No. 21-0909

IN THE

Supreme Court of the United States

OCTOBER TERM, 2021

IN RE TERRAPIN STATION, LLC, DEBTOR,

TOUCH OF GREY ROASTERS, INC., PETITIONER,

v.

CASEY JONES, CHAPTER 7 TRUSTEE, RESPONDENT.

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

BRIEF FOR RESPONDENT

Team Number 46
Counsel for Respondent

QUESTIONS PRESENTED

I. Whether a creditor can assert the subsequent new value defense under 11 U.S.C. § 547(c)(4) to reduce its preference exposure when, after providing such new value to the debtor, the creditor has been paid in full by the debtor for this new value pursuant to a court-ordered and Code authorized administrative expense under 11 U.S.C. § 503(b)(9).

II. Whether a debtor's postpetition rent obligation under a noncommercial lease befallen upon a trustee owed to a landlord-creditor pursuant to 11 U.S.C. § 365(d)(3) should be determined by a prorated, benefit-proportional basis, accruing per diem until the lease rejection date, aligning with the intent of the section and principles of the Bankruptcy Code.

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The Thirteenth Circuit Court of Appeals' decision is available at No. 20-0803 and reprinted at Record 2. The United States Bankruptcy Court for the District of Moot ruled in favor of Trustee on both issues. On appeal, the United States Court of Appeals for the Thirteenth Circuit affirmed in favor of Trustee on both issues.

STATEMENT OF JURISDICTION

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

RELEVANT STATUTORY PROVISIONS

11 U.S.C. § 365 Executory Contracts and Unexpired Leases

(a) – (c) [omitted]
(d)
(1) – (2) [omitted]
(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.
(4) [omitted]
(e) – (p) [omitted]

11 U.S.C. § 503 Allowance of Administrative Expenses

(a) [omitted]
(b) After notice and a hearing, there shall be allowed administrative expenses, other than claims allowed under 502(f) of this title, including—
(1) – (8) [omitted]
(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.
(c) [omitted]

11 U.S.C. § 547 Preferences

(a) [omitted]
(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—
(1) to or for the benefit of a creditor;
(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
(3) made while the debtor was insolvent;
(4) made—
(A) on or within 90 days before the date of the filing of the petition; or
(B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and
(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—
(1) – (3) [omitted]
(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;
(5) [omitted]
(d) – (j) [omitted]

11 U.S.C. § 549 Postpetition Transactions

(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.

(b) – (d) [omitted]

STATEMENT OF THE CASE

I. FACTUAL HISTORY

A. Terrapin Station, LLC and Touch of Grey Roasters, Inc. Enter into a Franchise Agreement Requiring Terrapin Station, LLC to Sell Specific Touch of Grey Roasters, Inc. Products and Diversify Terrapin Station, LLC's Current Business Model.

In fall 2017, Terrapin Station, LLC, ("Debtor") and Touch of Grey Roasters, Inc., ("Touch of Grey") (collectively known as the "Parties") entered into a business relationship to sell and distribute a line of Touch of Grey's coffeehouse products through Debtor's locally owned coffeehouse. R. at 3. Debtor's coffeehouse was founded in 2005 by Mr. William Tell ("Tell") in the Town of Terrapin, Moot. R. at 3. Touch of Grey operates an international chain of coffeehouses, consisting of more than 1,900 locations. R. at 3.

After experiencing a plateau in sales, Debtor entered into a franchise agreement with Touch of Grey, providing Debtor would 1) close its current coffeehouse; 2) open a new coffeehouse under the franchise agreement with Touch of Grey; and 3) purchase Touch of Grey's new line of coffee products (the "Dark Star" line) and sell them at the new franchised location. R. at 4. Touch of Grey, as franchisor, purposefully avoided branding its newly franchised coffeehouses as Touch of Grey coffee shops, and instead, focused its efforts on franchising the stores with locally owned and existing coffeehouses. R. at 4. In addition, the "Dark Star" line of coffee products was not one of Touch of Grey's recognizable or popular product lines; therefore, customers were unlikely to realize they were purchasing Touch of Grey's products while patronizing Debtor's coffeehouse. R. at 4. In addition to selling the "Dark Star" products, the agreement also specified Debtor's coffeehouse would provide expanded menu options and more nightlife entertainment opportunities by expanding business hours. R. at 4. This franchise agreement was entered into by the parties on July 1, 2018. R. at 4.

B. Touch of Grey Purchases a Warehouse to Serve as the New Coffeehouse and Subsequently Leases the Space to Debtor.

The franchise agreement required Debtor to close its existing coffeehouse and reopen at a different location. R. at 4-5. Touch of Grey agreed to purchase a warehouse space (the "Premises") and subsequently lease the Premises to Debtor for the purpose of operating the new coffeehouse. R. 4. The Parties entered into a twenty-year, triple-net lease agreement (the "Lease") on July 1, 2018, the same day the franchise agreement was signed, listing Debtor as tenant and Touch of Grey as landlord. R. at 4. The Lease contained a clause stating the $25,000 per month rent was "due in advance on the first day of each month." R. at 4. Renovations were completed by November of 2018, and the new Terrapin Station Coffeehouse opened on December 1, 2018, the same day Debtor closed its original coffeehouse. R. at 5.

C. Debtor Encounters Financial Difficulties After Opening New Terrapin Station Coffeehouse, Subsequently Leading to Debtor's Chapter 11 Bankruptcy Filing and Forcing Attempts at Reorganization.

Unfortunately, Debtor encountered numerous financial difficulties after negative public reception of the extended nightlife concept and its franchise agreement with Touch of Grey—a national coffee conglomerate. R. at 5. By September 2019, Debtor could not pay its debts, and by November 1, 2019, it owed Touch of Grey over $700,000 for previously purchased "Dark Star" products. R. at 5. On December 5, 2019, Touch of Grey sent a notice of default to Debtor, warning of possible termination of the franchise agreement. R. at 5. Nevertheless, on December 7, 2019, Touch of Grey agreed to forbear terminating the franchise agreement if Debtor 1) paid $250,000 of the $700,000 it owed Touch of Grey for inventory (which Debtor paid that same day); 2) reaffirmed its obligations under the lease; and 3) released any and all claims or causes of action it had against Touch of Grey. R. at 5. On December 18, 2019, Debtor purchased an additional

$200,000 worth of "Dark Star" products on credit, for which Tell executed a personal guarantee. R. at 5-6. These products were delivered to Debtor on December 21, 2019. R. at 6.

After efforts to increase sales failed, on January 5, 2020, Debtor filed a petition for relief under chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the District of Moot. R. at 6. At that time, the Lease obligations were current; however, Debtor owed Touch of Grey $650,000 for previously purchased goods and owed an additional $500,000 in unsecured debt to other unsecured creditors. R. at 6. Debtor, supported by declaration from Tell, also filed "first day" motions, including Debtor's intent to 1) return to traditional coffeehouse operations and hours; 2) find a sub-lessee to decrease its personal rental obligations; and 3) continue selling "Dark Star" products per the franchise agreement. R. at 6.

In support of its reorganization plan, Debtor motioned the court for authority to pay Touch of Grey $200,000 as a "critical vendor" and to encourage Touch of Grey to continue selling goods to Debtor on credit. R. at 6. Debtor contended this payment would be applied to the Invoice and was entitled to "priority in payment as an administrative expense pursuant to § 503(b)(9)," and would thus not prejudice any other creditor. R. at 7. The United States Trustee opposed Debtor's motion, however, counsel for the creditors' committee supported the motion in light of Touch of Grey's significant role in Debtor's reorganization. R. at 7.

In ruling on these issues, the bankruptcy court declined to approve the $200,000 payment as a critical vendor payment but did allow Debtor to make the $200,000 payment as an administrative expense under § 503(b)(9). R. at 7. After this payment was made, Touch of Grey continued to sell the Debtor goods on credit. R. at 7.

D. Debtor's Reorganization Efforts Fail and a Newly Appointed Trustee Challenges Touch of Grey.

Despite Debtor's efforts, its attempts at reorganization were unsuccessful. R. at 7. On May 5, 2020, Debtor ceased operations and vacated the Premises, returning its keys to Touch of Grey. R. at 7. On May 6, 2020, Debtor filed a motion to reject the lease and franchise agreement. R. at 7. In response, Touch of Grey filed a motion on May 8, 2020, seeking to compel payment of the entirety of the May 2020 rent. R. at 7. Touch of Grey claimed the totality of the rent was due as of May 1st, and thus was due and owing prior to the date of rejection of the lease. R. at 7-8. On May 29, 2020, a hearing was held on the issue, wherein Debtor announced the conversion of its case from a chapter 11 reorganization to a chapter 7 liquidation. R. at 8. Subsequently, a trustee ("Trustee") was appointed over Debtor's estate. R. at 8. Additionally, the bankruptcy court upheld Debtor's motion to reject the lease and franchise agreement as of May 5, 2020, requiring additional briefing on the issue of the May rental payment. R. at 8.

