Team 6

No. 21-0909

IN THE

Supreme Court of the United States

IN RE TERRAPIN STATION, LLC, DEBTOR,

TOUCH OF GREY ROASTERS, INC.,

Petitioner,

v.

CASEY JONES, CHAPTER 7 TRUSTEE,

Respondent.

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

BRIEF FOR RESPONDENT

JANUARY 20, 2020

TEAM NUMBER 6

COUNSEL FOR RESPONDENT

QUESTIONS PRESENTED

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

II. Under 11 U.S.C. § 365(d)(3), must a trustee timely perform the obligations of a debtor by paying rent due prior to the rejection of an unexpired non-residential real property lease but allocable to the post-rejection period in which the debtor is not occupying the leased premises?

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

STATEMENT OF JURISDICTION

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

RELEVANT STATUTORY PROVISIONS

The relevant portion of 11 U.S.C. § 547 provides:

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

The relevant portion of 11 U.S.C. § 503 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. § 365 provides:

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

STATEMENT OF THE CASE

This case is about the two things that fuel America: money and coffee. Unfortunately for the parties to this suit, the latter flowed freely, but the former did not. The following complex set of facts chronicles a local coffeehouse's bitter descent into bankruptcy.

I. FACTUAL HISTORY

A. A local, independent coffeehouse partners with an industry giant.

The coffeehouse at the center of this dispute, Terrapin Station, LLC (the "Debtor"), was founded by its sole member, William Tell, in 2005. Record 3. From the start, the independent coffeehouse enjoyed great success in the Town of Terrapin, Moot, even gaining recognition as "Independent Coffeehouse of the Year" in 2009 by a leading coffee industry trade magazine. R. 3. Fast forward to the fall of 2017.

Touch of Grey, Inc. ("Touch of Grey"), an international coffee company and coffeehouse chain headquartered in California, approached the Debtor with a business opportunity. R. 3, 4. In an effort to grow into new markets, Touch of Grey asked the Debtor to franchise a "neighborhood coffeehouse" secretly affiliated with Touch of Grey which would sell its new line of "Dark Star" coffee products. R. 4. The Debtor, recognizing that its earnings had become stagnant and its store was in need of a remodel, agreed to partner with the industry giant. R. 4.

Touch of Grey's vision for the new neighborhood coffeehouse involved expanded food offerings, alcoholic beverages and live music in the evenings, and a new storefront in Terrapin's downtown entertainment district. R. 4. To that end, Touch of Grey purchased a recently renovated warehouse space located downtown (the "Premises") and agreed to lease the space to the Debtor. R. 4. On July 1, 2018, the parties entered into a lease agreement (the "Lease") for the Premises. R. 4. The twenty-year triple-net lease required the Debtor to pay above-market monthly rent of

$25,000, with such rent being "due in advance on the first day of each month." R. 4. The parties also entered into a franchise agreement the same day whereby the Debtor agreed to exclusively sell "Dark Star" coffee products purchased from Touch of Grey. R. 4. The Debtor moved into the Premises in November 2018, closed its original coffeehouse, and opened the new "Terrapin Station Coffeehouse" on December 1, 2018. R. 5.

B. The joint venture struggles to gain traction and the Debtor encounters financial hardship.

Unfortunately for Touch of Grey and the Debtor, their joint venture failed to gain traction. R. 5. Early on, a group of local independent coffeehouse owners learned of the Debtor's affiliation with Touch of Grey and levied an effective local advertising campaign against the new coffeehouse, characterizing Terrapin Station Coffeehouse as "big coffee in disguise." R. 5. Furthermore, the coffeehouse struggled to break into the competitive nightlife scene in the downtown entertainment district. R. 5.

Consequently, the Debtor struggled throughout 2019 and, beginning in September of that year, became unable to pay its many debts as they came due. R. 5. Though current on its rent obligations under the Lease, the Debtor owed Touch of Grey over $700,000 for Dark Star products as of November 1, 2019. R. 5. After threatening to terminate the franchise agreement in light of the default, Touch of Grey entered into a forbearance agreement with the Debtor in early December, agreeing to forbear from terminating the franchise agreement if the Debtor fulfilled certain conditions. R. 5. One such condition was that the Debtor would pay $250,000 to Touch of Grey on account of the outstanding invoices for Dark Star products. R. 5. The Debtor made the $250,000 payment that same day. R. 5.

Less than two weeks after the parties executed a forbearance agreement, the Debtor purchased an additional $200,000-worth of Dark Star coffee products from Touch of Grey on credit, as set forth in an invoice dated December 18, 2019 (the "Invoice"). R. 5. William Tell personally guaranteed the balance of the Invoice to induce Touch of Grey to sell the goods to the Debtor. R. 5–6. The goods identified on the Invoice were delivered to the Debtor on December 21, 2019. R. 6.

C. The Debtor files for Chapter 11 bankruptcy and attempts to reorganize.

Upon reviewing its disappointing sales numbers from the holiday season, the Debtor filed a petition for relief under Chapter 11 of the Bankruptcy Code on January 5, 2020 (the "Petition Date"). R. 6. As of the Petition Date, the Debtor owed Touch of Grey $650,000, including the $200,000 due under the Invoice, for goods that it had purchased. R. 6. The Debtor owed several other creditors unsecured debt exceeding $500,000. R. 6. Along with the petition, William Tell filed a declaration with the bankruptcy court outlining the Debtor's plan for reorganization. R. 6. The plan included the continued sale of Dark Star products as required by the franchise agreement, but otherwise reflected Tell's desire to return to traditional coffeehouse operations and hours. R. 6. Two weeks after the Petition Date, the Debtor asked the bankruptcy court for permission to pay to Touch of Grey a "critical vendor payment" in the amount of $200,000 to be applied to the Invoice. R. 6–7. Uncertain of the propriety of a critical vendor payment under the Code, the court instead permitted immediate payment of the $200,000 as an administrative expense pursuant to section 503(b)(9). R. 7.

D. The Debtor's reorganization efforts are unsuccessful.

Though back in the good graces of Touch of Grey, the Debtor's reorganization efforts were anything but successful. R. 7. Most notably, the Debtor was forced to temporarily shut its doors in

March 2020 due to the COVID-19 pandemic. R. 7. The Debtor reopened in April 2020 to a nonexistent customer base, but like most businesses during the early months of the pandemic, the Debtor remained optimistic that things might improve and struggled to stay afloat in the interim. R. 7. Nevertheless, the Debtor finally gave up hope and permanently shut its doors on May 5, 2020, vacating the Premises and returning the keys to Touch of Grey. R. 7.

