No. 20-0803

IN THE

Supreme Court of The United States

IN RE TERRAPIN STATION, LLC, DEBTOR,

TOUCH OF GREY ROASTER, INC., PETITIONER

V.

CASEY JONES, CHAPTER 7 TRUSTEE, RESPONDENT.

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

BRIEF FOR RESPONDENT

JANUARY 19, 2022

TEAM NUMBER 44
COUNSEL FOR RESPONDENT

QUESTIONS PRESENTED

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

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

TABLE OF CONTENTS

QUESTIONS PRESENTED i
TABLE OF CONTENTS ii
TABLE OF AUTHORITIES iii
OPINIONS BELOW v
STATEMENT OF JURISDICTION v
PERTINENT PROVISIONS v
STATEMENT OF FACTS 1
I. Factual History 1
II. Procedural History 2
STANDARD OF REVIEW 2
SUMMARY OF THE ARGUMENT 3
ARGUMENT 4
I. The lower courts were correct to hold Touch of Grey could not both recover section 503(b)(9) transfer and reduce its preference exposure under section 547(c)(4) for the same transaction. 4
A. The plain language of section 547(c)(4)(B) unambiguously bars the use of the new value defense when there is also a section 503(b)(9) transfer. 5
B. Statutory context further supports that Touch of Grey cannot recover both a new value preference exposure reduction under section 547(c)(4) and be paid in full under section 503(b)(9). 9
C. Statutory purposes are best served by not allowing Touch of Grey to double-dip and limiting its recovery payment under section 503(b)(9). 12
II. Section 365(d)(3) supports post-rejection prorating of rent, and does not require the Trustee to pay rent for the period after rejection of the lease. 14
A. Section 365(d)(3) is ambiguous as to which obligations "arise" 15
B. Prorating rent is the only approach to section 365(d)(3) lease obligations that makes sense. 17
CONCLUSION 20

TABLE OF AUTHORITIES

Cases

American Textile Mfrs. Institute, Inc. v. The Limited, Inc., 190 F.3d 729 (6th Cir. 1999). 21
Beaulieu Liquidating Tr. v. Fabric Sources, Inc. (In re Beaulieu Grp., LLC), 616 B.R. 857 (Bankr. N.D. Ga. 2020). .... *passim*
Burival v. Roehrich (In re Burival), 613 F.3d 810 (8th Cir. 2010). 20
Circuit City Stores, Inc. v. Mitsubishi Dig. Elecs. Am., Inc. (In re Circuit City Stores, Inc.), 2010 Bankr. LEXIS 4398 (Bankr. E.D. Va. Nov. 30, 2010). 12, 15, 19
Cohen v. de la Cruz, 523 U.S. 213 (1998). 23
Commissary Operations, Inc. v. Dot Foods, Inc. (In re Commissary Operations, Inc.), 421 B.R. 873 (Bankr. M.D. Tenn. 2010). 18
Daugherty v. Kenerco Leasing Co. (In re Swanton Corp.), 58 B.R. 474 (S.D.N.Y. 1986). 20, 24
Friedman's Liquidating Tr. v. Roth Staffing Cos. LP (In re Friedman's Inc.), 738 F.3d 547 (3d. Cir. 2013). .... *passim*
HA-LO Indus. v. CenterPoint Props. Tr., 342 F.3d 794 (7th Cir. 2003). 22
In re All For A Dollar, Inc., 174 B.R. 358 (Bankr. D. Mass. 1994). 20, 24
In re Ames Department Stores, 150 B.R. 107 (Bankr. S.D.N.Y. 1993). 20, 22, 24
In re Bellanca Aircraft Corp., 850 F.2d 1275 (8th Cir. 1987). 19
In re CCI Wireless, LLC, 279 B.R. 590 (Bankr. D. Colo. 2002). 20
In re Child World, Inc., 161 B.R. 571 (S.D.N.Y.1993). 20, 23, 24
In re Cukierman, 265 F.3d 846 (9th Cir. 2001). 20
In re Duckwall–ALCO Stores, Inc., 150 B.R. 965 (D. Kan. 1993). 20
In re Handy Andy Home Improvement Ctrs., Inc., 144 F.3d 1125 (7th Cir. 1998). 23, 24
In re Koenig Sporting Goods, Inc., 203 F.3d 986 (6th Cir. 2000). 20, 22
In re Krystal Co., 194 B.R. 161 (Bankr. E.D. Tenn. 1996). 20
In re Montgomery Ward Holding Corp., 268 F.3d 205 (3d Cir 2001) 23, 24
In re NETtel, 289 B.R. 486 (Bankr. D.D.C. 2002). 21
In re Victory Markets, Inc., 196 B.R. 6 (Bankr. N.D.N.Y. 1996). 20, 24
NLRB v. Bildisco & Bildisco, 465 U.S. 513 (1984) 13
Phx. Rest. Grp., Inc. v. Ajilon Prof'l Staffing LLC (In re Phx. Rest. Grp., Inc.), 317 B.R. 491 (Bankr. M.D. Tenn. 2004). 15
Razavi v. Comm'r of Internal Revenue, 74 F.3d 125 (6th Cir. 1996). 8
Reves v. Ernst & Young, 507 U.S. 170 (1993). 21
Texas v. Soileau (In re Soileau), 488 F.3d 302 (5th Cir. 2007). 8
TI Acquisition, LLC v. S. Polymer, Inc. (In re TI Acquisition, LLC), 429 B.R. 377 (Bankr. N.D. Ga. 2010). 15, 18, 19