The newly appointed Trustee took issue with Touch of Grey's contentions regarding the rent payment and the ability to reduce its preferential exposure. R. at 8. Trustee maintained payment of the entirety of May's rent under § 365(d)(3) was inequitable due to Debtor's occupancy of the Premises for only five days of the month. R. at 8. Additionally, Trustee moved to avoid and recover the $250,000 paid to Touch of Grey as a preferential transfer under §§ 574(b) and 550(a). R. at 8. Touch of Grey responded, stating it was "entitled to reduce any preference exposure by the $200,000 it sold to Debtor" under § 574(c)(4). R. at 8.

II. PROCEDURAL HISTORY

The bankruptcy court ruled in favor of Trustee on both issues, finding 1) Debtor was only required to pay Touch of Grey an administrative expense in the amount of $4,032.26 for the five days of May rent; and 2) Touch of Grey could not reduce its preferential exposure by using the

$200,000 worth of goods it subsequently sold to Debtor given "the Invoice was paid pursuant to section 503(b)(9)." R. at 9. Accordingly, the bankruptcy court entered a judgment of $250,000 against Touch of Grey. R. at 9. The United States District Court for the District of Moot and the United States Court of Appeals for the Thirteenth Circuit affirmed the rulings of the bankruptcy court on both issues.

STANDARD OF REVIEW

The facts herein are undisputed by the parties, and as such, this appeal concerns issues of law. R. at 9. In a bankruptcy appeal, issues of law are reviewed *de novo*. Carr v. Cross Keys Bank (*In re* Padco Pressure Control, L.L.C.), 797 F. App'x. 893, 894 (5th Cir. 2020). Under a *de novo* standard of review, a reviewing court will contemplate questions of law as if it were the original trial court. Ky Emples. Ret. Sys. V. Seven Ctys. Servs., 550 B.R. 741, 752 (W.D. Ky. 2016).

SUMMARY OF THE ARGUMENT

The Court should affirm both decisions rendered by the Court of Appeals for the Thirteenth Circuit on both issues presented. Bankruptcy courts are courts of equity, and an inherent pillar of bankruptcy law is the equal treatment of similarly situated creditors. The rationale behind a bankruptcy court's equitable power is to prevent substance from giving way to form and to ensure justice will prevail over technicalities and habit. A cornerstone of bankruptcy policy is the equitable distribution of the bankruptcy estate among affected creditors. It is integral to the purpose of the Bankruptcy Code that similarly situated creditors be placed on equal footing and no creditor be elevated to a financial status above its analogous counterparts. To give a creditor favored treatment would run afoul of the fair and equitable tenants that form the foundation of bankruptcy law.

One way the Bankruptcy Code and bankruptcy courts facilitate the goal of equity and fairness is by allowing a trustee to avoid preferential payments made by a debtor to a creditor. A preference, in bankruptcy, is the transfer of a debtor's property or assets to one creditor that is not made available to other creditors. These preferential transfers intrinsically diminish the bankruptcy estate to the disadvantage of other creditors. Section 547(b) of the Bankruptcy Code authorizes a trustee to claw back certain prepetition payments made to a creditor and restore those funds to the bankruptcy estate to be equitably divided among all creditors. This action constitutes one of the avoiding powers assumed by a bankruptcy trustee.

In response to a trustee's ability to avoid a preferential transfer, a creditor may assert a litany of affirmative defenses under § 547(c). Among these available defenses is the subsequent new value defense under § 547(c)(4). This defense precludes a trustee from avoiding a prepetition transfer when, after such transfer, the creditor provides new value to the debtor. The subsequent new value defense allows a creditor to limit its preference exposure by subtracting from the total preference payment the value of goods or services provided to the debtor following the debtor's preferential payment to the creditor. Explicit in this defense is the requirement that, on account of said new value, the debtor did not make an **otherwise unavoidable transfer**.

Pursuant to § 549(a)(2)(B), a trustee may not avoid a transfer that is authorized under the Bankruptcy Code or ordered by the bankruptcy court. These transfers are deemed "otherwise unavoidable transfers" for purposes of analyzing the validity of a subsequent new value defense under § 547(c)(4). Therefore, when analyzing the validity of a creditor's subsequent new value defense under § 547(c)(4), a court must first categorize the type of payment in question to determine if it is in fact an unavoidable transfer.

In the case at bar, Debtor made a $200,000 postpetition payment to Touch of Grey. This payment was made pursuant to § 503(b)(9), which authorizes a court to order the payment of administrative expenses for the value of goods received by the debtor from the creditor within 20 days of the filing of the bankruptcy petition. A postpetition payment made from a debtor to a creditor under § 503(b)(9) is a prime example of an unavoidable transfer under § 549(a)(2)(B). The $200,000 transfer made from Debtor to Touch of Grey is thus an unavoidable transfer under § 549(a)(2)(B), as it was both authorized under the Code through § 503(b)(9) and was ordered by the United States Bankruptcy Court for the District of Moot.

Given the categorization of this $200,000 payment as an unavoidable administrative expense, Touch of Grey is prohibited from utilizing this payment to assert a subsequent new value defense under § 547(c)(4). As stated, a necessity of § 547(c)(4) is that the debtor did not make an otherwise unavoidable transfer on behalf of the new value it received from the creditor. Here, Debtor clearly made an otherwise unavoidable transfer when it subsequently paid Touch of Grey $200,000 for the new value it received from Touch of Grey within 20 days of Debtor's bankruptcy filing. It is clear the $200,000 payment made to Touch of Grey is a transfer made under § 503(b)(9) and is thus an unavoidable transfer per § 549(a)(2)(B). Thus, Touch of Grey's attempt to reduce its preference exposure on behalf of these sums fails under § 547(c)(4). As such, this Court should affirm the decision of the Thirteenth Circuit, holding § 547(c)(4) precludes Touch of Grey from asserting new value for goods subject to a satisfied administrative expense under § 503(b)(9), as such payment is an "otherwise unavoidable transfer" under § 549(a)(2)(B).

Further, allowing Touch of Grey to utilize the court ordered and Code authorized payment to assert a subsequent new value defense would constitute double recovery for Touch of Grey. Essentially, Touch of Grey would be compensated by Debtor and subsequently allowed to use that

compensation to offset its preference liability. This act of "double dipping" places Touch of Grey in a better position than similarly situated creditors and is plainly contrary to the equitable principles of bankruptcy law. When a preferential transfer, such as the one herein, is made, it does not simply reduce the bankruptcy estate—it does so unjustly.

A key inquiry when analyzing a subsequent new value defense is whether the new value replenishes the bankruptcy estate. In order for the estate to have been replenished by the new value, the new value must remain unpaid. If the new value is subsequently paid for, the debtor is utilizing assets from the bankruptcy estate to preferentially compensate a certain creditor. This reduces the bankruptcy estate to the disadvantage of other creditors and results in the paid creditor being put in a better position than its counterparts. Therefore, allowing Touch of Grey to assert a subsequent new value defense under § 547(c)(4) for new value that was paid for in full pursuant to § 503(b)(9) would contradict the inherent principles of equity and fairness that form the foundational purpose of bankruptcy law. Thus, this Court should affirm the decision of the Thirteenth Circuit, holding § 547(c)(4) precludes Touch of Grey from asserting new value for goods subject to a satisfied administrative expense under § 503(b)(9) as it would result in a "double recovery" to Touch of Grey's benefit, putting it in a better position than similarly situated creditors.

The United States Bankruptcy Court for the District of Moot, the United States District Court for the District of Moot, and the Court of Appeals for the Thirteenth Circuit all correctly decided the second issue before the Court. This issue asks this Court to consider Trustee's obligations under 11 U.S.C. § 365(d)(3) relating to May's postpetition, prerejection rent due under the Lease.