II. PROCEDURAL HISTORY

The day after it closed its coffeehouse, the Debtor filed a motion with the bankruptcy court to reject the Lease and its franchise agreement with Touch of Grey. R. 7. Two days later, Touch of Grey filed a motion seeking to compel payment of the May rent, including the twenty-six days post-petition in which the Debtor was not occupying the Premises. R. 7. The bankruptcy court scheduled a virtual hearing on both motions for May 29th, at which the Debtor converted its Chapter 11 case to a Chapter 7 case and the court appointed Casey Jones as the Chapter 7 trustee (the "Trustee"). R. 2, 8.

At the May 29 hearing, the court granted the Debtor's motion to reject the Lease and franchise agreement effective as of May 5, 2020. R. 8. The court did not rule on the motion to compel the rent payment, but asked for additional briefing on the issue. R. 8. The Trustee objected to the motion to compel payment for the entirety of the May rent and commenced an adversary proceeding against Touch of Grey to avoid and recover the $250,000 invoice payment as a preferential transfer. R. 8.

After unsuccessful attempts to resolve these issues through mediation, the parties agreed to litigate the issues at a subsequent hearing, at which the bankruptcy court ruled in favor of the Trustee on both issues and entered judgment in its favor for $250,000. R. 8–9. The United States

District Court for the District of Moot affirmed on both issues and upon Touch of Grey's timely appeal, the United States Court of Appeals for the Thirteenth Circuit likewise agreed with the Trustee on both issues. R. 3, 9. This Court granted Touch of Grey's petition for a writ of certiorari to consider the questions presented. R. 1.

STANDARD OF REVIEW

Because the foregoing issues involve pure questions of law based on statutory interpretation of the Bankruptcy Code,[1] this Court should review them *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 reviewing court to decide the issues as though it were the original trial court. *See, e.g., Belfance v. Bushey (In re Bushey)*, 210 B.R. 95, 99 (B.A.P. 6th Cir. 1997).

SUMMARY OF THE ARGUMENT

This appeal arises out of Touch of Grey's efforts to construe the provisions of the Bankruptcy Code in a manner wholly inconsistent with the Code's central policy goal of achieving equal distribution among creditors. This Court has the opportunity here to reaffirm the basic purpose of bankruptcy law and provide lower courts with clarity and guidance in resolving these important issues.

The first issue lies at the crossroads of the section 547(c)(4) new value defense and section 503(b)(9) administrative claims. The issue arises where creditors extend subsequent new value to a debtor within twenty days before the petition date. Because of the timing of the creditor's transfer of new value, the creditor has a priority claim for an administrative expense. However, lower courts

[1] Specific sections of the Bankruptcy Code—set forth in 11 U.S.C. §§ 101 *et seq.*—are identified herein as "section ___." The Bankruptcy Code as a whole is sometimes referred to herein as "the Code."

have only recently confronted the question of whether a creditor may reduce its preference exposure by the amount it receives in full as an administrative expense.

Resolution of this issue is blessedly simple if courts really believe what they say about adhering to the terms of unambiguous statutory text. Section 547(c)(4)(B) clearly prevents creditors from asserting a new value defense where the debtor makes an otherwise unavoidable transfer to the creditor on account of the supposed new value. The administrative expense payment here is a one-for-one unavoidable transfer on account of the new value the Debtor received. The case is, as they say, open and shut.

This first issue becomes complex only when courts attempt to read extra words into the statute. In particular, some courts wish that section 547(c)(4)(B)'s bar applied only to "otherwise unavoidable [*pre-petition*] transfers." But wishing does not make it so. And here, even Touch of Grey's contextual gymnastics cannot make the law say what it does not say. In fact, Congress deliberately excluded from the statute any temporal limitation after which unavoidable transfers can no longer reduce a new value defense. Not only do neighboring provisions demonstrate Congress's ability to include temporal limitations where desired, but the predecessor statute to section 547(c) included a reference to the petition date which Congress subsequently omitted when enacting the current version. The congressional silence is deafening.

And if the plain meaning of the law is not enough (though it most certainly must be), the refusal to permit double recovery by a creditor is also consistent with bankruptcy law's key policy objectives. First, it advances the goal of equal distribution among creditors by preventing one creditor from double-dipping into the common pool. Second, it reinforces the justification underlying the new value defense by foreclosing a reduction in preference exposure to a creditor who has not truly replenished the estate. And finally, refusing double recovery will not have the

chilling effect on creditor involvement that Touch of Grey forewarns, particularly where, as here, the creditor obtains personal guarantees on the value it advances.

In contrast to section 547(c)(4), the statute at the center of the second issue suffers from textual ambiguity. Indeed, courts have struggled for decades to select the most reasonable meaning in light of policy considerations and legislative history. The basic division among these courts is between the proration approach and the billing date approach. Those adopting the proration approach treat rent and tax obligations as accruing day-by-day, and award landlords of nonresidential real property an administrative expense only for the unpaid amount spanning the post-petition, pre-rejection period. On the other hand, adherents to the billing date approach require debtors to pay lease obligations in full on the date specified in the lease, regardless of whether the debtor occupies the premises for the duration of the period in question.

Because the text of section 365(d)(3) is amenable to either construction, courts must determine its meaning by reference to other tools of interpretation. One such tool is statutory context. Here, when one reads section 365(d)(3) *in pari materia* with sections 365(g) and 502(g) of the Code, it becomes evident that bankruptcy courts are to treat claims for post-petition, pre-rejection rent allocable to the post-rejection as general unsecured claims and not elevate them to administrative expense status as the billing date approach permits. Further, common law bankruptcy practice was to award landlords claims limited to the period in which the debtor-tenant was actually occupying the premises. Congress codified this practice in 365(d)(3) but removed the burden on landlords to show that the lease price of rent during this post-petition, pre-rejection period was fair. There is nothing in the congressional record to indicate that Congress intended to go beyond this relief and instead permit recovery for post-rejection, post-occupancy rent obligations.

Perhaps above all else, plain common sense supports adopting the proration approach. As evidenced by the divisiveness of this issue in the lower courts, there are good arguments on both sides pertaining to construction and the congressional record. But common sense dictates that when presented with the choice between (1) predictable recovery based on the period of occupancy and (2) random recovery based on whatever the billing date *happens to be* in the lease, the average debtor or creditor probably does not want to spin the roulette wheel. Especially in the context of bankruptcy, where all parties must make sacrifices in the face of undesirable circumstances, it is particularly unfair to leave non-landlord creditors of the estate guessing as to whether the debtor's landlord will win big or not.