Statutes

11 U.S.C. § 101(13). 16
11 U.S.C. § 101(54)(D). 12, 16
11 U.S.C. § 364. 18
11 U.S.C. § 365(d)(3). 19, 22
11 U.S.C. § 503(b)(9). 10, 18

11 U.S.C. § 521 16
11 U.S.C. § 522 16
11 U.S.C. § 533(b) 12
11 U.S.C. § 544 12
11 U.S.C. § 545 .... 12, 16, 17
11 U.S.C. § 547(a)(2) 18
11 U.S.C. § 547(a)(4) 16
11 U.S.C. § 547(b)(4)(A) 16
11 U.S.C. § 547(c)(5) 16
11 U.S.C. § 549 12
11 U.S.C. § 724(a) 12
11 U.S.C. §§ 547(c)(4) 10, 13, 16

Other Authorities

Paul R. Hage & Patrick R. Mohan, *Is it Still New Value? Application of Section 503(b)(9) to the Subsequent New Value Preference Defense*, 19 J. BANKR. L. & PRAC. 4, Art. 7 (2010) 15, 16

OPINIONS BELOW

The Thirteenth Circuit Court of Appeals' decision is available at No. 20-0803. The bankruptcy court decided in favor of the Trustee on both issues. On direct appeal, the United States District Court for the District of Moot affirmed on both issues. On further appeal, the United States Court of Appeals for the Thirteenth Circuit affirmed in favor of the Trustee.

STATEMENT OF JURISDICTION

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

PERTINENT PROVISIONS

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

(d)

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

The relevant portion of 11 U.S.C. § 503(b)(3) provides:

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

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

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

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

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

STATEMENT OF FACTS

I. Factual History

The Debtor, Terrapin Station, began as a small and successful independent coffeehouse founded and run by William Tell. R. at 3. The debtor's fate spiraled into insolvency, reorganization, and now, finally, liquidation. R. at 4-8. The Debtor's fall from success is associated with its decision in 2017 to remodel and become a franchisee of the coffee giant, Touch of Grey. R. at 4-6. The venture seemed like a promising way to revitalize The Debtor's consumer base and revenue. R. at 4. But once the association with an industry giant like Touch of Grey became known to the public, The Debtor's once loyal customer base was repelled by the loss of the small and independent coffeehouse culture—members of the community chastised the Debtor as "big coffee in disguise." R. at 5. Then, like a nail in the Debtor's coffin, the world succumbed to the COVID-19 pandemic. R. at 7. On January 5, 2020, the Debtor filed a petition for relief under Chapter 11 of the Bankruptcy Code, which was voluntarily converted to a Chapter 7 liquidation on May 29th, and at this time the Trustee was assigned. R. at 6, 8.

Touch of Grey is the Debtor's majority creditor and landlord. R. at 4, 6. In addition to the coffee supply agreement, the parties entered into a *Lease Agreement* (the "lease"), in which debtor would operate selling exclusively Touch of Grey's coffee and products. R. at 4. The lease required the Debtor to pay a monthly rent, in the amount of $25,000, due on the first day of each month. *Id.* The Trustee rejected the lease effective May 5th with Bankruptcy Court's unopposed approval. R. at 8. Touch of Grey moved to compel rent for the entire month of May, citing section 365(d)(3). R. at 7-8. The Trustee objected to this motion, and the court ruled in favor of the Trustee. R. at 8-9.

In the months leading up to bankruptcy, the Debtor attempted to work out a debt agreement with Touch of Grey. R. at 5. The resulting forbearance agreement included a payment from the Debtor to Touch of Grey for $250,000. *Id*. Following the forbearance agreement, but within 20 days of bankruptcy, Touch of Grey provided the Debtor with a shipment of coffee and paraphernalia worth $200,000. *Id*. After the commencement of bankruptcy, the Court approved compensation for this shipment for the full $200,000, pursuant to Bankruptcy Code section 503(b)(9). R. at 7. After the case converted to a Chapter 7 liquidation, the Trustee initiated an adversary proceeding seeking to avoid and recover a separate $250,000 pre-petition payment to Touch of Grey as a preferential transfer. R. at 8. Touch of Grey asserted an affirmative defense under section 547(c)(4), claiming that it was entitled to reduce any amount of preference exposure by the $200,000 in goods that it sold to the debtor. *Id*. The Trustee objected, and the court ruled in favor of the Trustee. R. at 8-9.

II. Procedural History

The Bankruptcy Court, District Court, and Court of Appeals for the 13th Circuit ruled in favor of the Trustee on both issues. R. at 9. The courts found that Touch of Grey was not entitled by section 503(b)(9) to reduce its preference exposure. *Id*. Further, the courts found that Debtor was only required to pay Touch of Grey rent for the five days of May before rejection, pursuant to section 365(d)(3). *Id*.

STANDARD OF REVIEW

The issues now before this court are questions of law to be reviewed *de novo*. *See, e.g., Texas v. Soileau (In re Soileau)*, 488 F.3d 302, 305 (5th Cir. 2007). A *de novo* standard of review requires the appellate court to decide the issues as if it were the first trial court. *Razavi v. Comm'r of Internal Revenue*, 74 F.3d 125, 127 (6th Cir. 1996) (quotation omitted).

SUMMARY OF THE ARGUMENT

The decisions of the lower courts in this case should be affirmed. Touch of Grey should not be permitted to recover twice—first under section 503(b)(9), and then again under section 547(c)(4) of the United States Bankruptcy Code. Additionally, section 365(d)(3) does not entitle Touch of Grey to rent for the post-rejection portion of the lease.