Prior to 1984, the Bankruptcy Code placed landlords in a precarious position as a creditor postpetition. The automatic stay affords a debtor the luxury of ceasing financial obligations

postpetition, which, pre-1984, included rent due to a landlord under a noncommercial, not yet rejected, lease. Landlords were forced to continue renting the property in question to the debtor, to allow the debtor's estate to continue operations of their business, before acceptance or rejection of the lease by the trustee. Congress passed § 365(d)(3) in an effort to ensure landlords are afforded current consideration in exchange for existing services rendered to debtors pending the acceptance or rejection of the lease, after which possession is returned back to the landlord.

A plain reading and application of § 365(d)(3) has sparked a split among circuit courts. The majority of courts applying the section have viewed a trustee's responsibility in regard to rent due to a landlord-creditor to be limited on a prorated, proportional basis. Namely, the trustee is only liable for postpetition, prerejection rent until a noncommercial lease is either accepted or rejected. This approach is known as the "proration approach." Conversely, a minority of judiciaries have interpreted the section to demand full term payment of rent incurred postpetition, prerejection, irrespective of the date of the month the lease is rejected. This approach is known as the "billing date approach." In this case, the United States Bankruptcy Court for the District of Moot and the United States District Court for the District of Moot found in favor of Trustee, siding with a majority of its sister courts and applying the proration approach, determining Trustee is only responsible for rent from May 1 to May 5. On appeal, the Court of Appeals for the Thirteenth Circuit upheld this ruling.

Section 365(d)(3) states, in part, a "trustee shall timely perform all the obligations of the debtor . . . arising from and after the order for relief under any unexpired lease of nonresidential real property until such lease is assumed or rejected. . . ." The existence of a split amongst circuits is evidence of the inherent ambiguity in the plain language of the statute. This Court has previously held a lack of ambiguity within a statute estops inquiry. However, when ambiguity rears its head

as to impede a statutes application, a court may look beyond its plain reading and examine legislative intent and practical implications.

The terms "obligation" and "arises" are ambiguous when reading and applying § 365(d)(3). The Bankruptcy Code has proven itself to be poignant in its word choice, yet this section utilizes the term "obligation;" verbiage not defined within the Code itself. An obligation under the purview of this section of the Code applies to a litany of financial liabilities that befall a trustee. This interpretation is congruent with the application of the proration approach in situations involving rent due to a landlord-creditor or other expenses, including, *inter alia*, real estate taxes. It is also unclear when an obligation actually arises. Proponents of the billing date approach allege an obligation comes due upon the date of billing of the obligation itself. The legislative intent of the statute is to ensure landlord-creditors are provided **current** pay for current services **until** the lease is rejected. Therefore, an accruing obligation compounded per diem aligns with this intent, as it ensures when the rental of a property is provided as a **current** service, the landlord receives consideration. But when the lease is rejected by the trustee, the service is no longer current and payment ceases. This Court should affirm the decision rendered by the Thirteenth Circuit and hold the proration approach not only applies to rent as an obligation due to a landlord-creditor, but that the obligation accrues as a per diem expense until current services are rendered moot by the rejection of the lease. This Court should hold for the Trustee.

Further, the doctrines of equity and fairness preclude a landlord from receiving a windfall as consideration and be placed on a postpetition pedestal above similarly situated creditors. The proration approach, as applied through § 365(d)(3), ensures a landlord is not receiving rental payment beyond the rejection date when a service is no longer provided. Collecting a full month's payment for five days of rent of a property allows a landlord-creditor to receive a windfall—

reaching beyond the constraints of both the plain reading of § 365(d)(3) and its legislative intent to provide current payment for ongoing services. Lastly, upon rejection of the lease by a trustee, a landlord is relinquished from its position as an involuntary creditor required to provide a service to a bankrupted debtor. Therefore, it becomes a voluntary creditor. This approach is in harmony with the legislative intent of the section and the aims and principles of the Bankruptcy Code by safeguarding the doctrines of fairness and equity amongst similarly situated creditors. Thus, this Court should affirm the decision rendered by the Thirteenth Circuit and hold the proration approach under § 365(d)(3) appropriate. This Court should rule in favor of Trustee on both issues.

ARGUMENT

I. THE THIRTEENTH CIRCUIT PROPERLY HELD § 547(C)(4) PRECLUDES A CREDITOR FROM ASSERTING NEW VALUE FOR GOODS SUBJECT TO A SATISFIED ADMINISTRATIVE EXPENSE UNDER § 503(B)(9).

This Court should affirm the decision of the Thirteenth Circuit, holding § 547(c)(4) precludes Touch of Grey from asserting new value for goods subject to a satisfied administrative expense under § 503(b)(9), as such payment is an "otherwise unavoidable transfer" under § 549(a)(2)(B). Furthermore, allowing Touch of Grey to utilize this defense would result in a "double recovery" to Touch of Grey's benefit, putting it in a better position than similarly situated creditors.

An overarching premise of the Bankruptcy Code is to treat similarly situated creditors equally. *See* Union Bank v. Wolas, 502 U.S. 151, 161 (1991). When a creditor receives payment shortly before the bankruptcy petition is filed, this creditor has been given preference and has been put in a better position than other, similarly situated creditors. "A preference, in law, is the assignment of an interest in one's property or assets to one creditor that is not made available to all creditors." *Preference*, THE WOLTERS KLUWER BOUVIER LAW DICTIONARY (Desk Ed., 2012).

To remedy this inequity, § 547(b) of the Bankruptcy Code authorizes a trustee to avoid a preferential transfer of interest in the debtor's property to a creditor by "clawing back" these payments and returning them to the bankruptcy estate to be split among the affected creditors. This action constitutes one of the avoiding powers of the trustee and ensures that creditors are on "equal footing" for the purposes of distributing the bankruptcy estate. *See* 11 U.S.C. § 926; *see also* Wiscovitch-Rentas v. PDCM Assocs., S.E. (*In re* PMC Mktg. Corp.), 518 B.R. 150, 156 (B.A.P. 1st Cir. 2014).

Under § 547(c), a creditor can assert various defenses in response to the trustee's avoidance of a preferential transfer under § 547(b). One of these available defenses, known as the subsequent new value defense, precludes a trustee from avoiding a transfer under the following circumstances:

> (c) . . .
>
> (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)(A)-(B). The subsequent new value defense allows a creditor to reduce its preference exposure by subtracting from the total preference payment the value of goods or services provided to the debtor following the debtor's preferential payment to the creditor. Inherent in a debtor's ability to claim a defense under § 547(c)(4) is that the transfer made was not an "otherwise unavoidable transfer." If the subsequent payment is deemed to be unavoidable, § 547(c)(4) does not apply and the trustee is authorized to avoid the transfer.

In 2005, the Bankruptcy Code enacted § 503(b)(9), which entitles a creditor to an administrative expense for the value of goods sold to and received by the debtor within 20 days of the petition date. 11 U.S.C. § 503(b)(9). Courts are split as to whether a creditor can assert a

subsequent new value defense under § 547(c)(4) when that value was paid in full pursuant to § 503(b)(9). However, a majority of courts hold that a creditor cannot reduce its preference exposure using value that was paid in full by the debtor under § 503(b)(9). An administrative expense paid pursuant to § 503(b)(9) is a postpetition payment and thus requires the bankruptcy court to assess § 549 of the Bankruptcy Code. Section 549, titled *Postpetition Transactions*, allows a trustee to avoid a transfer made after the filing of the petition which, *inter alia*, is not a transfer that has been authorized by the bankruptcy court or the Bankruptcy Code. *See* 11. U.S.C. § 549(a)(2)(B). Thus, a postpetition transfer that does not constitute a payment under § 549 is an unavoidable transfer.

This brief will analyze the relationships between §§§ 503(b)(9), 547(c)(4), and 549(a)(2)(B) in order to assess the legitimacy of Trustee's ability to avoid the $200,000 postpetition payment made to Touch of Grey. In doing so, this brief will explain how a payment made under § 503(b)(9) is both authorized by the bankruptcy court and the Bankruptcy Code, and is thus an unavoidable transfer under § 549, disqualifying its use for a defense under § 547(c)(4). Further, this brief will address the issue of double recovery when a creditor asserts a subsequent new value defense for goods that are paid postpetition pursuant to § 503(b)(9). Allowing Touch of Grey to proffer a subsequent new value defense for goods that have been paid for in full pursuant to § 503(b)(9) would put Touch of Grey in a better position than similarly situated creditors, which is inherently contrary to the tenants of bankruptcy law.

A. Debtor's § 503(b)(9) Postpetition Payment to Touch of Grey Was Ordered by the Bankruptcy Court and Authorized by the Bankruptcy Code and is thus an Unavoidable Transfer Under § 549(a)(2)(B).