ARGUMENT

This Court should affirm the Thirteenth Circuit Court of Appeals' interpretation of 11 U.S.C. § 547(c)(4) which precludes a creditor from reducing its preference exposure by an amount it has already received *in full* as an administrative expense. Further, this Court should affirm the circuit court's interpretation of 11 U.S.C. § 365(d)(3) which prorates lease obligations for the post-petition, pre-rejection period.

I. THE THIRTEENTH CIRCUIT CORRECTLY DETERMINED THAT 11 U.S.C. § 547(C)(4) PRECLUDES CREDITORS FROM ASSERTING A NEW VALUE DEFENSE FOR GOODS SUBJECT TO A *SATISFIED* ADMINISTRATIVE EXPENSE UNDER 11 U.S.C. § 503(B)(9).

Touch of Grey seeks to have its cake and eat it, too. Here, the "cake" is an invoice for goods valued at $200,000. Not only does Touch of Grey wish to pocket the payment for this invoice in the form of a court-approved section 503(b)(9) administrative expense, but it also wishes to leverage the goods as "subsequent new value" to reduce its preference exposure pursuant to section 547(c)(4). Touch of Grey is, of course, content to let all other creditors of the estate go hungry. But the animating purpose of bankruptcy law is to ensure that, to the extent possible, there

is enough to go around. Therefore, this Court should prohibit Touch of Grey from receiving a windfall recovery based on the same goods that underly a single claim.

Of the few courts that have considered this precise issue, a majority have concluded that sections 547(c)(4) and 503(b)(9) are mutually exclusive. *See Beaulieu Liquidating Tr. v. Fabric Sources, Inc. (In re Beaulieu Grp., LLC)*, 616 B.R. 857 (Bankr. N.D. Ga. 2020); *Siegal v. Sony Elecs., Inc. (In re Circuit City Stores, Inc.)* (reaffirming its prior holding in *Circuit City Stores, Inc. v. Mitsubishi Dig. Elecs. Am. (In re Circuit City Stores, Inc.)*, 2010 WL 4956022 (Bankr. E.D. Va. Dec. 1, 2010)); *TI Acquisition, LLC v. S. Polymer, Inc. (In re TI Acquisition, LLC)*, 429 B.R. 377, 381, 384 (Bankr. N.D. Ga. 2010); *cf. Friedman's Liquidating Trust v. Roth Staffing Cos. LP (In re Friedman's, Inc.)*, 738 F.3d 547, 555 (3d Cir. 2013) (discussing the issue in the context of a work order); *Commissary Operations, Inc. v. Dot Foods, Inc. (In re Commissary Operations, Inc.)*, 421 B.R. 873 (Bankr. M.D. Tenn. 2010) (analyzing the issue before the debtor had paid a § 503(b)(9) administrative expense).

Because some courts have conflated the two questions central to the resolution of this issue, it is necessary to clarify them and identify the true crux of the dispute. As an initial matter, the parties have stipulated that new value need not remain unpaid in order for a creditor to establish a defense under section 547(c)(4). R. 10. Having thus narrowed the scope of the inquiry, the first question this Court must resolve is whether the payment of an administrative expense under section 503(b)(9) constitutes an "otherwise unavoidable transfer" as that phrase is used in section 547(c)(4). This question, though important, is easily answered in the affirmative, but its resolution does not end the inquiry. The second and more perplexing question is whether section 547(c)(4), though completely lacking a temporal limitation, nevertheless identifies the petition date as the cut-off for calculating a creditor's new value defense. This section addresses these two questions

in turn and concludes with a discussion about the consonance between the statutory text and overarching bankruptcy policy objectives.

A. A court-approved payment of an administrative expense is an "otherwise unavoidable transfer" within the meaning of section 574(c)(4)(B).

Section 547(c)(4)(B) precludes a trustee from avoiding a preferential transfer to a creditor who gave subsequent new value to a debtor *unless the debtor made an "otherwise unavoidable transfer" to the creditor on account of the new value*. 11 U.S.C. § 547(c)(4)(B) (emphasis added). Here, the preferential transfer is the $250,000 payment under the forbearance agreement. The purported "new value" is the $200,000-worth of goods Touch of Grey extended to the Debtor on credit. And the otherwise unavoidable transfer on account of that new value is the $200,000 administrative expense the Debtor paid to Touch of Grey post-petition. The trustee's inability to avoid this administrative expense "transfer" is manifest in the plain language of the Bankruptcy Code.

1. The payment is unavoidable.

First, the administrative expense payment at issue here is decidedly unavoidable. By the very terms of section 503(b)(9), a debtor in possession or trustee will not have occasion to satisfy an administrative expense before the post-petition period (i.e., until after the debtor has filed for bankruptcy). Consequently, a trustee may avoid the post-petition payment of an administrative expense *only if* the transfer (A) is "authorized only under section 303(f) or 542(c)" of the Code or (B) was not authorized by either the Code or the bankruptcy court. 11 U.S.C. § 549(a)(2). Here, because section 549(a)(2)(A) is inapplicable and the transfer *was* authorized by the bankruptcy court, the trustee lacks authority under the Code to avoid the transfer. R. 7. Thus, the administrative expense payment here was unavoidable.

Notably, not even Judge Weir, the sole dissenter below, disputed the unavoidability of the administrative expense payment. *See* R. 23 (moving straight to the argument that the payment was not a "transfer" without first contending that the payment was avoidable).

2. The payment is a transfer.

In an attempt to forge a path to avoidance that the Bankruptcy Code expressly forecloses, Touch of Grey insists that the $200,000 administrative expense payment was not a "transfer" at all. R. 13. Specifically, Touch of Grey argues that the payment was not paid "by the Debtor" as required by section 247(c)(4)(B) but instead was a *distribution* by the Debtor's estate. Consequently, Touch of Grey argues, the payment cannot qualify as an "otherwise unavoidable *transfer*" to defeat Touch of Grey's new value defense.

This contrived reading of Section 247(c)(4)(B) finds no support in the statute, properly construed, nor in the Code as a whole. The definitional section of the Code provides: "the term transfer means . . . 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). Even if this court accepts Touch of Grey's precise characterization of the administrative expense payment as a "distribution," this broad definition of "transfer" would encompass such distributions. R. 13 (citing *In re Beaulieu Grp., LLC)*, 616 B.R. at 870).

Importantly, then, this broad definition controls the construction of the term "transfer" throughout the Code. *See In re Etchin*, 128 B.R. 662, 668 (Bankr. W.D. Wis. 1991) (internal citations omitted) ("[I]t is an elementary precept of statutory construction that the definition of a term in the definitional section of a statute controls the construction of that term wherever it appears throughout the statute."). Furthermore, the breadth of the definition signals a deliberate choice by Congress to discourage courts from tacking on additional requirements or modifiers. *See*

Consumers Union of the United States, Inc. v. Heimann, 589 F.2d 531, 533 (D.C. Cir. 1978) (Where "Congress has intentionally and unambiguously crafted a particularly broad, all-inclusive definition," it is not the courts' function "to subvert that effort."). Consequently, this Court should recognize the administrative expense as a "transfer" under the Code.