Section 547(c)(4) is the subsequent new value defense for voidable preference claims by the estate. It is only available where a creditor has provided new value to the estate after receiving a voidable preference, and where that new value will not be repaid via an unavoidable transfer. In this case, because Touch of Grey received a 503(b)(9) priority payment from the estate for the entire amount it is claiming for the subsequent new value defense, it is not entitled to the new value defense. First, the under the plain meaning of the language in section 547(c)(4), the 503(b)(9) priority payment was an unavoidable transfer rendering the subsequent new value defense unavailable. Second, because Touch of Grey was repaid in full for the new value it claims to have provided the estate, it is no longer entitled to the subsequent new value defense. The statutory context of section 547(c)(4) supports this interpretation. Lastly, it is against public policy and inequitable for Touch of Grey to recover under both section 547(c)(4) and section 503(b)(9) because it would then be receiving a double payment for the same value.

Section 365(d)(3) assigns to the Trustee obligations that arise under the lease. Touch of Grey claims that because the terms of the lease require payment in advance, they are owed rent for the entire rental period despite the lease having been rejected five days into the month. This is based on a misunderstanding of section 365(d)(3): the statute supports the lower courts' post-rejection prorating of rent. The "billing date" approach is not supported by the text and would lead to inequitable results. Further, it would undermine the Trustee's § 365 rejection power if the

rejection does not release the estate from post-rejection obligations. The approach most consistent with the statute, the common law—and common sense—is to compensate creditors only for services rendered. The lower courts were therefore correct to continue the tradition of post-rejection prorating rent.

ARGUMENT

I. The lower courts were correct to hold Touch of Grey could not recover both a section 503(b)(9) priority transfer and reduce its preference exposure under section 547(c)(4) for the same transaction.

This is a dispute about double-dipping. Section 547(c)(4) and section 503(b)(9) each serve to compensate creditors for goods and services provided to the debtor in the proximity of bankruptcy. 11 U.S.C. §§ 547(c)(4), 503(b)(9). However, the plain language of the statutes supports the intuitive inference: creditors are not entitled to duplicative compensation. Once the debt has been paid, it must be put to rest.

Section 547(c)(4) is the "subsequent new value defense". *Beaulieu Liquidating Tr. v. Fabric Sources, Inc.* (In re Beaulieu Grp., LLC), 616 B.R. 857, 866 (Bankr. N.D. Ga. 2020). It allows a creditor to reduce their preference exposure by the amount of new value they provided the debtor during the preference period, after they received a voidable preference. §547(c)(4). The subsequent new value defense is limited by section 547(c)(4)(B). This limit provides that a creditor cannot use the subsequent new value defense if the debtor made an otherwise unavoidable transfer to the creditor on account of the claimed new value. *Id*. In other words, a creditor that has provided new value may not reduce their preference exposure if they have received an unavoidable transfer on account of that new value.

Section 503(b)(9) allows a creditor to receive administrative priority for the value of any goods provided to the debtor, in the ordinary course of business, and within 20 days of filing for bankruptcy. §503(b)(9). A section 503(b)(9) priority expense is only granted by court approval. *Id*. A core dispute in this case is whether a section 503(b)(9) administrative expense granted by the Court is an "otherwise unavoidable transfer" for purposes of section 547(c)(4)(B).

The facts of the dispute are as follows. Debtor paid Touch of Grey a $250,000 preference, but in return Touch of Grey provided $200,000 of new value in goods. R. at 5-6. After the bankruptcy petition, the court approved a payment to Touch of Grey for $200,000 as a section 503(b)(9) administrative expense. R. at 7. Now, the trustee is seeking a return of the $250,000 as a voidable preference. R. at 8. If the section 503(b)(9) administrative expense is an "otherwise unavoidable transfer" under section 547(c)(4)(B), Touch of Grey will need to return the full $250,000 to the estate. Alternatively, if it is not, Touch of Grey will be able to keep the $200,000 administrative expense payment and reduce its preference liability to $50,000.

Plain language, statutory context, and policy considerations all favor affirming the lower courts' judgment that Touch of Grey cannot reduce its preference exposure by the amount of the section 503(b)(9) administrative priority. First, the plain and unambiguous language of the Code sections at issue show that a section 503(b)(9) administrative expense is an "otherwise unavoidable transfer" under section 547(c)(4)(B). Second, the statutory context of the provisions supports this conclusion and suggests that Touch of Grey is not entitled to a subsequent new value defense. Lastly, it would be inequitable and against public policy to allow Touch of Grey to double-dip by receiving an administrative priority payment and reduction of preference liability for same value in the same transaction.

A. The plain language of section 547(c)(4)(B) unambiguously bars the use of the new value defense when there is also a section 503(b)(9) transfer.

The plain language of the sections supports affirmation because section 503(b)(9) is an "otherwise unavoidable transfer" and section 547(c)(4)(B) is not limited to the pre-petition time period. "When the language of a statute has a plain and unambiguous meaning with regard to the particular dispute in the case and the statutory scheme is coherent and consistent, the inquiry is over." *Beaulieu Liquidating Trust*, 616 B.R. at 869 (internal citations omitted).