Touch of Grey is precluded from asserting a subsequent new value defense under § 547(c)(4) to reduce its preference exposure on behalf of Debtor's $200,000 payment because such

payment was ordered by the bankruptcy court and authorized under § 503(b)(9); therefore, this payment is an unavoidable transfer under § 549(a)(2)(B).

1. Debtor's $200,000 Payment to Touch of Grey Under § 503(b)(9) was a Postpetition Payment Ordered By the Bankruptcy Court and Authorized Under the Bankruptcy Code.

   11 U.S.C. § 503(b)(9) provides:

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

11 U.S.C. § 503(b)(9). A payment made pursuant to § 503(b)(9) is a postpetition payment that is authorized by the Bankruptcy Code. Beaulieu Liquidating Tr. v. Fabric Sources, Inc. (*In re* Beaulieu Grp., LLC), 616 B.R. 857, 869 (Bankr. N.D. Ga. 2020). A plain reading of the statute permits a court to order a postpetition payment for certain goods provided to the debtor by the creditor.

In the present case, Debtor received $200,000 worth of Dark Star product from Touch of Grey on December 21, 2019. R. at 5-6. Fifteen days later, on January 5, 2020, Debtor filed for chapter 11 bankruptcy. R. at 6. Therefore, this delivery of goods occurred within the requisite 20-day, prepetition time period, allowing the court to order payment for these goods under § 503(b)(9) as an administrative expense. Following the commencement of this bankruptcy case, the district court herein ordered such payment for these goods pursuant to § 503(b)(9). R. at 7. As such, the $200,000 postpetition payment made to Touch of Grey by Debtor was both authorized by the bankruptcy court and under § 503(b)(9) of the Bankruptcy Code.

2. Under § 549(a)(2)(B), Debtor's $200,000 Postpetition Payment to Touch of Grey is an Unavoidable Transfer.

Treatment of Debtor's postpetition payment to Touch of Grey requires the Court to look to section § 549 of the Bankruptcy Code: *Postpetition Transactions*. *See* 11 U.S.C. § 549. Under §

549(a)(2)(B), a trustee may avoid a postpetition transfer so long as, *inter alia*, the transfer was NOT authorized by the bankruptcy court or under the Bankruptcy Code. Still v. Rossville Bank (*In re* Chattanooga Wholesale Antiques, Inc.), 67 B.R. 899, 902 (Bankr. E.D. Tenn. 1986). A trustee's power to avoid postpetition transfers is authorized under § 549; however, "one class of transactions excepted from that power is transfers authorized by the court." Vogel v. Russell Transfer, Inc., 852 F.2d 797, 800 (4th Cir. 1988).

In Vogel v. Russell Transfer, Inc., a trustee sought to avoid a debtor's postpetition, court-approved sale of security interests to a creditor. Id. at 797-98. The trustee relied on § 549 to support its contention that avoiding this transaction was proper. Id. at 798. The court disagreed, holding § 549, by its terms, expressly prohibited the trustee from avoiding this transfer because it was specifically authorized by the court. Id. at 800.

The facts herein mimic the court-authorized transfer in Vogel. In the present case, the bankruptcy court ordered Debtor to pay an administrative expense to Touch of Grey for the $200,000 worth of goods received by Debtor within 20 days of commencement of this proceeding. R. at 7. This payment was expressly ordered by the bankruptcy court, and therefore is not a transfer eligible for avoidance under § 549.

In this case, however, Trustee's ability to avoid this transfer also fails under § 549 because it was not only ordered by the bankruptcy court but was also authorized under the Bankruptcy Code. As referenced above, *In re* Beaulieu Grp. LLC held a postpetition payment ordered under § 503(b)(9) is authorized by the Bankruptcy Code. This is exactly the situation presented here: the bankruptcy court explicitly ordered the $200,000 payment, citing it as an administrative expense under § 503(b)(9). R. at 7. Debtor's $200,000 postpetition payment to Touch of Grey was both

ordered by the bankruptcy court and authorized by the Bankruptcy Code under § 503(b)(9). Stated simply, the $200,000 postpetition payment is an unavoidable transfer under § 549(a)(2)(B).

3. Touch of Grey is Unable to Assert a Subsequent New Value Defense Under § 547(c)(4) on Behalf of Debtor's $200,000 Postpetition Payment, as this Payment is an Otherwise Unavoidable Transfer.

As Debtor's $200,000 payment to Touch of Grey is an unavoidable transfer under § 549(a)(2)(B), Touch of Grey is unable to assert a subsequent new value defense on behalf of this payment. Courts have relied on Collier on Bankruptcy, one of the most comprehensive and extensive resources in bankruptcy law, which explains:

> [I]f subsequent new value has been paid by a payment that is itself avoidable, then it should still qualify as subsequent new value for purposes of section 547(c)(4). . . . However, to the extent that the debtor made an unavoidable transfer on account of the new value, the "new value" defense does not apply. In this regard, section 547(c)(4) should not provide a defense to the extent that a preference transferee received "critical vendor" payments for the subsequent new value, or received administrative expense payments under section 503(b)(9).

Gonzales v. Sun Life Ins. Co. (*In re* Furr's Supermarkets, Inc.), 485, B.R. 672, 726-27 (Bankr. D.N.M. 2012). (citing 5 COLLIER ON BANKRUPTCY ¶547.04[4][e]). Similarly, the United States Bankruptcy Court for the Northern District of Georgia has held:

> [W]hen a creditor has a claim under § 503(b)(9) and a defense under § 547(c)(4) and when the debtor has established reserves to pay administrative claims in full, then that reserve constitutes an "otherwise unavoidable transfer" by the debtor, and the new value represented by the § 503(b)(9) claim cannot be used to offset the creditor's preference liability.

In re Beaulieu Grp., LLC, 616 B.R. at 878. In *In re Beaulieu Grp., LLC*, a creditor sold and delivered $1,088,942.67 worth of goods to a debtor during the 90-day preference period; of which $160,088.92 worth of those goods were delivered within 20 days of filing the bankruptcy petition. Id. at 861. As such, the creditor was entitled to a § 503(b)(9) administrative expense claim for the $160,088.92 worth of goods. Id. at 865-66. When the trustee filed a complaint seeking to avoid and recover this preferential transfer made by the debtor, the creditor filed an answer and

counterclaim, asserting the subsequent new value defense under § 547(c)(4). The creditor contended that proposing a defense under § 547(c)(4) did not preclude the creditor from also receiving a distribution for an administrative claim under § 503(b)(9) for these same funds. Id. at 859.

The court disagreed, holding "'a creditor that delivered goods to the debtor pre-petition is not entitled to the new value defense under § 547(c)(4) when that creditor has been paid in full by a § 503(b)(9) claim.'" Id. at 866 (quoting TI Acquisition, LLC v. S. Polymer, Inc. (*In re* TI Acquisition, LLC), 429 B.R. 377, 385 (Bankr. N.D. Ga 2010). Relying on the court's reasoning in *In re TI Acquisition, LLC*, the *Beaulieu* court noted that when administrative claims under § 503(b)(9) are paid in full, these claims are analogous to reclamation claims under § 546(c) because the "new value" does not enhance the bankruptcy estate. Id. at 866. Therefore, allowing a creditor to utilize the subsequent new value defense when that creditor has been paid in full for the new value goods, would be inequitable and contrary to the purpose of the statute. Id. (citing *In re* TI Acquisition, LLC, 429 at 385.) Ultimately, the court held a creditor could not rely on the subsequent new value defense to offset its preference liability on behalf of administrative claims paid in full under § 503(b)(9). Id. at 878.

In the present case, Touch of Grey provided new value to Debtor on December 21, 2019, when it delivered $200,000 worth of "Dark Star" products to Debtor, pursuant to the December 18, 2019, invoice. R. at 5-6. This transfer was made within 20 days of Debtor filing its petition for bankruptcy, thus qualifying it for an administrative expense claim under § 503(b)(9). The bankruptcy court authorized payment under § 503(b)(9) for the $200,000 worth of goods. R. at 7. Debtor fulfilled its payment obligation to Touch of Grey within days of the court entering its order authorizing the § 503(b)(9) administrative claim. R. at 7.