In fact, the Third Circuit Court rejected an argument identical to Touch of Grey's "transfer" argument in the very decision the creditor most heavily relies upon in support of its position. *See In re Friedman's, Inc.*, 738 F.3d at 555. There, the court entertained appellee's argument that "the use of the word 'debtor' rather than 'estate' or 'debtor-in-possession' [indicates] that [section 547(c)(4)(B)] only refers to pre-petition activity." *Id.* The Third Circuit summarily rejected this myopic argument and instead relied on relevant provisions of the Code to demonstrate why a post-petition payment *can be* an otherwise unavoidable *transfer*. *Id.* (observing that the Code does not define "debtor" as only a pre-petition entity in section 101(13) and "many other" provisions of the Code refer to "debtors" in the post-petition context); *see also id.* at 549 (characterizing the post-petition payment as an "otherwise unavoidable transfer").

Having established that the administrative expense payment here is an "otherwise unavoidable transfer," the decisive question is "*when* an otherwise unavoidable transfer must be made in order to preclude a creditor from using the underlying value as new value to reduce its preference exposure under section 547(c)(4)." R. 12. As the following section will explain, *any time* a debtor makes an otherwise unavoidable transfer on account of new value it received from a creditor, the plain language of section 547(c)(4)(B) precludes that creditor from using the subsequent new value defense to reduce its preference exposure.

B. The unambiguous language of section 547(c)(4)(B) does not close the preference analysis at the petition date.

Any exercise in statutory interpretation begins—and, if unambiguous, ends—with the language of the statute itself. *See, e.g., Conn. Nat'l Bank v. Germain*, 503 U.S. 249, 253–54 (1992). Here, the language of section 547(c)(4)(B) is clear and clearly omits a temporal limitation.

1. Section 547(c)(4)(B) omits any temporal limitation after which payment of an "otherwise unavoidable transfer" cannot reduce a creditor's new value defense.

Section 547(c)(4)(B) provides that whenever a debtor makes an "otherwise unavoidable transfer" on account of new value it received from the creditor subsequent to a preferential payment, the trustee may avoid the preference notwithstanding the subsequent new value. *See* 11 U.S.C. § 547(c). The statute does *not* provide that this nullification of the new value defense applies only where the debtor makes the unavoidable transfer *pre-petition*. In fact, it includes no temporal limitation at all.

This congressional silence is especially significant because Congress has, in neighboring provisions, demonstrated that it knows how to impose temporal limitations. *See Russello v. United States*, 464 U.S. 16, 23 (1983) (internal citation omitted) ("Where Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion."). For example, in section 547(c)(5) immediately following the provision at issue, Congress included the language, "as of the date of the filing of the petition" to limit the scope of that particular defense to avoidance. 11 U.S.C. § 547(c)(5).

Furthermore, Congress's choice to omit from section 547(c) the temporal reference included in its predecessor statute reinforces the notion that Congress did not intend to cabin the

new value calculation to only pre-petition events. *In re Beaulieu Grp., LLC*, 616 B.R. at 872. The predecessor statute provided:

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

11 U.S.C. § 96(c) (1976) (emphasis added).

Courts have found the omission of the above italicized language instructive in determining whether the current version of the provision requires new value to "remain unpaid" before a creditor may bring a subsequent new value defense under section 547(c). *See, e.g., Kaye v. Blue Bell Creameries, Inc. (In re BFW Liquidation, LLC)*, 899 F.3d 1178, 1191 (11th Cir. 2018) ("[I]n the absence of any evidence to the contrary, one can plausibly infer that, by replacing § 60(c)'s 'remaining unpaid' language with new language that omits any such requirement, Congress intended to eliminate § 60(c)'s requirement that new value remain unpaid."). The Eleventh Circuit's reasoning is equally relevant to the "at the time of the adjudication in bankruptcy" language, the subsequent omission of which indicates that Congress intended to eliminate any temporal limitation with respect to the preference calculation. Indeed, this Court has said, "When Congress acts to amend a statute, we presume it intends its amendment to have a real and substantial effect." *Stone v. INS*, 514 U.S. 386, 397 (1995) (internal citation omitted). Thus, Congress's decision to exclude from the amended version of the statute any reference to the petition date suggests that courts need not close the preference analysis upon the date of a filing in bankruptcy.

2. In the presence of an unambiguous statutory directive, resort to policy arguments is unavailing.

Despite the clear congressional directive in section 547(c)(4)(B), the circuit court in *In re Friedman's, Inc.* permitted a creditor to reduce its preference exposure by an amount it received in full pursuant to a wage order (i.e., an otherwise unavoidable transfer). 738 F.3d 547. But at least one court has acknowledged that the court in *Friedman's* "did not intend for its decision to extend to § 503(b)(9) claims." *In re Circuit City Stores, Inc.*, 515 B.R. at 313 (citing *In re Friedman's, Inc.*, 738 F.3d at 561 n. 9). Indeed, the bankruptcy court in *In re Circuit City Stores, Inc.* refused to depart from its earlier decision holding sections 503(b)(9) and 547(c)(4) to be mutually exclusive, despite the intervening decision from the United States Court of Appeals for the Third Circuit. *Id.*

Even if the reasoning in *Friedman's* is applicable to administrative expenses, the Third Circuit erroneously relied upon policy concerns and contextual indicators to conclude that creditors may leverage the same transaction of goods to obtain a double recovery. In particular, the Third Circuit's resort to context and policy is inappropriate in light of the clear statutory language. *Sebelius v. Cloer*, 569 U.S. 369, 380 (2013) (internal citation omitted) ("Our 'inquiry ceases [in a statutory construction case] if the statutory language is unambiguous and the statutory scheme is coherent and consistent.'"). However, to the extent that policy considerations are relevant to the resolution of this issue, the following section demonstrates that general and specific bankruptcy policy objectives only further support the interpretation compelled by a plain reading of section 547(c)(4).

C. To the extent that policy arguments are instructive, bankruptcy policy reinforces the interpretation compelled by a plain reading of section 547(c)(4)(B).

1. The Thirteenth Circuit's interpretation better serves the overarching bankruptcy policy of equalizing distributions among creditors.

