No. 21-0909

IN THE

Supreme Court of the United States

IN RE TERRAPIN, LLC, DEBTOR,

TOUCH OF GREY ROASTERS, INC., PETITIONER

v.

CASEY JONES, CHAPTER 7 TRUSTEE, RESPONDENT.

ON APPEAL FROM THE
UNITED STATES COURT OF APPEALS
FOR THE THIRTEENTH CIRCUIT

BRIEF FOR RESPONDENT

JANUARY 20, 2022

TEAM NUMBER 8
COUNSEL FOR RESPONDENT

QUESTIONS PRESENTED

I. Under 11 U.S.C. § 547(c)(4), is a creditor precluded from reducing its preference liability when such creditor receives a preferential payment and subsequently advances new value to a debtor but is thereafter paid in full on account of the new value as a fully funded administrative expense under 11 U.S.C. § 503(b)(9)?

II. Does 11 U.S.C. 365(d)(3) allow a creditor-landlord to receive a prorated rental payment when a tenant-debtor would otherwise be paying rent for days it did not occupy the property and other creditors would be disadvantaged if the landlord were paid in full?

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The Thirteenth Circuit Court of Appeals' decision is available at No. 20-0803 and reprinted at Record 2. Both the bankruptcy court and the district court decided in favor of Casey Jones, Chapter 7 trustee. On appeal, the United States Court of Appeals for the Thirteenth Circuit affirmed in favor of Casey Jones, Chapter 7 Trustee.

STATEMENT OF JURISDICTION

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

RELEVANT STATUORY PROVISIONS

This action requires statutory construction of certain provisions of Title 11 of the United States Code. The following sections are also restated in full in the Appendix.

The relevant portion of 11 U.S.C. § 365(d)(3)(A) 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.

The relevant portion of 11 U.S.C. § 503(b)(9) provides:

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

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

> (c) The trustee may not avoid under this section a transfer–
>
> (4) to or for the benefit of a creditor, to the extent that, after such transfer, such creditor gave new value to or for the benefit of the debtor–
>
> (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.

STATEMENT OF THE CASE

This appeal arises from Petitioner's attempt to receive more than authorized by the Bankruptcy Code in the distribution of the Debtor's assets to the detriment of similarly situated creditors. Petitioner's appeal jeopardizes the Bankruptcy Code's integrity by seeking a disproportionate distribution of assets in lieu of the more equitable approaches contemplated by the Code.

I. FACTUAL HISTORY

Terrapin Station, LLC (the "Debtor") is a coffeehouse owned by William Tell ("Tell"). R. at 3. *Id.* Petitioner, Touch of Grey Roasters, Inc. ("Touch of Grey") is an international coffee company with nearly 2,000 coffeehouses worldwide. *Id.* In 2017, Touch of Grey began opening a series of "neighborhood coffeehouses" and approached Tell with a franchising opportunity. *Id.* at 4. The parties agreed to partner in a coffeehouse venture. *Id.* Touch of Grey included a franchise agreement requiring the Debtor to exclusively sell "Dark Star," a new Touch of Grey coffee product. *Id.* at 3–4. Selling Dark Star was one of Touch of Grey's many attempts to remain an anonymous franchisor to the public. *Id.* at 4.

Additionally, Touch of Grey purchased and renovated a building at 5877 Shakedown Street (the "Premises"). *Id.* at 4. In July 2018, the parties entered into a twenty-year-triple-net lease agreement (the "Lease") with an above-market monthly rent of $25,000 "due in advance on the first day of each month." *Id.* By November 2018, the Premises' renovations were completed, and the Debtor closed its independent shop to open Touch of Grey's new franchised location one month later.

Local patrons reacted poorly to Touch of Grey's attempted corporate anonymity when they discovered its involvement in the venture. *Id.* at 5. Sales suffered, and the Debtor's unpaid

invoices mounted quickly, reaching over $700,000 for Dark Matter products alone. While the Debtor became insolvent in September 2019, it stayed current with its Lease payments. *Id.* Nonetheless, Touch of Grey issued the Debtor a notice of default and threatened to terminate their franchise agreement. *Id.* Two days later, the parties entered into a forbearance agreement requiring the Debtor to (1) pay $250,000 towards their Dark Matter invoices, (2) reaffirm their Lease obligations, and (3) release all claims against Touch of Grey. *Id.* To induce Touch of Grey to provide an additional $200,00 of Dark Star products on credit (the "New Value") in return, Tell provided Touch of Grey with a personal guarantee for the Debtor's order. *Id* at 5–6. Per the agreement, the Debtor paid Touch of Grey the $250,000 on the same day (the "Preferential Payment"). *Id.* at 5. After it made the Preferential Payment, the Debtor received the New Value, which was delivered on December 21, 2019. *Id.* at 5–6.

