See also In re Montgomery Ward Holding*, 268 F.3d at 213 (Mansmann, J., dissenting). Without a doubt, "the phrase 'arising from and after the order for relief…' is far from clear." *In re McCrory Corp.*, 210 B.R. 934, 939 (S.D.N.Y. 1997). Therefore, because an obligation may be said to "arise" on the rental due date controlled by the lease or "arise" piecemeal each day that the debtor in possession occupies the premises, this language in the state is ambiguous.

2. The term "obligation" is ambiguous because courts are unclear as to what lease commitments it constitutes.

Another source of ambiguity in the statute is the term "obligations." Section 365(d)(3) states that "the trustee shall timely perform all the *obligations* of the debtor…" (emphasis added).

The term "obligations" has been construed differently, as courts have struggled to determine what commitments it constitutes. Although the Third Circuit characterized the definition as "well settled," (*In re Montgomery Ward Holdings*, 268 F.3d at 213) the term in the broader context of section 365(d)(3) is actually far from settled.

"Black's Law Dictionary states that obligation is '[a] generic word… having many, wide, and varied meanings, according to the context in which it is used." *In re Child World*, 161 B.R. at 574. The Third Circuit defined obligation as "something that one is legally required to perform under the terms of the lease." *In re Montgomery Ward Holdings*, 268 F.3d at 213. In that same vein, the Northern District of Illinois has held that "an obligation related to a past even may be said to originate when that even occurs, but an obligation to pay for the promise of future consideration originates or comes into being, not when the future consideration is provided, but when the payment is due." *In re Comdisco*, 272 B.R. 671, 676 (Bankr. N.D. Ill. 2002).

However, some courts have interpreted "obligation" to mean a "claim." Stulman Article at 664. To illustrate, the D.C. District noted:

> For purposes of section 365(d)(3) an obligation under a lease to pay rent may be just as readily said to originate with respect to the period of occupancy to which the rent related: performance may be due in advance, but the compensation obligation arises as of the period of occupancy.

In re NETtel Corp., 289 B.R. 486, 496 (Bankr. D.D.C. 2002). Even more than that, the Southern District of New York has also held that the Bankruptcy Code recognized unmatured obligations, citing the Code's definition of a "claim" to be a corollary to "obligation." *See In re Child World*, 161 B.R. at 574.

Given the fact that some courts define obligation as a legally required performance, while other courts determine that the term to be a corollary of the term "claim," and thus determine the

issue to hinge on whether the supposed obligation occurred pre- or post-petition, this Court should find that this term is ambiguous.

3. The phrase "until such lease is assumed or rejected" is ambiguous because it could reasonably be construed to modify different terms in the statute.

Another reason this Court should determine that section 365(d)(3) is ambiguous because the phrase "until such lease is assumed or rejected" in the statute could reasonably modify two different terms. As the Thirteenth Circuit aptly stated, "the phrase 'until such lease is assumed or rejected' is likewise subject to two plausible interpretations given its grammatical placement." (R. at 18).

One reasonable interpretation is that the phrase could modify the term "perform." By this interpretation, the trustee "must make any payment due under a lease until such time as it is assumed or rejected." Id. (*citing In re Ames Dep't Stores, Inc.*, 306 B.R. 43, 67 (Bankr. S.D.N.Y. 2004)). The phrase, however, could also modify the term "obligations" (once again adding to the ambiguity of that term, as noted above). Under this interpretation of the modification, the trustee's duty to perform the obligation ceases upon rejection. Id. (*citing In re Ames Dep't Stores*, 306 B.R. at 67). Neither of these modifications is unreasonable, giving the statute's wording, structure, and punctuation. *In re Ames Dep't Stores*, 306 B.R. at 67.

The court in *In re Ames Dep't Stores* found this phrase to be of "critical importance," especially in light of sections 365(g) and 502(g) "which treat failures to honor lease obligations after rejection as pre-petition claims. *Id.* If the former modification is adopted (the phrase modifies "perform"), this would support an "absolutist view," which would be "inconsistent with prorating." *Id.* However, if the latter, more plausible view is adopted, prorating would be "necessary and appropriate." *Id.*

Because this phrase could reasonably be construed to modify two different terms in the statute, this Court should determine that section 365(d)(3) is ambiguous.

4. The phrase "notwithstanding § 503(b)(1)" is ambiguous because analysis and application of the term has led to different interpretations by courts.