It is unsurprising that a faithful reading of section 547(c) reinforces bankruptcy law's central policy of achieving an equal distribution of the estate among a debtor's creditors. *See Union Bank v. Wolas*, 502 U.S. 151, 161 (1991). To permit creditors to "have their cake and eat it, too" (i.e., recover the full amount of new value as an administrative expense and leverage that same new value to reduce its preference exposure) would unfairly deplete the debtor's estate to the detriment of other creditors. *See In re Beaulieu Grp., LLC*, 616 B.R. at 877 (recognizing the resulting penalty to unsecured creditors if certain creditors are permitted a double recovery); *see also* R. 6 ("the Debtor [in this case] . . . owed over $500,000 to other unsecured creditors); see also *Trs. of Amalgamated Ins. Fund v. McFarlin's, Inc.*, 789 F.2d 98, 100 (2d Cir. 1986) ("[B]ecause the presumption in bankruptcy cases is that the debtor's limited resources will be equally distributed among his creditors, statutory priorities are narrowly construed.").

It is one thing for a creditor to achieve an advantage over other creditors by adhering to the mechanisms plainly devised by Congress as reflected in the Code. It is quite another to permit creditors to capitalize on dishonestly-construed congressional silence. For example, as Judge Weir observed below, the Code contains "special provisions for aircraft leases and shopping center leases, and some claims are given priority over others." R. 27 (quoting *In re Friedman's, Inc.*, 738 F.3d at 560). However, these advantages, to the extent they are plainly permitted by the Code, reflect the deliberate policy choices of Congress. On the contrary, the relatively recent and controversial issue of how section 503(b)(9) affects a defense to preference liability under

547(c)(4) reflects anything but clear congressional intent to give certain creditors a compounded advantage over all others.

2. The Thirteenth Circuit's interpretation better serves the essential feature of the new value defense, which is to reward creditors who provide debtors with no-strings-attached replenishment.

In addition to serving the central policy objective of bankruptcy law in general, refusing to permit double recovery respects the underlying justification for the new value defense in particular. Specifically, the "essential feature of [the new value] defense is that two different transactions, one that depletes the estate for a certain amount and another that replenishes the estate for that same amount in goods, will 'net out' and cancel each other with regard to their effect on the debtor's estate." Nick Sears, *Defeating the Preference System: Using the Subsequent New Value Defense and Administrative Expense Claims to "Double Dip*,*"* 28 EMORY BANKR. DEV. J. 593, 599 (2012); *see also Ringel Valuation Servs. v. Shamrock Foods Co. (In re Ariz. Fast Foods, LLC)*, 299 B.R. 589, 596 (Bankr. Ariz. 2003) ("However, where the repayment of the new value is unavoidable, the new value does not replenish the estate for prior preferential transfers, and those preferences may be avoided.").

This essential feature, however, is not served where the transaction that is meant to replenish the estate is not "free of the seller's strings." Sears, *Defeating the Preference System,* 28 EMORY BANKR. DEV. J. at 611 (quoting *Phoenix Rest. Grp., Inc. v. Proficient Food Co. (In re Phx. Rest. Grp., Inc.)*, 373 B.R. 541, 548 (M.D. Tenn. 2007)) (observing that a seller of goods subject to a reclamation claim does not replenish the estate insofar as that seller may either reclaim the goods themselves or increase the priority of its monetary claim for the goods). Like goods subject to reclamation claims, goods received by the debtor within twenty days before the petition date are not free of the seller's strings. *See In re TI Acquisition, LLC*, 429 B.R. at 381, 384 (drawing a

parallel between reclamation claims and administrative claims insofar as they both deprive the debtor of "the uninhibited use of new value")*; see also* 11 U.S.C. § 503(b)(9). This is because, barring administrative insolvency, the creditor is sure to receive payment for the goods advanced. Consequently, the goods representing "subsequent new value" have not *truly* replenished the debtor's estate nor balanced out the creditor's earlier preference. Sears, *Defeating the Preference System*, 28 EMORY BANKR. DEV. J. at 611–12; *In re TI Acquisition, LLC*, 429 B.R. at 381 ("[O]nce a creditor has been given an allowed § 503(b)(9) claim and the claim has been paid . . . , it is clear that the estate was not enhanced by the new value.").

In sum, to the extent that paid administrative claims are unavoidable transfers, it is inconsistent with the Code's text and policy to permit a creditor to leverage the basis of that claim to reduce its preference exposure. To allow such a windfall ignores the nature of the new value defense, which is to reward no-strings-attached replenishment of the estate.

3. The Thirteenth Circuit's interpretation does not undermine the policy of encouraging creditors to continue dealing with troubled businesses, especially in the present case.

Despite this demonstrated harmony between text and policy, Touch of Grey and Judge Weir, dissenting below, insist that a different policy goal should govern the result here: that of encouraging trade creditors to continue dealing with financially-distressed businesses. R. 25–26. But while permitting double recovery would certainly make creditors happy, refusing to do so will not discourage them from dealing with businesses in distress, especially in circumstances similar to those at issue here.

For one, the nature of a section 503(b)(9) administrative claim prevents the creditor from assessing whether it *has one* until after the creditor has already shipped the relevant goods. As one court aptly noted:

> When a creditor ships goods pre-petition, . . . the creditor never knows whether a bankruptcy will be filed within 20 days of the shipment. The creditor cannot, therefore, know that it may be able to assert a § 503(b)(9) claim. *From the creditor's pre-petition perspective, there is no difference in incentive if the new value defense the creditor may have relied on is lost as a result of a § 503(b)(9) claim*.

In re Beaulieu Grp., LLC, 616 B.R. at 876 (quoting *In re TI Acquisition, LLC*, 429 B.R. at 385) (emphasis added). In other words, creditors who choose to deal with a business in financial distress likely do so without regard to the *form* in which the creditor may recover the value of its unpaid goods or services in the event of bankruptcy.

Additionally, trade creditors who are troubled about choosing between a 503(b)(9) administrative claim and a 547(c)(4) reduction in preference exposure can protect themselves, as Touch of Grey did here, by requiring personal guarantees on extensions of subsequent new value. R. 5–6 ("Tell signed a personal guarantee with respect to the Invoice."). Creditors who neglect to obtain this extra layer of protection do so at their own peril. Of course, the peril in this context is not great, for a creditor who extends new value is likely to enjoy either a reduction in its preference exposure or, if the debtor receives the goods in the last twenty days of the preference period, a priority claim for payment in full under section 503(b)(9). In any event, Touch of Grey's insistence that double recovery is necessary to serve the professed policy goal of encouraging creditor engagement with distressed business is not quite as compelling where the creditor has another pocket into which it can reach to satisfy its claims.

II. The Thirteenth Circuit correctly adopted and applied the proration approach to Section 365(d)(3), which does not require the trustee to satisfy obligations allocable to the post-rejection period.