The $200,000 payment from Debtor to Touch of Grey was an otherwise unavoidable, postpetition transfer under § 549(a)(2)(B), as it was paid after the filing of the petition and was a transfer authorized by both the bankruptcy court and Bankruptcy Code. Following *Beaulieu* and *TI Acquisition LLC*, Touch of Grey is unable to assert a subsequent new value defense under § 547(c)(4) on behalf of this $200,000 payment. Because the $200,000 § 503(b)(9) claim was paid in full by Debtor, the new value provided by Touch of Grey did not enhance the bankruptcy estate. Thus, it would be inequitable and in opposition to the purpose of § 547 for Touch of Grey to assert a subsequent new value defense on behalf of this payment. When viewing §§§ 503(b)(9), 549(a)(2)(B), and 547(c)(4) together, it is evident that the $200,000 postpetition payment made by Debtor to Touch of Grey is an otherwise unavoidable transfer, and therefore, the Thirteenth Circuit properly held Touch of Grey cannot utilize these sums to assert a subsequent new value defense to offset its preference liability.

B. Allowing Touch of Grey to be Paid in Full for Value Given to Debtor Under § 503(b)(9), While Simultaneously Using that Value to Lessen its Preference Exposure, Would Constitute Double Recovery and Put Touch of Grey in a Better Position Compared to Similarly Situated Creditors.

Allowing Touch of Grey to minimize its preference exposure for value that was paid in full by Debtor pursuant to § 503(b)(9) would allow Touch of Grey to receive double recovery for this transfer. This act of "double dipping" is explicitly contrary to an inherent tenant of bankruptcy law: the equal treatment of similarly situated creditors. Union Bank, 502 U.S. at 161. One of the main principles of the Bankruptcy Code is to secure equal distribution amongst creditors. Howard Delivery Serv. v. Zurich Am. Ins. Co., 547 U.S. 651, 655 (2006). A preferential transfer does not simply reduce the bankruptcy estate, it does so unjustly. *In re* Kroh Bros. Dev. Co., 930 F.2d 648, 652 (8th Cir. 1991). Therefore, a trustee's ability to avoid a preferential transfer is necessary to ensure equal distribution of assets among creditors. Id. Preferential treatment of a class of creditors

is only proper when that treatment has been authorized by Congress. Howard Delivery Serv., 547 U.S. at 655.

The subsequent new value defense prevents a trustee from avoiding a debtor's payment to a creditor when 1) the creditor has given new value to the debtor following the payment; 2) the payment was not secured by an otherwise unavoidable security interest; and 3) on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor. 11 U.S.C. § 547(c)(4). Section 547(c)(4) has typically been interpreted to require three elements: 1) the creditor must have given new value to the debtor after receiving payment from the debtor; 2) the new value must not be secured; and 3) the new value must remain unpaid. *In re* Jet Fla. Sys., 841 F.2d 1082, 1083 (11th Cir. 1988).

The question under § 547(c)(4) is "whether the new value replenishes the estate." Harrah's Tunica Corp., v. Meeks (*In re* Armstrong), 291 F.3d 517, 526 (8th Cir. 2002). (quoting Kroh, 930 F.2d at 652). A creditor who provides new value to a debtor after receiving payment should not be deemed to have diminished the bankruptcy estate to the disadvantage of other creditors. Id. However, when a creditor is subsequently paid for the new value received by the debtor, the bankruptcy estate has not been replenished, and in fact, the estate has been reduced. This puts the "new value" creditor in a better position than other similarly situated creditors. Kroh, 930 F.2d at 652. In order to stay in conformity with the equitable distribution tenant of bankruptcy law, the bankruptcy estate must not be harmed by a postpetition transfer.

Further, in asserting a subsequent new value defense, it is inherent that the new value remains unpaid, otherwise the estate has been adversely affected. Id. at 778 (citing Prescott, 805 F.2d. at 728). "An unavoidable post-petition transfer on account of new value extended subsequent to a preference should limit the use of § 547(c)(4) by the amount of the unavoidable transfer, as

without reduction in the new value offset, the transferee would be receiving double use of the new value." *In re* Furr's Supermarkets, Inc., 485 B.R. at 729. (quoting MMR Holding Corp. v. C & C Consultants (*In re* MMR Holding Corp.)), 203 B.R. 605 (Bankr. M.D. La. 1996)).

Thus, the rationale behind the subsequent new value defense is that "to the extent new value is offered, the preference is repaid to the estate." Paloian v. Quad-Tech, Inc. (*In re* GGSI Liquidation, Inc.), 313 B.R. 770, 777 (Bankr. N.D. Ill 2004). (quoting *In re* Prescott, 805 F.2d. 719, 727 (7th Cir. 1986)). In *In re GGSI Liquidation*, a creditor received a $827,832.90 payment from a debtor within the 90-day pre-filing preference period. Id. Following this payment, the creditor advanced $804,244 worth of goods to the debtor. Id. The debtor subsequently paid the creditor $720,833 for these goods. Id. Upon the debtor filing its bankruptcy proceeding, the trustee attempted to avoid the $827,832.90 payment received by the creditor during the 90-day preference period. Id. at 772. However, the creditor asserted a subsequent new value defense under § 547(c)(4), claiming its delivery of $804,244 worth of goods constituted new value and prevented the trustee from avoiding this portion of the transfer. Id. at 773.

The court held the creditor could only assert a new value defense for the portion of the $804,244 worth of goods that remained unpaid by the debtor ($83,411). Id. at 777. Thus, the creditor could not advance a new value defense for the $720,833 payment the debtor had provided after receiving the goods. Id. at 777-78. The court held the creditor was only entitled to a new value defense worth $83,411, as this was the only portion of the transfer that remained unpaid. Id. at 779. The court relied on Seventh Circuit precedent to support its contention that new value must remain unpaid in order to qualify as a defense under § 547(c)(4). Id. at 778.

In the present case, Debtor owed Touch of Grey $700,000 as of November 1, 2019, for Dark Star-branded goods. R. at 5. On December 7, 2019, Debtor paid $250,000 to Touch of Grey

on behalf of this debt. R. at 5. This payment was made within 90 days of Debtor's bankruptcy filing, and as such, was a preferential payment that is avoidable under § 547(b). However, on December 18, 2019, Debtor and Touch of Grey entered into an invoice wherein Touch of Grey provided Debtor with an additional $200,000 worth of product. R. at 5. This initial advance was new value provided to Debtor by Touch of Grey.

However, at the end of January 2020, pursuant to an administrative claim under §503(b)(9), Debtor paid Touch of Grey $200,000 for the new product received under the invoice. R. at 7. Thus, the new value advanced by Touch of Grey did not remain unpaid. Because Touch of Grey received subsequent payment for this new value, the bankruptcy estate was diminished by $200,000 and Touch of Grey was put in a better position than similarly situated creditors. Therefore, Touch of Grey is unable to assert a subsequent new value defense on behalf of this $200,000 payment. This payment is an "otherwise unavoidable transfer," and therefore, must be reinstated to the bankruptcy estate in order to ensure equitable treatment amongst all similarly situated creditors and prevent double recovery by Touch of Grey.

II. THE THIRTEENTH CIRCUIT CORRECTLY HELD TRUSTEE SHALL ONLY BE RESPONSIBLE FOR A PRORATED, BENEFIT-PROPORTIONAL PAYMENT OF THE UNEXPIRED TOUCH OF GREY LEASE.

This Court should affirm the decision rendered by the United States Court of Appeals for the Thirteenth Circuit and hold Trustee only responsible for a prorated, proportional payment for the unexpired Touch of Grey Lease. Codified within the Bankruptcy Code, § 365 enumerates a trustee's ability to either accept or reject a non-expired, commercial lease, depending on its impact on the estate. *See* 11 U.S.C. § 365(a); *see also* Mission Prod. Holdings v. Tempnology, LLC, 139 S. Ct. 1652, 1658 (2019) (explaining a trustee can reject a lease and "repudiat[e] any further performance of its duties" if the lease is not beneficial to the estate). Unexpired leases and their

respective lessors are inevitable collateral damage following the petition of a debtor-lessee. *See* Matter of Handy Andy Home Improvement Ctrs., Inc., 144 F.3d 1125, 1128 (7th Cir. 1998) ("[T]he landlord [is] in an awkward spot during the interval between the entry date of the tenant into bankruptcy and the tenant's decision to assume or reject the unexpired lease.").

The ramifications and corresponding trustee duties relating to unexpired leases of a debtor are codified in detail within § 365(d)(3), which provides, in part:

> The trustee shall timely perform all of the obligations of the debtor . . . arising from and after the order for relief under any unexpired lease of nonresidential real property, until such lease is assumed or rejected, notwithstanding section 503(b)(1) . . . .