Similar to the aforementioned terms and phrases, the phrase "notwithstanding section 503(b)(1)" is yet another source of ambiguity. Some courts have held this phrase mandates a "super-priority for a section 365 claim, higher than even an administrative claim." Stulman Article at 666 (*citing In re Telesphere Commc'ns, Inc.*, 148 B.R. 525, 532 (Bankr. N.D. Ill 1992)). In jurisdictions where courts have applied this rule, "payment must be immediate regardless of whether the debtor has the money to pay other administrative expense claims in full." *Id.*

Other courts have held that section 365(d)(3) "creates a new and different kind of 'obligation'—one that does not necessarily rest on the administrative expense concept." *In re Valley Media, Inc.*, 290 B.R. 73, 77 (Bankr. D. Del. 2003). However, some courts have entirely disregarded the term "notwithstanding," holding instead that the landlord must still prove the "tedious requirements" of section 503(b)(1). Stulman Article at 667. Given the multiple interpretations courts have given this phrase, this Court should determine that section 365(d)(3) is ambiguous.

With an abundance of inter-circuit splits and intra-district splits, it is clear that the language of section 356(d)(3) is ambiguous, and this Court should look to other canons of statutory interpretation to determine its correct meaning and application.

B. When considering statute's context pre-amendment practices and the legislative history, only the proration approach comports with legislative intent.

The plain language of section 365(d)(3) is facially ambiguous, meaning this Court may utilize other canons of statutory construction to help resolve the ambiguity. *United States v.*

Colasuonno, 697 F.3d at 173 (2d Cir. 2012). "In [ambiguous] cases, the intention of the drafters, rather than the strict language controls." *United States v. Ron Pair Enters., Inc.*, 489 U.S. at 242. Further, when a statute is ambiguous, "courts rely heavily on legislative intent." *In re McCrory Corp.*, 210 B.R. at 937-38. In determining legislative intent, the context of the statute, the pre-amendment practices, and the legislative history underscore the adoption of the proration approach.

1. The context surrounding section 365(d)(3) highlights the necessity for adopting the proration approach.

When looking at the context of section 365(d)(3), the proration approach is supported by the other Code provisions. Bankruptcy Code provisions must be construed together. *In re Ames Dep't Stores*, 306 B.R. at 66. As the Thirteenth Circuit noted, "it is a fundamental canon of statutory construction that the words of a statute must be read in their context and with a view to their place in the overall statutory scheme." (R. at 18.) (*quoting Roberts v. Sea-Land Servs., Inc.*, 566 U.S. 93, 101 (2012)).

In *Ames Dep't Stores*, the court held that the proration approach best fits with the overall context of the Bankruptcy Code. 306 B.R. at 70. At the heart of that dispute, the landlord argued for the adoption of the billing date approach, asserting that it would be prejudiced by the proration approach. *See id.* at 63. The debtor-tenant advocated for the proration approach, which the court ultimately found persuasive. *See id.* In making this determination, the court looked to other sections of the Bankruptcy Code, particularly sections 365(g) and 502(g). *Id.* at 70. With the enactment of these statutes, Congress directed federal courts to "treat claims for breaches of lease obligations following rejection as prepetition claims." *Id.* To adopt the billing date approach would "render those provisions nugatory." *Id.*

This Court should find that Congress "fully understands" the distinction between pre-petition and post-petition administrative expenses. *In re Furr's Supermarkets*, 283 B.R. at 69. Section 365(d)(3) did not disrupt the statutory priority, which clearly suggests that the scheme should remain in place. As the Southern District of New York has stated, "When Congress amends bankruptcy laws, it does not write on a clean slate." *In re McCrory Corp.*, 210 B.R. at 939. The context of the Bankruptcy Code coupled with the language of section 365(d)(3) illustrate that Congress did not intend a major change to the well-established priority scheme. The billing date approach necessarily changes that scheme because it elevates landlords above all other creditors by allowing landlords to have a pre-petition claim treated as an administrative expense. Stulman Article at 669.

Moreover, statutes should be given a reasonable and practical interpretation. *See In re Handy Andy Home Improvement Ctrs., Inc.*, 144 F.3d at 1128 ("When context is disregarded, silliness results."). The proper interpretation of section 365(d)(3) is to construe the provision as a whole to accomplish the plain purpose of the law. *In re Stone Barn Manhattan LLC*, 398 B.R. at 366. Proration is the only principle that accomplishes that result. *See id.* ("The billing date approach thus contradicts the plain purpose of the statute."). The proration approach is therefore the only approach that is coherent within the broader context of the Bankruptcy Code.