The two-hundred thousand dollar disbursement in this case falls under the textual plain meaning of a section 547(c)(4)(B) "otherwise unavoidable transfer." § 547(c)(4)(B). First, under a common sense construction, because the court ordered the amount to be paid in full and in a manner unavoidable by the estate, this was an "otherwise unavoidable transfer". *See Circuit City Stores, Inc. v. Mitsubishi Dig. Elecs. Am., Inc.* (In re Circuit City Stores, Inc.), 2010 Bankr. LEXIS 4398, at *30 (Bankr. E.D. Va. Nov. 30, 2010) (holding that because the section 503(b)(9) was unavoidable through the use of §§ 544, 545, 547, 548, 549, 553(b) or 724(a), it was an otherwise unavoidable transfer under section 547(c)(4)).

Second, under a textual parsing of the words "otherwise unavoidable transfer" the section 503(b)(9) administrative priority of $200,000 is covered. "Otherwise unavoidable" refers to all possible code provisions under which a transfer could be avoided, other than section 547(c)(4). This raises an issue of whether a section 503(b)(9) administrative priority transfer is "avoidable" under the code. Possible avoidance provisions include: §§ 544 (trustee's power to avoid transfers as certain types of creditors), 545 (trustee's power to avoid some statutory liens), 547 (trustee's power to avoid voidable preferences), 548 (trustee's power to avoid some fraudulent transfers), 549 (trustee's power to avoid certain postpetition transactions), 553(b) (trustee's power to avoid certain setoff activity) or 724(a) (trustee's power to avoid certain liens). 11 U.S.C. §§ 544, 545, 547, 549, 533(b), 724(a); *see Circuit City Stores, Inc.*, 2010 Bankr. LEXIS 4398, at *29. Because

a section 503(b)(9) administrative priority payment is not avoidable under any of these provisions, once it is approved by the court, the transfer in this case falls within the plain meaning of an otherwise unavoidable transfer.

A "transfer" is defined by the Code to include "each mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or an interest in property". 11 U.S.C. § 101(54)(D) (internal subdivisions omitted). This broad definition of "transfer" includes disbursements from the estate. *See Beaulieu Liquidating Trust*, 616 B.R. at 870; *Circuit City Stores, Inc.*, 2010 Bankr. LEXIS 4398, at *22-23. Thus, the plain language of an "otherwise unavoidable transfer" must include section 503(b)(9) administrative priority payments.

The language of section 547(c)(4)(B) contains no time limitation, nor does it limit the "otherwise unavoidable transfer" language to the 90-day preference period. The Code places two—and only two—limits on the subsequent new value defense: that the new value must "not be secured by an otherwise unavoidable security interest" and the debtor must not have made an "otherwise unavoidable transfer" to the creditor on account of the new value. § 547(c)(4); *see Beaulieu Liquidating Trust*, 616 B.R. at 871. The statute contains no time limit for when the "otherwise unavoidable transfer" must be made or claimed. Further, there is no statement or indication that the "otherwise unavoidable transfer" must be made pre-petition. To limit the meaning of "otherwise unavoidable transfer" to solely pre-petition conduct would be to read a temporal limit into section 547(c)(4) that is plainly not in the text of the provision. If Congress had intended for there to be a temporal limit to the "otherwise unavoidable transfer" clause, it would have added one explicitly.

Although section 547(c)(4)(B) specifies that "the *debtor*" makes the "otherwise unavoidable transfer", this language does not mean that section 547(c)(4)(B) is unavailable when an "otherwise unavoidable transfer" is made by the trustee or granted by the court. The Supreme Court has recognized that a debtor is not a completely distinct legal entity from the debtor's estate under the code. *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 528 (1984) (explaining that debtor's estate is not an entirely different legal entity than the debtor, rather it is "the same 'entity' which existed before the filing of the bankruptcy petition, but empowered by virtue of the Bankruptcy Code to deal with its contracts and property in a manner it could not have employed absent the bankruptcy filing"). Further, "[t]he fact that Debtor has transferred all its assets to a Trust does not mean Debtor is incapable of paying the section 503(b)(9) Claim. Any such payment would ultimately come from Debtor; the Trust is a pass-through vessel through which Debtor's assets flow pursuant to the Plan and Confirmation Order." *Beaulieu Liquidating Trust*, 616 B.R. at 870. Thus, although the provision says the "debtor," this does not support the inference that an "otherwise unavoidable transfer" from the trustee, estate, or through the bankruptcy court would not qualify for section 547(c)(4)(B).

Touch of Grey will likely argue that because section 547(c)(4)(B) was drafted in the past tense, it is only intended to have a pre-petition application. This argument is grasping at textual straws. First, "[w]hile in two instances in §547(c)(4) 'transfer' is clearly modified in a way referring back to the 90-day period, in the last instance, referring to the 'otherwise unavoidable transfer' issue here, it is not." *Friedman's Liquidating Tr. v. Roth Staffing Cos. LP* (In re Friedman's Inc.), 738 F.3d 547, 555 (3d. Cir. 2013). Second, courts have routinely rejected this argument because the tense of the clause does not change the meaning of the text: there is no cut off at the petition date or any other date listed in the provision. *See, e.g., id.*; *Beaulieu*

Liquidating Trust, 616 B.R. at 871. Using past tense alone to suggest a cut off at the petition date would be an unprincipled reading-in of an arbitrary date where the statute plainly contains no such restriction.

B. Statutory context further supports that Touch of Grey cannot recover both a new value preference exposure reduction under section 547(c)(4) and be paid in full under section 503(b)(9).