11 U.S.C. § 365(d)(3).

Prior to the enactment of § 365(d)(3), lessors were forced to minimize harm through lease provisions drafted to protect against tenants who declared bankruptcy. Victoria Kolthari, *11 U.S.C. § 365(D)(3): A Conceptual Status Argument for Proration*, 13 AM. BANKR. INST. L. REV. 297, 299 (2005). However, debtor-friendly financial safeguards, like the automatic stay, significantly hindered a lessor's ability to recover postpetition rent. *See* id. In 1984, Congress passed § 365(d)(3) to remedy unpaid commercial lessors who were providing postpetition debtors "**current** services—[i.e.,] use of property, utilities, security, and other services—without **current** payment" until the assumption or rejection date. 130 CONG. REC. S8887, 8895 (daily ed. June 29, 1984) (statement of Sen. Hatch) (**emphasis** added).

Courts are inherently bifurcated when interpreting the plain language of this section. The majority of judiciaries have chosen to follow the "proration approach." *See e.g.*, Matter of Handy Andy, 144 F.3d at 1128; El Paso Props. Corp. v. Gonzales (*In re* Furr's Supermarkets, Inc.), 283 B.R. 60 (B.A.P. 10th Cir. 2012). Namely, a trustee's duties require the payment of "only those amounts due under a lease that pertain to the benefits realized by the estate during the postpetition,

prerejection period regardless of when the payment became due." *In re* Travel 2000, 264 B.R. 444, 446 (Bankr. W.D. Mich. 2001). This contrasts with a minority of courts, which use the "billing date approach." *See e.g.*, Centerpoint Properties v. Montgomery Ward holding Corp. (*In re* Montgomery Ward Holding Corp.), 268 F.3d 205 (3rd Cir. 2001); Koenig Sporting Goods, Inc. v. Morse Rd. Co. (*In re* Koenig Sporting Goods, Inc.), 203 F.3d 686 (6th Cir. 2000). The billing date approach requires trustees to make payments in full of "any amount due under a lease in the postpetition, prerejection period . . . without regard to whether the payment pertains to prepetition or postrejection benefit." *In re* Koenig Sporting Goods, Inc. v. Morse Rd. Co. (*In re* Koenig Sporting Goods, Inc.), 229 B.R. 388, 390 (B.A.P. 6th Cir. 1999).

The Thirteenth Circuit correctly sided with the majority in holding the prorated approach is the best path forward in the case at bar. This brief will provide support for the application of the prorated approach because the use of the terms "obligation" and "arises" within § 365(d)(3) is inherently ambiguous. Thus, the section was adeptly interpreted by the Thirteenth Circuit after an analysis of its legislative history and intent, as well as its real-world application. Additionally, this brief will show that the principles of equity and fairness require this Court to apply the prorated approach in order to avoid Touch of Grey receiving a windfall payment for days beyond the rejection date of the Lease, when Debtor realized no benefit or consideration in exchange. Finally, this brief will explain how prorating Debtor's May rent ensures Touch of Grey is not placed on a postpetition pedestal, rendering it superior to other similarly situated creditors after the rejection of the Lease. The inherent ambiguity within § 365(d)(3)'s plain language, combined with the requirement to adhere to doctrines of fairness and equity—both aims and principles of the Bankruptcy Code—direct this Court to uphold the decision rendered by the Thirteenth Circuit and prorate the rent owed to Touch of Grey by Trustee until the rejection date of May 5.

A. The Plain Language of § 365(d)(3) is Ambiguous and Thus Does Not Expressly Require Trustee to Compensate Touch of Grey for an Entire Month of Rent Obligation.

The Thirteenth Circuit correctly found ambiguity within the text of § 365(d)(3) and interpreted its instructions appropriately in applying the proration approach. Ordinarily, "a legislature says in a statute what it means and means in a statute what it says," with a mandated deference for courts to follow such an assumption. Conn. Nat. Bank v. Germain, 503 U.S. 249, 253-54 (1992). Should the plain language of a statute be unambiguous, "judicial inquiry is complete." Id. at 254. However, when a statute's verbiage is inherently ambiguous, a court is well within its discretion to lift the veil of the plain text and investigate the true legislative intention of its purpose. *In re* Phar-Mor Inc., 290 B.R. 319, 324 (Bankr. N.D. Ohio 2013) (citations omitted). Courts have previously held the plain language of § 365(d)(3) is inherently ambiguous as to whether a trustee is liable for an entire month's rent payment under an unexpired lease or, alternatively, a pro-rated, per diem responsibility for a benefit actually conferred upon a debtor-lessee. *See e.g.*, *In re* Furrs Supermarkets, 283 B.R. at 66.

Touch of Grey will undoubtedly rely on the minority courts' claims that the terms of § 365(d)(3) are clear and unambiguous, and should be applied without further analysis, as judicial inquiry would be complete. *See e.g.*, *In re* Koenig Sporting Goods, 203 F.3d at 989. This argument categorically turns a blind eye to the reality of the discussion at bar. Based on the evident circuit split in the interpretation of § 365(d)(3), it logically follows that the plain language of the statute is inherently ambiguous. *See In re* Furrs Supermarkets, 283 B.R. at 70, n.8 ("The existence of a split in the circuits in the interpretation of § 365(d)(3) is, in itself, evidence of the ambiguity in the language.") (citing *In re* Southern Star Foods, Inc., 144 F.3d 712, 715 (10th Cir. 1998)).

1. The Term "Obligations" Under § 365(d)(3) is Ambiguous; Therefore, There is No Distinction Between Tax Obligations and Rent Obligations in its Interpretation as Applied to the Touch of Grey Lease.

The Thirteenth Circuit was correct in its interpretation of § 365(d)(3) since the term "obligation" is not defined in the context of the section. Further, it is unclear when any "obligation" actually "arises" as applicable to Debtor's obligation of rent payment to Touch of Grey. Section 365(d)(3) is fraught with ambiguity. "[S]tatutory language, like other language, should be read in context." Matter of Handy Andy, 144 F.3d at 1128 (citations omitted). The section must be viewed in context as both language on a page and through the lens of the real-world application in which the provision is realistically applied. *See* id. (referring to § 365(d)(3) and stating if courts turn a blind eye to its real-world application when determining its meaning, "silliness results."). The Thirteenth Circuit correctly applied the prorated approach after interpreting the inherent ambiguity present in the text.

Section 365(d)(3) governs tenant-debtor's outstanding obligations to a landlord-creditor between the time of petition and the date of rejection. *In re* Travel 2000, 264 B.R. at 446. However, despite the term "obligation" being the epicenter of the section's intent and language, the Bankruptcy Code is bereft of a definition for the term. *See* id. at 450. Absent a definition, and when read in context, an "obligation" within the purview of the section refers to a litany of outstanding obligations potentially owed by a tenant-debtor; including both rent and taxes. *See* *In re* Montgomery Ward, 268 F.3d at 212 (finding no clear legislative intent to delineate between any potential obligation of a tenant-debtor within the meaning of § 365(d)(3)).

The prorated approach has been applied by a majority of courts, many times, in situations where a tenant-debtor owes a real estate tax obligation to a landlord-creditor for sums amounting within the postpetition, prerejection period. *See e.g.*, Matter of Handy Andy, 144 F.3d 1125 (using the proration approach for the payment of property taxes billed to debtor during the postpetition,

prerejection period). Undoubtedly, the distinction between taxes and rent owed will be a lynchpin upon which Touch of Grey will rely to illuminate the inapplicability of the proration approach in the present case. Real estate taxes, unlike monthly rent, are sunk costs for landlords, meaning their payment is inevitable whether there is a renter or not. *See* id. Some courts have relied on this logic and held the billing date approach is preferred in situations where postpetition rent is due the first of the month and the rejection date falls mid-month. *See e.g.*, HA-LO Indus. Inc. v. Centerpoint Properties Tr., 342 F.3d 794, 798-99 (7th Cir. 2003). In *HA-LO Indus. Inc.*, the Seventh Circuit declined to follow its own circuit's precedent in *Matter of Handy Andy*. *See* id. In comparing taxes and rent, the court reasoned real estate taxes are "sunk costs" that relate to the prepetition period. Id. at 799. Conversely, rent pertains to the "consumption of a resource during the administration of the estate." Id.