On January 5, 2020, the Debtor filed its petition for chapter 11 relief. While the Debtor remained current with its Lease payments and had no secured debt, the Debtor owed Touch of Grey $650,000 for Dark Matter goods (including the New Value) and $500,000 of unsecured debt to other creditors. *Id.* at 6. Two weeks after the petition date and to support its reorganization, the Debtor filed a critical vendor motion requesting court authorization to pay Touch of Grey $200,000. *Id.* Without the payment, Touch of Grey refused to provide postpetition goods to the Debtor. *Id.* Due to the franchise agreement, the Debtor argued it needed the ability to purchase Dark Star from Touch of Grey to continue operations. *Id.* The bankruptcy court, however, rejected the Debtor's pleas to pay Touch of Grey as a critical vendor, reasoning that such orders are not expressly authorized by the Bankruptcy Code. R. at 7. The bankruptcy court nevertheless awarded administrative expense priority to Touch of Grey under section 503(b)(9) for the New Value because it was extended within the twenty days preceding the petition date and authorized the

Debtor to pay such administrative expense immediately. *Id.* After receiving the blessing of the bankruptcy court's order, the Debtor paid Touch of Grey on account of the New Value (the "Unavoidable Transfer") and Touch of Grey resumed selling products to the Debtor.

In March 2020, Debtor met an insurmountable challenge as the COVID-19 pandemic forced the coffeehouse to close temporarily. *Id.* The Debtor reopened the shop one month later, but customers did not return. *Id.* On May 5, 2020, the Debtor permanently ceased operations and vacated the Premises. *Id.* The following day, the Debtor filed motions to reject the franchise and lease agreements pursuant to section 365(a). *Id.* Touch of Grey, seeking preferential treatment, filed a motion to compel May's rent payment in its entirety ($25,000), but did not oppose the Debtor's rejection of the Lease's termination date effective May 5, 2020. *Id.* at 7–8. At the corresponding hearing, Debtor converted its case to chapter 7 pursuant to section 1112(a) without objection. *Id.* at 8. The court granted Debtor's motions to reject the lease and franchise agreement as of May 5, 2020 and requested additional briefing regarding Touch of Grey's rent request.

In addition to objecting to Touch of Grey's request for full payment of the May 2020 rent, the Trustee sought to recover and avoid the Preferential Payment. *Id.* In response, Touch of Grey asserted the subsequent new value defense under section 547(c)(4), contending that it could reduce its preference liability to the extent of the New Value it provided the Debtor. *Id.*

II. PROCEDURAL HISTORY

The bankruptcy court faced two issues in this case and ruled in favor of the Trustee on both. *Id.* First, the court held that Touch of Grey could not use the New Value to reduce its preference exposure because it was paid in full by the Unavoidable Transfer. *Id.* The court also sided with the Trustee when it held that the Debtor was only required to pay rent allocated to the first five days of May 2020, the time during which it occupied the leased property, totaling

$4,032.26. *Id.* On appeal, the United States District Court for the District of Moot affirmed the bankruptcy court's rulings on both issues. *Id.* Touch of Grey timely appealed and the Thirteenth Circuit likewise affirmed. *Id.*

STANDARD OF REVIEW

The questions presented are based on statutory interpretation of the Bankruptcy Code[1] and are therefore purely issues of law. Accordingly, the standard of review for this appeal is *de novo*. *Pierce v. Underwood*, 487 U.S. 552, 558 (1988).

SUMMARY OF THE ARGUMENT

The Thirteenth Circuit correctly ruled in favor of the Trustee when it held first, that Touch of Grey was not entitled to reduce its preference liability pursuant to section 547(c)(4)'s new value defense when it was fully paid on account of its new value as an administrative expense claimant under section 503(b)(9), and second, that the proration approach applied to postpetition, prerejection rent payments under section 365(d)(3) aligns with Congressional intent, best serves the goals of the Bankruptcy Code, and provides the most equitable outcome for the Debtor, the landlord, and other creditors.

Touch of Grey's appeal seeks to circumvent section 547(c)(4)'s plain meaning to obtain double recovery from the Debtor. The plain meaning of the statute is unambiguous, and this Court should conduct no further judicial inquiry. If this Court were to inquire further, the statutory and historical context require the same conclusion: allowing double recovery for a creditor that seeks to reduce its preference exposure with value that has been paid for in full as an administrative expense is inconsistent with the statutory context and the policy goals of the Bankruptcy Code.