Statutory context bars Touch of Grey from the subsequent new value defense and clarifies that a section 503(b)(9) priority is an "otherwise unavoidable transfer". First, because Touch of Grey was paid in full for the value it provided the estate, it no longer qualifies for the subsequent new value defense. Second, statutory context supports that the section 503(b)(9) priority was an "otherwise unavoidable transfer". Lastly, contextual arguments that assessments of "otherwise unavoidable transfers" should be cut off at the petition date fail to be persuasive in light of the plain language as well as the statutory context.

Touch of Grey is claiming the subsequent new value defense despite having been paid in full for the new value given. R. at 8. Case law on the subsequent new value defense has split into two approaches: the "subsequent advance approach" and the "remains unpaid approach". *See, e.g., TI Acquisition, LLC v. S. Polymer, Inc.* (In re TI Acquisition, LLC), 429 B.R. 377, 382-83 (Bankr. N.D. Ga. 2010); Paul R. Hage & Patrick R. Mohan, *Is it Still New Value? Application of Section 503(b)(9) to the Subsequent New Value Preference Defense*, 19 J. BANKR. L. & PRAC. 4, Art. 7 (2010). Under either approach, Touch of Grey is not entitled to the subsequent new value defense.

The "subsequent advance approach" requires either that the new value claimed remain unpaid or not be secured by an unavoidable transfer. *See, e.g., TI Acquisition*, *LLC*, 429 B.R. at 383; *Circuit City Stores, Inc.*, 2010 Bankr. LEXIS 4398, at *23-26. The reasoning behind this

approach is that if the new value given by the creditor after the voidable preference has been repaid in full, then the debtor's estate has no longer been enriched at the expense of the creditor. *See TI Acquisition*, *LLC*, 429 B.R. at 382-84. Thus, because the section 503(b)(9) priority payment in this case repays the claimed new value in full and is unavoidable, as discussed above, Touch of Grey cannot claim the subsequent new value defense.

The "remains unpaid" approach requires that the new value remain unpaid to be claimed for the subsequent new value defense. *See, e.g., Phx. Rest. Grp., Inc. v. Ajilon Prof'l Staffing LLC* (In re Phx. Rest. Grp., Inc.), 317 B.R. 491, 498 n.1 (Bankr. M.D. Tenn. 2004) (listing authority cases on the "remains unpaid" approach); Paul R. Hage & Patrick R. Mohan, *Is it Still New Value? Application of Section 503(b)(9) to the Subsequent New Value Preference Defense*, 19 J. BANKR. L. & PRAC. 4, Art. 7 (2010). Because 503(b)(9) priority payment in this case repaid Touch of Grey's claimed new value in full, Touch of Grey is not entitled to the subsequent new value defense.

Moving to even broader statutory context, a section 503(b)(9) priority is emphatically an "otherwise unavoidable transfer" under section 547(c)(4)(B). First, there is no clear indication contextually that the "otherwise unavoidable transfer" under section 547(c)(4)(B) must occur pre-petition or at any other specific time. Many sections around section 547(c)(4) contain specific time constraints, even more strongly indicating that section 547(c)(4)(B) intentionally does not contain one limiting otherwise unavoidable transfers. §§ 547 (a)(4), (c)(1), (c)(5). For example, section 547(c)(5) contains a time limit, specifically limiting it to the pre-petition period. § 547(c)(5).

Further, a "preference" is defined as necessarily falling within the 90 days before the petition date for non-insiders. § 547(b)(4)(A). Whereas, the definition of a "transfer" does not

contain a time constraint. § 101(54)(D). If section 547(c)(4)(B) was intended to be limited to the pre-petition period, congress could easily have specified an "otherwise unavoidable preference" as opposed to an "otherwise unavoidable transfer". But, because Congress chose the word "transfer" as opposed to "preference", Congress did not intend the preference time-frame to be applied to section 547(c)(4)(B).

Context also supports that section 547(c)(4)(B)'s reference to "the debtor" does not limit the provision to the pre-petition debtor. The Code does not define a "debtor" as a pre-petition entity. § 101(13); *Friedman's Liquidating Tr.* 738 F.3d at 555. Further, many sections of the Code refer to "the debtor" in a post-petition context. See, e.g., §§ 329; 521; 522; 545. *Friedman's Liquidating Tr.* 738 F.3d at 555. For example, section 545 describes how the trustee may avoid the fixing of a statutory lien on the property of the debtor to the extent that such lien becomes first effective against the debtor when a bankruptcy case commences. 11 U.S.C. § 545(1)(A). "Effective against the debtor" in this section is not saying the statutory lien has to become effective only against the debtor and not the estate—it is referring to the debtor in a sense that may include the estate in some circumstances. § 545(1)(A). Similarly in this case, section 547(c)(4)(B) does not only refer to a transfer from the debtor, but rather is contextually able to include transfers from the estate.

Touch of Grey will argue that context suggests section 547(c)(4) is meant to be limited to pre-petition transfers. For example, cases have looked to section 547's title, "Preferences", as suggesting that it concerns transactions occurring during pre-petition preference period. *See, e.g.*, *Friedman's Liquidating Tr.* 738 F.3d at 555. A section title is not enough to create an implicit time frame for all content therein. *See Beaulieu Liquidating Trust*, 616 B.R. at 873 ("[A] title of a statute cannot trump the plain meaning of its text. Here, the text is plain and unambiguous.")

(internal quotations and citations omitted). Such a reading would render all other time limits in section 547 duplicative or ambiguous. Further, as discussed previously, section 547(c)(4) does concern preferences in that it is an exception to preference liability. Also, section 547(c)(4)(B) does not contain a time limit or use the term "preference" to limit its applicability.