Unlike the provision central to the first issue, the meaning of section 365(d)(3) is not easily discernible on its face, as evidenced by the decades of differing interpretations among the lower courts. The resolution of the text's meaning, of course, has serious practical ramifications, as the

choice between the so-called "billing date" and "proration" approaches significantly impacts landlords and other creditors who have claims against the debtor's estate. Specifically, the interpretation of 365(d)(3) determines whether post-petition, pre-rejection rent obligations allocable to the post-rejection period are entitled to priority administrative expense status or whether the landlord has only a general unsecured claim on equal footing with other creditors.

In this case, the choice between the billing date approach and the proration approach determines whether the estate owes Touch of Grey $25,000 or $4,032, respectively. The stakes are potentially higher because the record indicates that the Lease was a triple-net lease, suggesting that the Debtor has real estate tax and other obligations under the Lease, the billing date for which is not specified in the record. R. 4; *see Westship, Inc. v. Trident Shipworks, Inc.*, 274 B.R. 856, 863 (M.D. Fla. 2000) (describing a typical triple net lease as one in which the tenant takes responsibility for "taxes, operating expenses, and the like").

A "substantial majority" of courts that have considered this issue have determined that under section 365(d)(3), "rent should be prorated to cover only the postpetition, prerejection period, regardless of the fortuity of the billing date." *Child World v. Campbell/Mass. Trust (In re Child World)*, 161 B.R. 571, 576 (S.D.N.Y. 1993) (collecting cases); *see also, e.g., In re Ames Dep't Stores, Inc.*, 306 B.R. 43, 66–68 (Bankr. S.D.N.Y. 2004) (considering this precise issue in the context of monthly rental payments and adopting the proration approach); *In re NETtel Corp., Inc.*, 289 B.R. 486, 487 (Bankr. D.D.C. 2002) (same). Furthermore, one circuit court has adopted this approach. *El Paso Props. Corp. v. Gonzales (In re Furr's Supermarkets, Inc.)*, 283 B.R. 60, 66 n. 8 (B.A.P. 10th Cir. 2002). Although three circuit courts have opted for the billing date approach, to quote Judge Gerber, writing for the court in *In re Ames*, the analysis of those courts, "with respect, . . . is not as persuasive, or thorough, as the contrary authority." 306 B.R. at 76.

A. Section 365(d)(3) is ambiguous.

Section 365(d)(3) requires a trustee to "timely perform all the obligations of the debtor . . . arising from and after the order for relief under any unexpired lease of nonresidential real property, until such lease is assumed or rejected, notwithstanding section 503(b)(1)." 11 U.S.C. § 365(d)(3). Many courts have found this language susceptible to more than one reasonable interpretation. In particular, the term "arising" and the phrase "until such lease is assumed or rejected" have troubled those courts that have truly engaged with the statutory language. The United States Bankruptcy Court for the Southern District of New York explained the ambiguity as follows:

> (1) "Arises" can be construed to mean having arisen in (a) absolutist terms or (b) in an accrual sense. And (2) "until such lease is assumed or rejected" can be construed to modify (a) "perform"—in which case it would support an absolutist view, inconsistent with prorating—or (b) equally or more plausibly, "obligations"—in which case prorating would be necessary and appropriate.

In re Ames Dep't Stores, Inc., 306 B.R. at 67 (internal citations omitted).

In stark contrast to the above recitation of the ambiguities that exist in the statute, courts that maintain that section 365(d)(3) is unambiguous presumably cannot explain *why* they find the text to be clear. *See In re Ames Dep't Stores, Inc.*, 306 B.R. at 76 (criticizing the Sixth and Seventh Circuits for concluding that section 365(d)(3) is unambiguous "with no more discussion of [the provision] than quotation of it"). Indeed, the court in *In re Koenig Sporting Goods, Inc.* concluded that section 365(d)(3) is unambiguous only after resorting to the purpose of the statute and the legislative history surrounding it. 203 F.3d 986, 989 (6th Cir. 2000). If nothing else, the confusion amongst lower courts demonstrates that the statutes language is not as straightforward as Touch of Grey suggests.

B. Context, common law practice, congressional intent, and common sense all support the adoption of the proration approach to section 365(d)(3).

Absent a clear statutory directive as to how courts should treat pre-rejection rent allocable to the post-rejection period, this Court should consult other interpretive tools to resolve this issue. The following four yardsticks of meaning—context, common law practice, congressional intent, and common sense—are appropriate supplements to the ambiguous statutory text, and all counsel in favor of adopting the proration approach.

1. Context supports the adoption of the proration approach.

As this Court has often observed, "statutory construction is a holistic endeavor," particularly when the relevant statute is a part of the Bankruptcy Code. *United Savings Ass'n of Texas v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 371 (1988); *accord Norton Bankruptcy Law & Practice 2d* § 154:5 (Nov. 2003) ("Each provision in [the Bankruptcy Code] must be read *in pari materia* with every other . . . One cannot read any one section in isolation either from the statute as a whole or from any other provision."). Consequently, although the text of section 365(d)(3) does not provide a clear answer to the "billing date versus proration" debate, surrounding statutes—namely, sections 365(g) and 502(g)—compel the conclusion that unperformed lease obligations post-rejection should be treated as general unsecured claims and not elevated to the status of section 503(b) administrative expenses.

In fact, to adopt the billing date approach to section 365(d)(3) would be to render sections 365(g) and 502(g) hollow. The undisputed purpose and effect of sections 365(g) and 502(g) are to treat claims for an estate's failure to perform post-rejection obligations as *pre-petition* claims (i.e., as general unsecured claims, and not claims for administrative expenses). Section 365(g) provides in relevant part:

> [T]he rejection of an executory contract or unexpired lease of the debtor constitutes a breach of such contract or lease—
>
> (1) if such contract or lease has not been assumed under this section or under a plan confirmed under [certain chapters] of this title, *immediately before the date of the filing of the petition*.

11 U.S.C. § 365(g) (emphasis added). Section 502(g) includes the following similar language:

> A claim arising from the rejection, under section 365 of this title or under a plan under [certain chapters] of this title, of an executory contract or unexpired lease of a debtor that has not been assumed shall be determined . . . the same as if such claim had arisen before the date of the filing of the petition.

11 U.S.C. § 502(g) (emphasis added). In other words, when a debtor in bankruptcy rejects a lease mid-month, that rejection constitutes a breach of the lease which, pursuant to sections 365(g) and 502(g), is deemed to have arisen pre-petition. *In re NETtel Corp., Inc.*, 289 B.R. at 491. The billing date approach, which would grant landlords a section 503(b) administrative claim for the full amount of rent that comes due pre-rejection, including the amount allocable to the post-rejection period, directly contradicts Congress's explicit intent to treat post-rejection sums as general unsecured claims.