Notwithstanding the similarities of the facts here and those in *HA-LO Indus. Inc.* (the debtor in *HA-LO* also rejected the lease and vacated the premises days after their monthly rental obligation became due), there is no basis within § 365(d)(3) to substantiate the delineation between the two expenses. A plethora of financial obligations befall a trustee during the postpetition, prerejection period of a commercial lease and land within the purview of § 365(d)(3), including both taxes and rent. *Compare* id. (pertaining to a rental obligation), *with* Matter of Handy Andy, 144 F.3d at 1126 (pertaining to a real estate tax obligation). Nowhere in the plain reading of the section does the word "obligation" draw a distinction between the two concepts. *In re* Montgomery Ward Holding Corp., 268 F.3d at 212 ("Tax reimbursement obligations are only a small constellation in the universe of obligations coming within the scope of § 365(d)(3), and **there is no basis in the text for distinguishing them from rent and numerous other obligations of tenants**.") (**emphasis** added).

2. The Term "Arises" Under § 365(d)(3) Is Ambiguous, And When Applied In Context Of the Section's Legislative Purpose, Supports Prorating the Rent Due to Touch of Grey.

The Thirteenth Circuit correctly hold the term "arises" is inherently ambiguous. Further, an analysis of the legislative intent behind § 365(d)(3), as well as its real-world application, requires prorating rent obligations for the first five days of May. Along with "obligations," an equally vague term within § 365(d)(3), is "arises." The term under this section takes on one of two definitions: "[a]n 'obligation' can 'arise' when it [1)] becomes due and payable[,] or [2)] when it accrues." *In re* Travel 2000, 264 B.R. at 450 (citations omitted).

A majority of courts have held postpetition, prerejection obligations, including rent, should be prorated as each per diem expense accrues, "regardless of the fortuity of the billing date." *See* Child World, Inc. v. Campbell/Mass. Trust (*In re* Child World Inc.), 161 B.R. 571, 576 (S.D. N.Y. 1993). This is because using the billing date to determine when an obligation "arises" runs contrary to both the legislative history of § 365(d)(3) and Congress' true intent of its application. *See* id. ("Those few courts which have interpreted § 365(d)(3) as providing that the billing date determines when lease obligations arise have produced results which, given the legislative history, we cannot believe were intended by Congress."). The split among circuits delineates clear evidence of the ambiguity of the section, and thus further analysis of its legislative history and its real-world application is required. *Compare In re* Furrs Supermarkets, 283 B.R. at 70, n.8 ("The existence of a split in the circuits in the interpretation of § 365(d)(3) is, in itself, evidence of the ambiguity in the language."), *with* Roberts v. Sea-Land Servs., Inc., 566 U.S. 93, 101 (2012) ("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."), *and* Matter of Handy Andy, 144 F.3d at 1128-29 (emphasizing the importance of evaluating the legislative history § 365(d)(3) and its applicability in the real-world to solve the section's ambiguity).

To determine the definition of "arises," the Court must turn to the Congressional intent behind § 365(d)(3). Congress intended § 365(d)(3) to remedy a landlord who was previously "forced to provide current services . . . without current payment." 130 CONG. REC. lS8887, 8895 (daily ed. June 29, 1984) (statement of Sen. Hatch). After the section's enactment, landlord-creditors were entitled to a tenant-debtor's "timely performance . . . pending the trustee's assumption or rejection of the lease." Id. If the billing date (i.e., the first of the month) were to determine when obligations were to arise postpetition, prerejection, the consideration paid by the tenant-debtor would extend beyond a trustee's rejection of the lease and would no longer be remedying current services without current payment. This approach would be contrary to the intent of § 365(d)(3).

However, if a rental obligation is viewed as a per diem expense accruing each day for a current service (i.e., rent of a property) provided to a tenant-debtor until a trustee rejects the lease, then landlord-creditors would be equitably paid current payment for current services. This latter reading § 365(d)(3) aligns with both Senator Hatch's quoted Congressional intent of the section, as well as the plain reading of the statute itself. *Compare* id. (Senator Hatch stating: "This timely performance requirement will ensure that debtor-tenants pay their rent, common area, and other charges on time pending the trustee's assumption or rejection of the lease."), *with* 11 U.S.C. § 365(d)(3) ("The trustee shall timely perform all of the obligations of the debtor . . . **until** such lease is assumed or rejected . . . .") (**emphasis** added).

Read in conjunction, the terms "obligation" and "arises" in § 365(d)(3) require the proration of rent owed to Touch of Grey under the Lease. Touch of Grey was providing a current service postpetition, prerejection in May: rental of the Premises. R. at 7. The outstanding rent owed by Trustee on behalf of Debtor is an obligation within the meaning of § 365(d)(3). However, that

service was only a "**current** service" for the first five days of May, until the lease was rejected by Trustee. R. at 7-8. Because the legislative intent of § 365(d)(3) is to remedy a landlord-creditor for timely payment for current services, the only time that should be evaluated when determining the amount owed is the five days during which the current service was provided. Each day, a current service was provided, i.e., rental of the Premises; therefore, each day, a new obligation for those current services accrued.

In a real-world application, if this Court utilized the first of the month as the date the obligation of rent due "arises," the application would run afoul of the legislative intent. Touch of Grey, as a landlord-creditor, would be compensated for services that were not "current services," as Debtor had vacated the Premises the same day the Lease was rejected. R. at 7. Additionally, the Court would be turning a blind eye to both Senator Hatch's commentary of Congressional intent and the plain language of the section, indicating the obligation arises "until" or "pending" the rejection of the lease. *See* 130 CONG. REC. S8887, 8895 (daily ed. June 29, 1984) (statement of Sen. Hatch) (indicating § 365(d)(3) calls for "timely performance . . . **pending** the trustee's assumption or rejection of the lease") (**emphasis** added); *see also* 11 U.S.C. § 365(d)(3) ("The trustee shall timely perform all of the obligations of the debtor . . . **until** such lease is assumed or rejected . . . .") (**emphasis** added). The Thirteenth Circuit correctly held there was ambiguity in the terms "obligation" and "arises" in § 365(d)(3). To remedy the ambiguity required further analysis to determine a proper meaning of these terms. R. at 16-18. After analyzing the legislative intent of § 365(d)(3), and the real-world application of the possible meanings of the word "arises" as it relates to rent "obligations," the Thirteenth Circuit was correct in finding the proration approach aligns with the object and reading of the section.

B. Compensating Touch of Grey Using the Proration Approach, Instead of the Billing Date Approach, Aligns with the Principles of the Bankruptcy Code.

1. Compensating Touch of Grey for an Entire Month's Rent Would Provide Touch of Grey with a Windfall.

The Thirteenth Circuit was correct in utilizing the proration approach to ensure Touch of Grey did not receive a windfall through payment of thirty days of rent for the Lease that was rejected five days into the month of May. Under the former Bankruptcy Act, landlord-lessors were estopped from collecting balances due under unexpired commercial leases as a result of the debtor-lessee's automatic stay. Kolthari, *supra* at 299. When Congress amended the previous provisions surrounding unexpired leases and their postpetition, prerejection treatment, it did so in an attempt to provide landlords with timely payment "**for services due** under an unexpired lease." Newman, et al. v. McCrory Corp. (*In re* McCrory Corp.), 210 B.R. 934, 936 (S. D. N.Y. 1997) (**emphasis** added). Congress was forced to strike a balance between the precariously placed creditor-landlords and the resource-strapped debtor-tenants. Since the inherent purpose of a bankruptcy case is to **equally** distribute debtor resources amongst creditors, "'statutory priorities are narrowly construed.'" *In re* Koenig, 229 B.R. at 396 (Rhodes, J. dissenting) (quoting Tr.'s of the Amalgamated Ins. Fund, v. McFarlin's, Inc., 789 F.2d 98, 100 (2d Cir. 1998)).

Section 365(d)(3) requires a trustee to fulfill obligations of an unexpired lease for nonresidential real property "**until** such lease is assumed or rejected." 11 U.S.C. § 365(d)(3) (**emphasis** added). The use of the word "until" denotes payment of the lease ceases when the lease is rejected. By allowing a landlord-creditor to receive money as consideration after rejection of the lease, the tenant is compensating the landlord for a service not otherwise received: rental of the property in question. *See Windfall*, BLACK'S LAW DICTIONARY (11th ed. 2019) (defining "windfall" as: [a]n unanticipated benefit . . . in the form of a profit and not caused by the recipient."). This compensation "would grant landlords a windfall payment . . . without any support from the legislative history" of the statute. *In re* Child World Inc., 161 B.R. at 576. The legislative

history simply does not support a landlord windfall as "Congress intended the subsection to put a landlord on equal footing, not to grant them a windfall at the expense of other creditors." *In re* McCrory, 210 B.R. at 940.