[1] The Bankruptcy Code is set forth in 11 U.S.C. §§ 101 *et seq.* Specific sections of the Bankruptcy Code are identified herein as "section __."

As the statute's plain text states, the new value defense is not available to the extent a Debtor subsequently pays for that new value with an "otherwise unavoidable transfer." Touch of Grey's shipment of $200,000 worth of goods qualified for administrative expense priority, and the bankruptcy court authorized immediate payment in full. Consequently, when the Debtor thereafter made such payment, Touch of Grey received a fully paid, unavoidable transfer pursuant to section 503(b)(9) because the only relevant section governing avoidance of postpetition transfers, section 549, does not allow the transfer to be unwound for the benefit of the estate. Therefore, the Thirteenth Circuit reached the only logical conclusion by affirming the bankruptcy court.

Even if there were reason to look beyond the statute's plain meaning, the statutory context and legislative history reach the same result. When it enacted section 547(c)(4), Congress codified 547(c)(4)(B) to remove its predecessor's temporal limitation. Congress is perfectly capable of imposing the petition date as a temporal limitation, as it did when it enacted the preference defense contained in section 547(c)(5). The fact that Congress did not so limit section 547(c)(4) indicates that the omission was intentional. Further, imposing the petition date as a cutoff for calculation of a creditor's new value defense would render the express language in 547(c)(5) superfluous. Additionally, section 503(b)(9) and the protection it provides by elevating a creditor's priority status vis-à-vis other creditors, reflects an outgrowth of the policies underlying the right of reclamation to certain sellers of goods on credit. As courts have reduced a creditor's new value defense to the extent of such creditor's reclamation claim, so too should this Court affirm the reduction of Touch of Grey's new value defense to the extent of its fully paid 503(b)(9) claim.

To allow Touch of Grey the new value defense would ultimately provide them with double recovery and neglect the Bankruptcy Code's prime policy goal of orderly, equitable distribution. If the new value defense were also applied, then Touch of Grey would receive double credit on

account of the same value, once as consideration for the 503(b)(9) payment and again to offset its prior receipt of Debtor's preferential payment. Consequently, other creditors' distribution would suffer more than is necessary or equitable. Further, the Debtor's full payment pursuant to section 503(b)(9) provides Touch of Grey with the payment it expected when it supplied its goods to the Debtor. Providing double recovery in bankruptcy is unnecessary to encourage a creditor to deal with a struggling business prior to the filing of a petition. Moreover, precluding a creditor from such a "double-dip" from a debtor's estate strikes the correct policy balance by treating fairly a creditor that continues dealing with struggling business while avoiding unjustified and unexpected windfalls to a preferred creditor to the detriment of others.

The proration approach to handling rent payments in the postpetition, prerejection period best serves the overarching goal of the Bankruptcy Code, namely, to create equality among similarly situated creditors. Section 365(d)(3) governs rent payments in the postpetition and prerejection period. This issue arises when a tenant pays rent in the postpetition period and later rejects the lease. There are two ways to handle these rent payments. The proration approach allows the tenant to pay rent for the days occupied prerejection, and the remainder treated as a general unsecured claim. The billing-date approach requires the debtor pay the entire rent payment on the day it is due, even if the debtor rejects the lease with days remaining in the rental term. A majority of courts correctly favor the proration approach, as did all reviewing courts in this case.

The text of section 365(d)(3) is ambiguous. Therefore, consideration of the legislative history, canons of construction, and the context of the Bankruptcy Code is appropriate. The legislative history, though scant, favors the proration approach. Prior to the enaction of section 365(d)(3) courts followed the proration approach. Congress failed to intentionally alter that approach in adopting section 365(d)(3). Therefore, the proration approach should remain in force.

The proration approach is also more sensible than the billing date approach when considering the entirety of the Bankruptcy Code, as well as real world situations implicating section 365(d)(3).

The proration approach is a better policy; it properly balances the interests of a debtor, its landlord, and other creditors. A landlord should receive payment for the services it provided prerejection but does not deserve a windfall payment for the days no longer occupied by the debtor postrejection. Likewise, a debtor should not have to pay rent for days it did not occupy the property. Lastly, other equally deserving creditors would be disadvantaged if landlords were able to receive the entirety of the rent payment instead of a prorated payment. These policy issues are even more concerning when the rental period is for three-months, semi-annually, or annually, as is the case with many commercial leases.

This Court should affirm on both issues.