2. Prior to the 1984 Amendments, courts applied the proration approach and nothing in section 365(d)(3) explicitly changed that practice.

In addition to the context of the Bankruptcy Code, this Court may look to the pre-amendment practices to determine the legislative intent of section 365(d)(3). The 1984 Bankruptcy Amendments and Federal Judgeship Act was enacted to include section 365(d)(3) as a way to codify the already-established practice of prorating. "All courts agree that the pre-code practice was to prorate." Stulman Article at 670. (*citing In re Montgomery Ward Holding Corp.*, 269 F.3d

at 214 (Mansmann, J., dissenting)). *See also In re Montgomery Ward Holding Corp.*, 269 F.3d at 211; *In re Child World*, 161 B.R. at 574-75; *In re Stone Barn Manhattan*, 398 B.R. at 363. To alter a well-established rule, Congress must *explicitly* state its intention to do so. *Pa. Dep't of Pub. Welfare*, 495 U.S. at 557.

The *Child World* court described the practice:

> In applying section 503(b)(1) to a debtor-tenant's rental obligation before the 1984 amendment, the courts would ordinarily allow as an administrative expense the full amount of the rent *prorated over the post-petition, pre-rejection period*, as long as it was reasonable…Nothing in the legislative history indicates that Congress intended section 365(d)(3) to overturn the *long-standing practice* under section 503(b)(1) of prorating debtor-tenants' rent to cover only the postpetition, prerejection period, *regardless of the billing date*.

In re Child World, 161 B.R. at 575-76 (emphasis added). The majority of courts have adhered to this longstanding practice, regardless of the billing date. *In re McCrory Corp.*, 210 B.R. at 937. *See also In re All for A Dollar, Inc.*, 174 B.R. 358, 361-62 (Bankr. D. Mass. 1994); *In re Almac's Inc.*, 167 B.R. 4,7 (Bankr. D.R.I. 1994); *In re Ames Dep't Stores, Inc.*, 150 B.R. at 107; *In re RB Furniture, Inc.*, 141 B.R. at 712; *In re Revco D.S., Inc.*, 111 B.R. at 628-29; *In re Warehouse Club, Inc.*, 184 B.R. 316, 317-18 (Bankr. N.D. Ill. 1995); *Matter of Swanton Corp.*, 58 B.R. 474, 475 (Bankr. S.D.N.Y. 1986).

Courts adopting the billing date method have reasoned that since prorating was the pre-amendment practice, this practice created problems that ultimately led Congress to codify section 365(d)(3) to amend the practice. *See In re Montgomery Ward Holding Corp.*, 269 F.3d at 211-12 (Congress enacted section 365(d)(3) for the purpose of altering a pre-Code practice.); *see also In re Cukierman*, 265 F.3d 846, 851 (9th Cir. 2001). This reasoning contradicts established law and practice. As the *McCrory Corp.* court explained, "the legislation need not explicitly state that courts should continue using pre-amendment practices; rather, it must explicitly state a *departure*

from those practices." 210 B.R. at 937-38. For these reasons, this Court should continue to adhere to the longstanding pre-amendment practice of prorating.

3. The legislative history further highlights Congress' intent to protect landlords from becoming involuntary creditors while still applying the proration approach.

In addition to the pre-amendment practice, the legislative history underscores the legislative intent to continue the practice of prorating. As the Third Circuit correctly noted, the pre-amendment practice was creating problems for landlords. *In re Montgomery Ward Holding Corp.*, 269 F.3d at 211-12. Prior to the 1984 amendments, landlords were forced to become involuntary creditors by providing the use of the leased property without receiving rent payments. *See* Stulman Article at 672-73. Section 365(d)(3) was enacted to ameliorate this issue without substantially altering the proration approach; as detailed above, if Congress intended to change the pre-amendment practice, that change would have been expressly stated in the legislative history.

Senator Hatch explained the problems sought to be addressed by the 1984 amendments.

> During the time the debtor has vacated the space but has not yet decided whether to assume or reject the lease, the trustee 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…The bill would lessen these problems by requiring the trustee to perform all the obligations of the debtor under a lease of nonresidential real property…

H.R. Conf. Rep. No. 98—882, at 598-99 (1984), reprinted in 1984 U.S.C.C.A.N. 576. Notably, this legislative history is utterly devoid of any intention to alter the established practice of prorating. To highlight this, the *NETtel* court stated how the 1984 Act assuaged the pre-1984 issues.