Not only does payment as consideration for a benefit not received contradict the legislative history of § 365(d)(3), but the landlord also possesses the capability of renting the empty property postrejection. If the rejection date is only a few days into the start of a month, as it is in the present case, a landlord can secure another renter for the property. Should a landlord receive a full month's rent for a property only occupied for five days, plus receive a monthly rental payment from a new renter, the landlord would be unjustly enriched for the rental of a singular property.

Touch of Grey will likely argue finding a renter five days into a month is a difficult feat; after all, Trustee was in control of setting the rejection date of the Lease. However, a "lessor has a duty to mitigate its damages." Unsecured Creditors' Comm. of Highland Superstores, Inc. v. Strobeck Real Estate, Inc. (*In re* Highland Superstores, Inc.), 154 F.3d 573, 577 (6th Cir. 1998). Irrespective of when a trustee rejects a lease during a given month, a landlord-creditor cannot claim damages against an estate without the effort to mitigate them first. Put simply, a rejection date on the last day of the preceding month versus the 5th day at issue provides no greater "leg up" for the landlord in finding a replacement tenant when no attempt was made to mitigate at all. A landlord-lessor is required, by law, to find a subsequent renter as a method of mitigation. The record herein is void of any instance of Touch of Grey taking any affirmative steps to mitigate its damages. Allowing a landlord to "double dip" by taking advantage of both the billing date approach *and* a subsequent renter's lease results in an unacceptable windfall.

A pro-landlord windfall is not the only type of windfall that arises under the billing date approach. Suppose an annual lease obligation was due one day prior to the petition date; under the

minority view's billing date approach, the creditor-landlord would not be entitled to any payment, as none of the payment became due postpetition, prerejection. *See* *In re* Child World, 161 B.R. at 576 (citing *In re* Appletree Markets, Inc., 139 B.R. 417 (S.D. Tex. 1993) as an example of a debtor-inherited windfall using the billing date approach because rent was due one day prior to the petition date and composed almost entirely of the prerejection period). Regardless of who benefits from the windfall, "the structure and purposes of the Bankruptcy Code as a whole, as well as simple common sense, suggest that the statute [§ 365(d)(3)] should not be interpreted to require the payment of a windfall." *In re* Koenig, 229 B.R. at 396 (Rhodes, J. dissenting).

By utilizing the billing date approach, Touch of Grey, as a landlord-creditor, would receive a windfall through payment of thirty days rent for the Lease that was rejected five days into May. Debtor's lease required the rent be paid in monthly increments on the first of each month. R. at 4. All parties concede the rejection of the Lease by Trustee was effective May 5. R. at 7-8. That same day, Debtor vacated the Premises and Touch of Grey retained full agency and possession. R. at 7. The plain reading of § 365(d)(3) mandates Trustee is responsible for financial obligations "**until** [the] lease is . . . rejected." 11 U.S.C. § 365(d)(3) (**emphasis** added). Payment beyond May 5 would be a windfall to Touch of Grey as it would constitute consideration paid for the rent of a property not actually occupied or leased by Debtor.

2. The Proration Approach Ensures Touch of Grey is Treated the Same as Similarly Situated, Voluntary Creditors Postrejection.

The Thirteenth Circuit was correct in utilizing the proration approach, as it ensures Touch of Grey is treated the same as similarly situated creditors. After the rejection of the Lease, Touch of Grey becomes a voluntary creditor, and compensating it only until the rejection date, as opposed to the entire month, upholds longstanding bankruptcy principles. The Bankruptcy Code "aims, in the main, to secure equal distribution to creditors," and deviation from this objective giving

"preferential treatment [to] a class of creditors" is allowable "only when clearly authorized by Congress." Howard Delivery Serv., Inc. v. Zurich Am. Ins. Co., 547 U.S. 651, 655 (2006) (citations omitted). Additionally, a cornerstone of bankruptcy statutory interpretation is to avoid contradiction with the purpose of the Bankruptcy Code. *In re* Travel 2000, 264 B.R. at 448 ("[A] court should not resolve questions of statutory interpretation so that a particular Bankruptcy Code section conflicts and disturbs the overall purpose and function of the Code.") (internal quotations omitted) (citations omitted).

Section 365(d)(3) isolates commercial landlords from other creditors given the uniqueness of their position in providing a current service during the period between the debtor's bankruptcy petition filing and their lease rejection. Matter of Handy Andy, 144 F.3d at 1128. Landlords are often unchoosing in their role of creditor by having to continue to provide a service to a debtor postpetition. *See In re* Furr Supermarkets, 283 B.R. at 69. This position is unlike, for example, a trade creditor who can elect to forgo providing services or selling goods to a debtor when a postpetition automatic stay is in place. *See In re* Travel 2000, 264 B.R. at 448-49 (drawing a distinction between landlords and trade creditors, as prepetition trade creditors "have the option of awaiting payment or demanding return of the goods" and not "involuntarily" dealing with a bankrupt debtor). However, a landlord is no longer an involuntary creditor when the debtor, or its trustee, rejects the lease and vacates the rented property. This is because no **current** service is being provided to the debtor after the lease is rejected. Therefore, postrejection, both the landlord-creditor and any other creditor not providing a **current** service are on the same footing and constitute similarly situated creditors. *See In re* Furr Supermarkets, 283 B.R. at 68-69.

Ultimately, "[t]here is no indication that Congress . . . meant to give [a] landlord favored treatment for any class of prepetition debts." Matter of Handy Andy, 144 F.3d at 1128 (Judge

Posner exploring whether Congress extended authorization to extend preferential treatment to landlord-creditors through the passage of § 365(d)(3)). Concededly, "[n]o other creditor is put into [the] position" of being "forced to provide **current** services . . . without current payment." 130 CONG. REC. S8887, 8895 (daily ed. June 29, 1984) (statement of Sen. Hatch) (**emphasis** added). And that landlords should "receive full and timely payment for postpetition services," thereby striking a balance between ensuring debtors can continue operating and priority given to postpetition creditors. *See* *In re* Montgomery Ward, 268 F.3d at 213 (Mansmann, J., dissenting).

However, when a landlord-creditor is no longer an involuntary creditor providing forced current services to a debtor-tenant postpetition, the doctrines of fairness and equity embedded in the Bankruptcy Code mandate landlords be treated the same as any other similarly situated creditor. After the lease is rejected, a landlord-creditor is no longer standing alone as a creditor providing current services without current payment. Compensating a landlord-creditor of a non-expired lease beyond the rejection date when their hands are no longer tied gives them preferential treatment. This runs afoul to the Bankruptcy Code's doctrines of fairness and equity. *See* id. at 215 ("Nothing in the text or legislative history [of § 365(d)(3)] suggests that Congress wished to go beyond putting landlords on the same footing with other trade creditors . . . ."). Conversely, the proration approach aligns with the aims and objectives of the Bankruptcy Code. *See* *In re* All for A Dollar, 174 B.R. 358, 361-62 (Bankr. D. Mass. 1994) ("[The proration] interpretation coincides with the policy of preserving the priority and distribution scheme established by the Bankruptcy Code . . . [while] the minority view departs from the legislative intent of providing a landlord 'current payment' for the 'current service' which the landlord is compelled to provide pending the assumption or rejection of a lease.") (citations omitted).

After Debtor petitioned for bankruptcy, Touch of Grey assumed the role of an involuntary creditor by providing a current service (i.e., rental of the Premises) to Debtor pursuant to an ongoing commercial triple-net lease agreement. However, on May 5, that Lease was rejected. R. at 7-8. On the same day, Debtor ceased operations and returned full possession of the Premises to Touch of Grey. R. at 7. Debtor only occupied the Premises for the first five days of the month. R. at 8. Thus, as it relates to the month of May (the only month in dispute for the purposes of this issue), only five days of **current** services were actually forcibly provided by Touch of Grey as an involuntary landlord-creditor. Therefore, postrejection, Touch of Grey is similarly situated to other creditors as it relates to rent. Should this Court choose to compensate Touch of Grey for a period extending beyond the services they were forced to provide as an involuntary landlord creditor, its decision would fly in the face of the aims of the Bankruptcy Code and contravene the legislative purpose of § 365(d)(3). Therefore, this Court should uphold the decision rendered by the Thirteenth Circuit relating to the proration of rent owed to Touch of Grey and render Trustee liable only for rent between May 1 and May 5.

CONCLUSION

Based on the foregoing reasons, Respondent Trustee respectfully requests this Court affirm the decisions rendered by the Thirteenth Circuit on both issues presented and hold in favor of the Respondent.

Respectfully Submitted,

Team 46
Counsel for Respondent
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