Touch of Grey may also argue that because section 547(c)(4) has been read to cut off at the petition date in circumstances where the creditor is trying to add new value post-petition, it should be cut off post-petition for assessments of otherwise unavoidable transfers. *See, e.g.*, *Friedman's Liquidating Tr.* 738 F.3d at 557. But the issue is not as simple as treating creditors' actions post-petition the same as debtor's. *See Beaulieu Liquidating Trust*, 616 B.R. at 876-78 ("[P]ost-petition advances of new value to *the debtor* can be distinguished from post-petition payment *to the creditor* on account of new value."). First, under section 547(c)(4) a creditor contributing assessing new value is textually different from assessing if there was an otherwise unavoidable transfer. "New value" is defined separately. 11 U.S.C. § 547(a)(2). New value is created by a deliberate choice of the creditor to assist a debtor that may be financially struggling. In contrast, an otherwise unavoidable transfer of the debtor means that the debtor intended to make a transfer, but that failed because the transfer later returned. Also, creditors aiding the estate post-petition are provided special priority for payment from the bankruptcy estate. *See* 11 U.S.C. §§ 364, 503(b). Unless a petition-date time frame is read in for section 547(c)(4), the creditor can double-dip and receive a priority payment and preference exposure reduction under section 547(c)(4). *Beaulieu Liquidating Trust*, 616 B.R. at 876-78.

C. Statutory purposes are best served by not allowing Touch of Grey to double-dip and limiting its recovery payment under section 503(b)(9).

Double recovery under section 547(c)(4) and section 503(b)(9) would be inequitable and contrary to policy goals. The policy reasoning behind section 547(c)(4) is to encourage trade

creditors to continue dealing with troubled businesses and to treat creditors fairly if they have replenished the estate after having received a preference. *Friedman's Liquidating Tr.* 738 F.3d at 558. Similarly, section 503(b)(9) is also aimed at encouraging trade creditors to continue doing business with distressed debtors near the time of bankruptcy. *See Commissary Operations, Inc. v. Dot Foods, Inc.* (In re Commissary Operations, Inc.), 421 B.R. 873, 879 (Bankr. M.D. Tenn. 2010). In the pre-petition period, creditors are incentivized by both provisions to offer credit to struggling debtors. From their perspective, there is frequently no way to tell if they will qualify for a section 503(b)(9) priority or the subsequent new value defense. *See TI Acquisition*, *LLC*, 429 B.R. at 385. The incentive benefit of the sections is the same from a pre-petition perspective because creditors don't know if they will qualify for the provisions. *Id*. Because creditors are incentivized pre-petition without knowing if they will qualify for a provision, the purposes of the sections are served adequately by allowing the creditor to receive section 503(b)(9) or section 547(c)(4) benefits. *Id*. Further, the purpose of treating creditors fairly does not favor permitting creditors to receive both sections because then they receive more than payment in full under section 503(b)(9), they essentially receive a double payment. *Id.*; *Circuit City Stores, Inc.*, 2010 Bankr. LEXIS 4398, at *34.

Further, permitting Touch of Grey to recover through both section 547(c)(4) and section 503(b)(9) is essentially "double-dipping" and inequitable to other creditors. *See TI Acquisition*, *LLC*, 429 B.R. at 385 (emphasizing that it is inequitable for a fully paid creditor to use both section 503(b)(9) and section 547(c)(4)). Generally bankruptcy seeks to generally provide for equality among unsecured creditors. *See In re Bellanca Aircraft Corp.*, 850 F.2d 1275, 1280 (8th Cir. 1987).While Touch of Grey may argue that exceptions swallow the rule, section 547(c)(4) was a carefully tailored exception containing two limits. *See Friedman's Liquidating Tr.* 738

F.3d at 560. These limitations show that not all creditors who offer some new value are entitled to reduce their preference exposure. Rather, only those who meet the specific criteria are, in order to protect other creditors.

II. Section 365(d)(3) supports post-rejection prorating of rent, and does not require the Trustee to pay rent for the period after rejection of the lease.

When the trustee rejects a lease after the payment date, but before the end of the billing period, does section 365(d)(3) of the Bankruptcy Code obligate the trustee to pay rent for the entire billing period, or only the prorated portion of the rent prior to the rejection? *See* 11 U.S.C. § 365(d)(3). The trustee rejected the lease effective May 5th. R. at 7-8. The rent for the month of May was due on May 1st. R. at 7. Touch of Grey, in their capacity as landlord, argues that they are due the rent for the entire month—$25,000—under section 365(d)(3). R. at 8. The trial court held in favor of prorating rent to the period prior to rejection—and against the billing date approach—and was twice affirmed. *See* R. at 9, 21.

The contextual and policy arguments favor prorating rent. The history of post-rejection prorating is robust and consistent with legislative history. Post-rejection prorating also leads to convincingly better and more consistent outcomes than strict adherence to the billing date under the lease. Section B demonstrates that contextual and policy analyses favor the Trustee's position: the rent should be prorated to the days prior to the rejection.

Textualists need not beware: the analysis will begin with an assessment of whether the text is clear and unambiguous. If section 365(d)(3) unambiguously commands full payment of the rent required by the lease, no matter the rental period nor the Trustee's date of rejection, then

Touch of Gray is due the full month's rent. If the obligations that arise from 365(d)(3) are ambiguous, however, then contextual and policy inquiries are informing.