2. Common law practice reflects consistent application of the proration approach.

Furthermore, a preference for the proration approach is manifest in the long history of bankruptcy practice. Before Congress added section 365(d)(3) to the Code as part of the 1984 amendments, "debtor-tenants' lease obligations in the postpetition, prerejection period were handled under the general statute for administrative expenses, 11 U.S.C. § 503." *In re Child World*, 161 B.R. at 574. Pursuant to section 503(b)(1), it was the common practice of the bankruptcy courts to allow—after a request, notice, and hearing—administrative expenses only for the debtor-tenant's post-petition period of *occupancy*. *Id.* at 574–75 (collecting cases); *see also In re J. Bain, Inc.*, 554 F.2d 255, 256 (5th Cir. 1977) (emphasis added) (permitting the landlord to recover as an

administrative expense only "the court-determined fair rental value of the premises for the period of the receiver's *occupancy*").

In sum, pre-1984, the common practice of bankruptcy courts was to prorate a debtor-tenant's post-petition, pre-rejection rent to compel priority payment only for the period in which the debtor-tenant was actually occupying the leased premises. And there is nothing in the congressional record surrounding section 365(d)(3) to indicate that Congress wished courts to suddenly abandon this practice. *See Cohen v. De La Cruz*, 523 U.S. 213, 221 (1998) (cautioning that the Bankruptcy Code should not be read "to erode past bankruptcy practice absent a clear indication that Congress intended such a departure") (internal citations omitted). In fact, the congressional record demonstrates that Congress's specific motivation in enacting section 365(d)(3) was to level the playing field between landlords and other creditors, not give landlords a decisive *advantage* over all others.

3. Congressional intent, as reflected in the congressional record for section 365, further supports adoption of the proration approach.

The congressional record demonstrates that, in enacting section 365(d)(3), Congress sought to entitle landlords to *current* payment for *current* services. *See* H.R. Conf. Rep. No. 98-882, at 599 (1984), reprinted in 1984 U.S.C.C.A.N. 576 (Senator Hatch, explaining that Congress's purpose in enacting section 365(d)(3) was to remedy the situation in which landlords were "forced to provide current services . . . without current payment"); *see also In re GCP CT Sch. Acquisition, LLC*, 443 B.R. 243, 255 (Bankr. D. Mass. 2010). Specifically, the intended effect of section 365(d)(3) was two-fold. It was enacted to (1) give landlords the right to rent payments "contemporaneous with its provision of services to the debtor during the post-order-for-relief, prerejection period" and (2) fix the landlord's administrative claim for occupancy according to the

terms of the lease, notwithstanding the general section 503(b) requirement that the claim be for "actual, necessary costs and expenses of preserving the estate." *In re NETtel Corp., Inc.*, 289 B.R. at 492; 11 U.S.C. § 503(b)(1)(A).

The purpose and effect of this provision, then, was to free landlords from the burden of demonstrating that post-petition, pre-rejection rents due under the lease were "actual" and "necessary." But the billing date approach represents an overcorrection from the problems Congress sought to resolve to the extent that it confers this benefit to even those rents allocable to the post-rejection period.

Contrary to the prevailing opinion among those partial to the billing date approach, adoption of the proration approach does not undermine Congress's intent to place landlords on equal footing with other creditors. *See* H.R. Conf. Rep. No. 98-882, at 599. Instead, proration merely prevents landlords from enjoying windfall payments for the period in which a debtor-tenant is not actually occupying the premises.

This distinction is evident in this case, where the debtor owes Touch of Grey, as an administrative expense, the post-petition, *pre-rejection* rent in full pursuant to the terms of the lease. This is so even though the agreed-upon rental rate is "above market." R. 5. Add to that the additional obligations of the triple-net lease, section 365(d)(3)'s assurance that the landlord will receive the benefit of its bargain for the period of occupancy is no small thing. *See Matter of Hempstead Country Club v. Bd. of Assessors*, 112 A.D.3d 123, 127 (N.Y. App. Div. 2013) (explaining that rent obligations for triple-net leases are often reduced to account for the additional financial burdens the tenant assumes). Congress sought to ensure that debtor-tenants could not quibble about the fairness of *the amount* of its obligations under the lease. *See In re Imperial Bev. Grp., LLC*, 457 B.R. 490, 500 (Bankr. N.D. Tex. 2011) (quoting *In re Burival*, 613 F.3d 810, 812

(8th Cir. 2010)) (arguing against a reduction in rent based on considerations of actuality and necessity). But the record does not reflect Congress's intent to *extend* those obligations beyond rejection of the lease (i.e., beyond the period in which the debtor-tenant actually occupies the leased premises).

Finally, in some circumstances, application of the billing date approach actually precipitates the very harm to landlords that Congress sought to avoid in enacting section 365(d)(3). *In re NETtel Corp.*, 289 B.R. at 493 ("Indeed, the goal stated in the legislative history of providing landlords with current payment for current services could be frustrated if proration were rejected."). Specifically, proration is necessary to protect the landlord in two situations: (1) when the lease calls for rent to be paid in advance on a date preceding the order for relief; and (2) when the lease calls for rent to be paid in arrears on a date after the rejection of the lease. *Id.* Particularly in the second scenario, the billing date approach would permit debtor-tenants to occupy the leased premises free-of-charge for most of the month provided the debtor rejected the lease before the end-of-month billing date. This possibility under the billing date approach suggests that the approach does not serve the purpose behind the statute's enactment. As one court explained:

> [R]ent for the days after the filing of the petition until the next lease payment is due are an administrative claim under § 365(d)(3) in a prorated amount of a full monthly lease payment . . . To rule otherwise would reward the estate to the detriment of the landlord, which was not the intent of Congress.

In re Leather Factory, Inc., 475 B.R. 710, 714 (Bankr. C.D. Cal. 2012). As the following section explores, the inconsistent results under the billing date approach weigh heavily in favor of proration.

4. Common sense and fairness counsel in favor of adopting the proration approach.

This Court has long recognized that bankruptcy courts are courts of equity. *In re Kaiser Aluminum Corp.*, 456 F.3d 328, 339 (3d Cir. 2006) (citing *Local Loan Co. v. Hunt*, 292 U.S. 234, 240 (1934)). As such, bankruptcy courts must have the latitude to "sift the circumstances surrounding any claim to see that injustice or unfairness is not done." *Id.* (internal citation omitted). Of course, notions of equity cannot trump specific provisions of the Bankruptcy Code, but must be exercised within its parameters. *Id.* (internal citation omitted). But where statutory text is amenable to an interpretation which uniformly effects fairness to all parties, this Court should not hesitate to adopt such an interpretation.

a. The basic purposes of assumption and rejection demonstrate why the proration approach is the better rule.