> The enactment of section 365(d)(3) addressed two problems: first, the landlord was given the right to rent payments contemporaneous with its provision of services to the debtor during the [post-petition, pre-rejection] period (and to seek relief if those payments were not made), and, second, the landlord's claim for occupancy was to be fixed by the rental terms of the lease, not by the 'actual, necessary' provision of

> section 503(b)(1) that governs allowance of administrative claims in general and that might limit reimbursement to the reasonable value of the trustee's actual use of the property. However, section 365(d)(3) was *not* intended to pay landlords for services *not actually provided* to the estate.

289 B.R. at 492 (emphasis added). Indeed, the legislative history once again connotes that nothing in section 365(d)(3) requires the elimination of the pre-amendment practice of prorating. *See id.*

The case at bar illustrates this principle clearly. In this case, it would make no sense to adopt the billing date approach because the landlord would be paid for services it never actually provided to the Debtor. The Debtor vacated the premises on May 5, 2020. (R. at 7). If the billing date approach were adopted by this Court, the landlord would receive payment for an empty warehouse. This is the exact type of "silliness" and "absurd results" that the *Handy Andy* court sought to avoid. *In re Handy Andy Home Improvement Ctrs., Inc.*, 144 F.3d at 1128. More appropriately, the proration approach would avoid those absurd results by reimbursing the landlord for services *actually provided* to the Debtor.

Further, the proration approach is the "better-reasoned approach" because it is more consistent with the legislative history of section 365(d)(3) by preventing landlords from becoming involuntary creditors. *In re Furr's Supermarkets*, 283 B.R. at 68. The billing date method forces landlords to be involuntary creditors, which is exactly what Congress intended to avoid. *See* Stulman Article at 672. Section 365(d)(3) was enacted to protect landlords and adopting the proration approach is the only way to ensure the protection of both landlords and debtor-tenants.

The legislative intent clearly reveals that Congress implemented section 365(d)(3) as a way to protect landlords from becoming involuntary creditors while still keeping with the practice of prorating rent. Nothing in the context of the statute or the legislative history reveals a clear intention to change the pre-amendment practice of proration, and thus the proration method is the only method that comports with these canons of statutory interpretation.

C. Considering the overall purpose of the Bankruptcy Code, public policy supports the adoption of the proration approach.

The proration approach is the only method that can be soundly supported by public policy. "The Bankruptcy Code aims, in the main, to secure equal distribution among creditors." *Howard Delivery Serv. Inc. v. Zurich Am. Ins. Co.*, 547 U.S. 651, 655 (2006). This Court should adopt the proration approach because it accomplishes the main goal of the Bankruptcy Code by providing consistent rulings and achieving equitable remedies.

1. The proration approach is the only reasonable construction of section 365(d)(3) because it is the only method that will provide consistent rulings.

Public policy supports the proration method because it is simple to apply and provides consistent rulings. *In re Ames Dep't Stores, Inc.*, 306 B.R. at 72. Indeed, the proration approach can be applied uniformly, but the billing date approach leads to absurd results. *See In re Stone Barn Manhattan, LLC*, 398 B.R. at 366.

For example, in *In re Furr's Supermarkets*, the commercial leases required the debtor-tenant to make quarterly installments payable in arrears. 283 B.R. at 63. Rent was to be paid on the last day of the months of March, June, September, and December. *Id.* In between lease payments, the tenant-debtor was forced to convert from a Chapter 11 to a Chapter 7 bankruptcy. *Id.* When rent became due, the landlord made demand on the Chapter 7 trustee for payment, which was met with a motion to extend the deadline to assume or reject the lease. *Id.* The Bankruptcy Court for the District of New Mexico ultimately held that the debtor-tenant would only be required to pay the rent accruing after the conversion date until the effective date of rejection. *Id.* at 64. On appeal, the landlord asserted that the Bankruptcy Court erred in ordering only prorated portions of the lease obligations attributable to the period in which the debtor-tenant was in possession be paid. *Id.* at 65.