Whether the text of 365(d)(3) is ambiguous is a question that has divided many courts, both across and within circuits. *See, e.g., In re Victory Markets, Inc.*, 196 B.R. 6 (Bankr. N.D.N.Y. 1996); *In re All For A Dollar, Inc.*, 174 B.R. 358 (Bankr. D. Mass. 1994); *In re Child World, Inc.*, 161 B.R. 571 (S.D.N.Y.1993); *In re Ames Department Stores*, 150 B.R. 107 (Bankr. S.D.N.Y. 1993); *Daugherty v. Kenerco Leasing Co.* (In re Swanton Corp.), 58 B.R. 474 (S.D.N.Y. 1986). *But see Burival v. Roehrich* (In re Burival), 613 F.3d 810 (8th Cir. 2010); *In re Cukierman*, 265 F.3d 846, 847 (9th Cir. 2001); *In re Koenig Sporting Goods, Inc.*, 203 F.3d 986, 989 (6th Cir. 2000); *In re CCI Wireless, LLC*, 279 B.R. 590, 594 (Bankr. D. Colo. 2002); *In re Krystal Co.*, 194 B.R. 161, 164 (Bankr. E.D. Tenn. 1996); *In re Duckwall–ALCO Stores, Inc.*, 150 B.R. 965, 976 (D. Kan. 1993). The case law speaks in many voices, and thus the law's position on whether 365(d)(3) is ambiguous is itself ambiguous. Section A navigates the nested ambiguity to determine the extent to which a textual reading of the statute is satisfactory.

A. Section 365(d)(3) is ambiguous as to which obligations "arise".

The issue in large part hinges on whether or not Section 365(d)(3) is ambiguous. Judicial norms and canons of statutory interpretation maintain that unambiguous statutes must be applied in accordance with their literal meaning, while ambiguous statutes require interpretation. Ambiguous statutes invite the Court to exercise discretion by considering context, congressional intent, policy, and equity to achieve the best results. *See Reves v. Ernst & Young*, 507 U.S. 170, 177 (1993); *American Textile Mfrs. Institute, Inc. v. The Limited, Inc.*, 190 F.3d 729, 738–39 (6th Cir. 1999).

It is not a novel exercise to investigate Section 365(d)(3)'s ambiguity. For instance, in *In re NETtel*, the court analyzes the text of section 365(d)(3). 289 B.R. 486, 489 (Bankr. D.D.C. 2002). The court there observes that 365(d)(3) only addresses obligations which *arise* after the order for relief and prior to rejection. *Id*. at 490-92. The term "arising," the court holds, is ambiguous: it lends itself to use in the accrual sense, where a rental obligation *arises* under a lease based on the corresponding period of occupancy. *Id*. Under that interpretation, a landlord's entitlement to compensation is fixed to the actual days the tenant was entitled to occupancy. This interpretation, the court observes, tracks the practical and fundamental economic reality of the lease. *Id*. At the same time, the term "arising" could also be interpreted to defer to the contractual language in the lease.

Courts that have found no ambiguity have not backed their holdings with robust reasoning, and thus make for weak authority on this issue outside of their own jurisdictions. *See In re Koenig Sporting Goods*, 203 F.3d at 989; *HA-LO Indus. v. CenterPoint Props. Tr.*, 342 F.3d 794, 798 (7th Cir. 2003). The court in *In re Ames* observes that the line of cases that find no ambiguity inadequately discuss the issue of ambiguity in their holding, limiting their persuasive authority. *In re Ames Dep't Stores, Inc.*, 306 B.R. 43, 76 n.131 (Bankr. S.D.N.Y. 2004) ("After quoting section 365(d)(3), the Koenig court noted the split in authority on the issue, id., and went on to discuss the legislative history, id., before coming back to its conclusion that section 365(d)(3) is unambiguous. Why it discussed the legislative history, given its conclusion that section 365(d)(3) is unambiguous, is unclear."). For instance, the court in *HA-LO* skimps on the ambiguity analysis of section 365(d)(3), thereby failing to distinguish *In re Handy Andy*, one of the most influential cases in favor of prorating rent—which originates from the same circuit as *HA-LO*, yielding an inconsistent holding. *See id.* at 66-68.

A common sense linguistic approach illuminates why the courts have fairly reached incompatible conclusions. Section 365(d)(3) assigns the obligations arising from a lease to the trustee, but does not describe what those obligations are. Imagine a six month lease payable at the end of the rental period: does the trustee have no obligation to pay the rent if the rejection occurs on the fifth month? A proper understanding of section 365(d)(3) requires a firm definition of the obligations arising from the lease, and such a definition is not contained within the code.

Suffice it to say that the jurisprudence around section 365(d)(3) is messy. To untangle this mess, deference to the text itself is insufficient, as even the brightest courts have yielded opposite and incompatible interpretations of the same language. Section 365(d)(3) is ambiguous.

B. Prorating rent is the only approach to section 365(d)(3) lease obligations that makes sense.

The text of section 365(d)(3) is silent with regard to measuring the obligations that arise under the lease. *See* § 365(d)(3). Interpreting that calculation to impute benefits not actually conferred to the bankrupt entity grants the landlord an unnecessary windfall to the detriment of the estate, or in the case of chapter 7, to the detriment of the other creditors. As the Trustee, it is our position as a matter of law as well as a matter of equity that this court should continue the tradition of post-rejection prorating.