To begin with, common sense weighs in favor of the proration approach because the billing date approach undermines the basic distinction between assumption and rejection of a lease. Assumption of a lease "entitles the estate to the benefits of a lease, but also saddles the estate with all obligations under the lease as an administrative claim." *In re NETtel Corp.*, 289 B.R. at 491. In contrast, rejection of a lease, as this Court recently articulated, has the effect of repudiating any further performance by the trustee of his or her duties. *Mission Prod. Holdings v. Tempnology, LLC*, 139 S. Ct. 1652, 1658 (2019). In other words, if a debtor rejects a lease, its duty to perform lease obligations ceases upon the effective date of rejection. Thus, the billing date approach, by granting the landlord an elevated claim for pre-rejection rent allocable to the post-rejection period, "saddle[s the estate] with a burden that rejection is designed to avoid." *In re NETtel Corp.*, 289 B.R. at 492.

Congress reiterated this distinction between assumption and rejection in the provision immediately following section 365(d)(3). Section 365(d)(4) requires the trustee to "immediately surrender" nonresidential real property to the lessor upon rejection of an unexpired lease. 11 U.S.C. § 365(d)(4). This immediate loss of benefit to the debtor-tenant (i.e., the benefit of occupancy) fairly triggers a corresponding loss of benefit to the lessor (i.e., the right to claim post-rejection rent as an administrative expense). *In re NETtel Corp.*, 289 B.R. at 491 ("[T]he Bankruptcy Code works this way: rejection ends the trustee's further entitlement to enjoy the right of occupancy under the lease in the period after rejection, and in exchange the estate is relieved of the liability for such future right of occupancy as an administrative claim."). If a debtor-tenant is obligated to pay a full month's rent (or more) despite rejecting a lease early in the month, rejection becomes difficult to distinguish from acceptance, except that by accepting the lease, the debtor would at least enjoy the benefit of occupancy for the duration of the month. In this way, the billing date approach is difficult to reconcile with basic bankruptcy concepts and, as demonstrated below, the overarching policy of bankruptcy law generally.

b. The proration approach serves the policy goal of equal distribution among creditors and balances the interests of landlords with those of the estate's other creditors.

Unlike the billing date approach, proration carefully balances the interest of landlords with those of the estate and its creditors. To the landlord, proration offers assurance that he will recover the agreed-upon value under the lease for the time the debtor occupied the space without shouldering the burden of proving that the rent was an "actual, necessary [cost or expense] of preserving the estate." 11 U.S.C. § 503(b)(1)(A). For the debtor's estate and its other creditors, proration promises that the landlord will not receive a windfall payment at the expense of the other creditors' recovery from the estate.

Some courts have suggested that the approach to section 365(d)(3) need not seek a balance between the landlord's interests and those of the debtor because the debtor or trustee controls the date of rejection and, thus, can protect itself by rejecting at the end of the month instead of immediately after an obligation arises under the lease. *See, e.g., In re Koenig Sporting Goods, Inc.*, 203 F.3d at 989. But the idea that no unfairness befalls the estate because the debtor holds the power to reject is less compelling in cases where, as here, the debtor is an unsophisticated party who is likely unfamiliar with the Code's machinery. In such cases, rejection is not a tool of the gamesman as Touch of Grey supposes, and the notion that the unsophisticated debtor should be prepared to suffer the consequences of his uninformed choice is against reason. Here, the record does not reflect that the Debtor made a calculated decision to wait until just after the first of the month to reject the lease. Instead, the record suggests that May 5th just so happened to be the day that the Debtor realized it could no longer go on operating. R. 7. It would be inequitable to penalize the estate's other creditors by requiring the Debtor to pay more than six times the rent it should owe simply because the Debtor is unfamiliar with the nuances of the Code.

c. The proration approach is simple to apply and, unlike the billing date approach, is universally fair.

In addition to the above discussion, the innate unfairness of the billing date approach is also evidenced by the tendency of some courts to preemptively limit the application of the approach even in the same breath with which they adopt it. For example, the bankruptcy court in *In re Koenig Sporting Goods, Inc.* adopted the billing date approach in a case with very similar facts to those underlying this one. 221 B.R. 737, 741 (Bankr. N.D. Ohio 1998). However, the court qualified its holding by admitting that it might reach a different conclusion if the result would require the debtor to pay an entire year's rent—as opposed to an entire month's rent—for only two days' occupancy. *In re NETtel Corp.*, 289 B.R. 486 at 494 n. 14 (discussing the *In re Koenig*

bankruptcy decision). Similarly, the bankruptcy appellate panel in that case left open the question of whether ambiguities in interpretation might arise under section 365(d)(3) where a nonresidential lease "requires substantial payments in arrears or imposes obligations that are fundamentally inconsistent with other provisions of the Bankruptcy Code." *Koenig Sporting Goods, Inc. v. Morse Rd. Co. (In re Koenig Sporting Goods, Inc.)*, 229 B.R. 388, 394 (B.A.P. 6th Cir. 1999); *see also In re NETtel Corp.*, 289 B.R. at 494 (confirming that proration is necessary to protect the landlord in certain situations). These excerpts demonstrate that the billing date approach is not palatable in every instance.

This Court should not be quick to adopt a rule that produces absurd results when applied to certain circumstances. In contrast to the billing date approach, the proration approach permits bankruptcy courts to apply a flexible, common sense doctrine that elevates a landlord's claim for only that portion of rent commensurate with the extent of services provided. As the Bankruptcy Court for the Southern District of New York explained,

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

In re Ames Dep't Stores, Inc., 306 B.R. at 72. The fact is that the billing date approach is at once inflexible and unpredictable. It leaves the payment of potentially large sums of money up to chance by relying on the fortuity of the billing date without any further inquiry into the actual services provided. *See Centerpoint Props. v. Montgomery Ward Holding Corp. (In re Montgomery Ward Holding Corp.)*, 268 F.3d 205, 212 (Mansmann, J., dissenting) (emphasis added) (criticizing the majority for adopting the view 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").

The best approach to resolving the ambiguity inherent in section 365(d)(3) is to rely on the common sense which bankruptcy courts have been authorized to exercise. Here, common sense, in addition to context, common law practice, and congressional intent, weighs heavily in favor of the proration approach.

CONCLUSION

For the foregoing reasons, the Respondent asks this Court to affirm the judgment of the United States Court of Appeals for the Thirteenth Circuit prohibiting Touch of Grey from reducing its preference exposure by $200,000 and denying Touch of Grey's motion for payment of the full May rent.