In refusing to apply the billing date approach, the Tenth Circuit noted that even the appellant's argument invited the adoption of the proration approach. *Id.* at 68. The appellants (although attempting to advocate for the billing date approach) "urged" the court to depart from the lease and place the tenant on a "pay as you go" status. *Id.* The court, in upholding the district court's ruling applying the proration approach explained that the proration approach accomplished exactly what the appellant (potentially inadvertently) argued. *Id.*

The counterintuitive argument raised by the landlord in *In re Furr's Supermarkets* emphasizes the need for this Court to adopt the proration approach. Courts supporting the billing date approach are forced to apply different rules for different types of obligations and lease durations. As evidenced above by *In re Furr's Supermarkets*, the billing date approach must be applied differently for yearly versus monthly leases, arrears versus in advance payment, and taxes versus rent obligations. Stulman Article at 673. This Court should avoid applying a rule that must be limited to the particular facts, as such a rule is impractical. The *In re Ames Dep't Stores* court went so far as to characterize the billing date approach as "a principle of illogical breadth," stating:

> Rather than articulating a principle of such illogical breadth that courts need to be apologizing for it in advance or need to immediately limit holdings to their particular facts, this Court believes it more appropriate to consider whether such a potentially illogical and unjust rule was really what Congress intended when it enacted section 365(d)(3).

150 B.R. at 72. It is evident that the billing date approach "forces courts to rule inconsistently with other provisions of the Code." Stulman Article at 673. These inconsistent results can easily be avoided by adopting the proration approach.

2. The proration approach is the only method that achieves an equitable remedy.

The proration approach achieves equity. As the *McCrory Corp.* court stated, "the bankruptcy court is essentially a court of equity…and it applies the principles and rules of equity jurisprudence." *In re McCrory Corp.*, 210 B.R. at 940 (*quoting In re Ionosphere Clubs, Inc.*, 85

F.3d 992, 999 (2d Cir. 1996)). The proration approach produces equitable results by "allowing both landlords and tenants to get what they bargained for—current service for current payment—at the rate agreed to in the lease." *In re Stone Barn Manhattan, LLC*, 398 B.R. at 364. Even more than that, proration "does not eliminate *any* obligations of tenants to landlords—it merely measures when obligations arise and when they end." *Id.* at 366.

Unlike the proration approach, which achieves equitable results, the billing date can easily be manipulated by one party, to the detriment of another. Landlords can manipulate the billing date approach because it converts what would be pre-petition debt into an administrative claim. *In re NETtel*, 289 B.R. at 492. This "violat[es] the principle of creditor equality and distort[s] the priority and distribution provisions of other sections of the Bankruptcy Code." *Id.* at 492-93. But, the billing date approach can also be manipulated debtors to the detriment of landlords. By controlling when they filed the petition, debtor-tenants can "consistently treat landlords worse than any other post-petition creditor by creating unsecured pre-petition claims to their own benefit." Stulman Article at 669. Thus, the proration approach should be adopted to avoid manipulation and to ensure that no obligations are eliminated.

The proration approach also prevents windfalls; the same for which cannot be said of the billing date approach. Even courts adopting the billing date approach have acknowledged that their method creates a windfall, but they seem to justify this practice because the windfall can "cut both ways." *See In re Comdisco, Inc,* 272 B.R. at 675. The idea that a court can accept this inequitable remedy is "illogical and is wholly rejected by an overwhelming number of courts," especially because the proration approach avoids this result in nearly every case. Stulman Article at 671. To illustrate, the proration approach prevents a windfall in the case at hand. The Debtor vacated the premises on May 5, 2020. (R. at 7). To reverse the Thirteenth Circuit would create a windfall of

$20,967.74, would essentially pay the landlord for an empty warehouse, and deprive all other creditors of the right to equal distribution.

The goal of the Bankruptcy Code is to secure equal distribution among creditors. Bankruptcy courts are essentially courts of equity in accomplishing that goal. The proration approach is the only approach that achieves equality among creditors, protects landlords from becoming involuntary creditors, and provides consistent rulings that will not be limited to the facts of any one particular case. Moreover, the proration approach prevents both landlords and debtors from manipulating the process to the detriment of all other parties. For these reasons, this Court should adopt the proration approach.

CONCLUSION

For the foregoing reasons, Respondent respectfully requests that this Court affirm Thirteenth Circuit's judgment and hold that (1) a seller of goods is not entitled to reduce its preference exposure pursuant to section 547(d)(3) by the value of goods sold to the Debtor even though it received payment in full for such goods pursuant to section 503(b)(9) and (2) under section 365(d)(3) a landlord is not entitled to the rent due under the lease prior to the effective date of rejection but allocable to the period after the effective date of rejection.