Post-rejection prorating is well-established and predates the enactment of section 365(d)(3). *See, e.g., Child World*, 161 B.R. at 575–76 (referring to "the long-standing practice under § 503(b)(1) of prorating debtor-tenant's rent to cover only the postpetition, prerejection period, regardless of billing date."). Absent a clear indication from Congress, established bankruptcy practice should not be changed. *See Cohen v. de la Cruz*, 523 U.S. 213, 118 (1998). Section 365(d)(3) contains no such indication.

The purpose of section 365(d)(3) is to give landlords additional protection. In many ways, landlords are in the same position as trade creditors in dealing with the bankrupt entity. Judge Posner reasons that while most creditors are dealing with the debtor voluntarily and assuming the risk, the automatic stay prevents the landlord from evicting the tenant. *In re Handy Andy Home Improvement Ctrs., Inc.*, 144 F.3d 1125, 1127 (7th Cir. 1998). Thus section 365(d)(3) allows the landlord the rent they are due as an administrative expense, rather than a general unsecured claim under section 365(g), to secure and simplify their recovery. *In re Montgomery Ward Holding Corp.*, 268 F.3d 205, 214 (3d Cir 2001) (Mansmann, J., dissenting); *Child World*, 161 B.R. at 575–76. On the contrary, the Congressional intent behind the enactment of section 365(d)(3) "was aimed at providing landlords with current pay for current services and relieving them from the "actual and necessary" analysis required under § 503(b)(1)." *In re Montgomery Ward*, 268 F.3d at 215 (Mansmann, J., dissenting).

The protection for landlords offered by 365(d)(3) does not include compensation for services not rendered. No other creditor is allocated a claim for services or goods that were not given to the estate. Interpreting 365(d)(3) to give landlords payment for portions of the lease that the estate has no legal entitlement to use would be inconsistent with the rest of the code.

The billing date approach is fundamentally based on the assessment that "an obligation that accrues over time does not arise as it accrues, but instead arises at whatever time the parties specify in their lease." *Id*. at 215. This results in a windfall either to the landlord or the tenant—imagine the billing period was not every month, but every six months. To avoid the wild and arbitrary outcome of the billing date approach, courts have long preferred post-rejection prorating. *See, e.g., id.*; *In re Victory Markets, Inc.*, 196 B.R. 6; *In re All For A Dollar, Inc.*, 174 B.R. 358; *In re Child World, Inc.*, 161 B.R. at 576 (observing that allowing landlords to recover

for pre-petition services billed post-petition "would grant landlords a windfall payment, to the detriment of other creditors"); *In re Ames Department Stores*, 150 B.R. 107; *Daugherty*, 58 B.R. 474 (prorating rent although lease called for *yearly* rental payments). While the billing date approach is a possible reading of section 365(d)(3), Judge Posner in *Handy Andy* concludes that it is "neither inevitable nor sensible." *In re Handy Andy Home Improvement Ctrs., Inc.*, 144 F.3d at 1127.

Touch of Grey will likely argue that the parties contracted for payment on the first of the month, and so the court should adhere to the letter of the contract. This argument mistakes the bankruptcy process for informal out-of-court restructurings. The bankruptcy code supersedes ordinary contract terms: the trustee is empowered by Congress to assume or reject executory contracts including leases, section 365(a), and this power to restructure the estate and divide it among the creditors' interests cannot be dampened by preferences written into the lease.

If the court were to adopt a rule of deference to the terms of the lease, the fate of many restructuring attempts will hinge on the arbitrary date of, and interval between, lease payments. The bankruptcy code is a flexible and powerful tool to preserve and create value out of insolvent entities. It is crucial that the rejection power of the trustee keeps its teeth. If prompt rejection of a lease does not reduce the amount of rent due for the remainder of the billing period, then the trustee is rendered impotent to terminate leases that burden the estate.

Further, if the Court finds Terrapin Station (debtor) liable for the full month's rent, the same rule of deference would find a debtor liable for none of the rent if it had been instead due at the end of the month. This result would be absurd, and demonstrates that the

"billing date" rule would not serve to protect landlords in the long run. Prorating the rent yields a sensible result consistent with Congress' goals.

Touch of Grey will also argue that the language of section 365(d)(3), requiring timely performance, puts the burden on the trustee to reject prior to the billing date in order to avoid paying it. But this rule would encourage opportunism by the trustee, contrary to the interests of both parties and the restructuring process. For instance, the trustee would reject contracts right before the bill becomes due, encouraging parties to contract around shorter billing cycles, raising their transaction costs to create no value.

Alternatively, if the Court seeks to interprets the obligations "arising" out of section 365 to require strict deference to the terms of the lease, the Court should still not require payment of post-petition rent. The lease specifies that the $25,000 is an "advance" for the full month. After the lease is rejected, the portions of an advance not used must be returned as property of the estate. Section 365(d)(3) support post-rejection prorating as a matter of law—but the rent due for five days of tenancy is the same regardless of interpretation.

CONCLUSION

Both of the questions presented in this case create the possibility for a creditor to receive a windfall from the estate not due to them under the Bankruptcy Code. The U.S. Bankruptcy Code should be interpreted in a manner consistent with its text. The section 547(c)(4) subsequent new value defense is a tool to compensate trade creditors who have gone unpaid. It is not a license for creditors to double dip—and so it is not available here to Touch of Grey. Touch of Grey has already been paid in full for the claimed new value. Additionally, section 365(d)(3)

supports post-rejection prorating. Touch of Grey is due rent for the period of tenancy, and not for the period after the lease was rejected. This Court should affirm the decisions of the lower courts.