ARGUMENT

This Court should affirm the Thirteenth Circuit's decision that a creditor cannot *both* be paid in full for value it provided the debtor under section 503(b)(9) *and* use that same value to reduce its preference exposure under section 547(c)(4). This Court should also affirm the circuit court's decision to adopt the proration approach under section 365(d)(3).

I. THE THIRTEENTH CIRCUIT CORRECTLY HELD THAT A SELLER OF GOODS IS NOT ENTITLED TO REDUCE ITS PREFERENCE EXPOSURE PURSUANT TO 11 U.S.C. § 547(C)(4)'S NEW VALUE DEFENSE TO THE EXTENT THE SELLER IS FULLY PAID FOR SUCH GOODS PURSUANT TO 11 U.S.C. § 503(B)(9).

Section 547(b) of the Bankruptcy Code empowers a trustee to avoid a transfer of an interest in the debtor's property to a creditor when, in addition to several other requirements, such transfer was made on or within ninety days before the petition date. *See* 11 U.S.C. § 547(b)–(c). That is, a trustee may claw back such payments to share its value among all creditors when the transfer would otherwise result in preferential treatment of one creditor at the expense of others. R. at 10.

While the parties here have stipulated that the Trustee could establish each element of a preference, a trustee's ability to avoid a preferential transfer is limited by defenses available to creditors under section 547(c).[2] *See* R. at 9 n.3; 11 U.S.C. § 547(c). Among these defenses is the "subsequent new value defense," which provides that a trustee may not avoid a transfer made:

> (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) (emphasis added).

While there are multiple subparts to section 547(c)(4), the section provides that when a creditor receives a preferential payment and subsequently advances new value to a debtor, the trustee or debtor-in-possession may not avoid the preferential transfer to the extent of the new value unless the new value is secured or if the debtor pays back the new value with a payment that cannot itself be avoided. *See* 11 U.S.C. § 547(c)(4). This defense allows a creditor such as Touch of Grey to reduce its preference exposure by subtracting new value it provided to the debtor after receiving a preferential payment. However, when a debtor makes—as the Debtor here made—an unavoidable transfer on account of new value, that value cannot be used to reduce the creditor's preference exposure. *See* Charles Jordan Tabb, *The Law of Bankruptcy* § 6.20, 543 (2d ed. 2009). The logic behind allowing creditors to assert a new value defense after receiving a subsequent avoidable transfer is that avoidance of a debtor's "payment" on the new value results in the creditor not actually being paid. *Id.* Conversely, when a creditor is paid in full on account of new value

[2] Here, the parties have further stipulated that none of section 547(c)'s defenses are applicable to the present case other than the subsequent new value defense set out in section 547(c)(4). R. at 9 n.3.

by a payment that cannot be clawed back by the debtor or trustee, the creditor need not be concerned with not being paid. *Id.*

While new value need not "remain unpaid" to establish a defense under section 547(c)(4), that does not mean debtor payments on account of new value are wholly irrelevant to such a defense. *See, e.g.*, *Kaye v. Blue Bell Creameries, Inc. (In re BFW Liquidation, LLC)*, 899 F.3d 1178, 1189 (11th Cir. 2018) (noting that the plain terms of section 547(c)(4)(B) exclude "'paid' new value that is paid for with 'an otherwise unavoidable transfer'"). Indeed, the critical inquiry in determining the extent of a creditor's new value defense is whether any subsequent payment by the debtor on account of the new value is an *otherwise unavoidable transfer*. *See, e.g.*, *id.*; *Beaulieu Liquidating Tr. v. Fabric Sources, Inc. (In re Beaulieu Grp., LLC)*, 616 B.R. 857, 878 (Bankr. N.D. Ga. 2020). Because the Debtor's payment on account of Touch of Grey's new value was otherwise unavoidable, Touch of Grey may not use that value to *also* reduce its preference exposure. Such an approach is consistent with the plain meaning of section 547(c)(4)'s text, its statutory and legislative context, and the policy goals of the Bankruptcy Code.

A. The plain meaning of section 547(c)(4) unambiguously requires consideration of postpetition payments made pursuant to section 503(b)(9) when calculating a creditor's new value defense.

The starting point in interpreting section 547(c)(4) is discerning its plain meaning; when the words of a statute are unambiguous, judicial inquiry is complete. *See Conn. Nat'l Bank v. Germain*, 503 U.S. 249, 253–54 (1992) (citations omitted) ("[C]ourts must presume that a legislature says in a statute what it means and means in a statute what it says there."). While section 547(c)(4) has been described as a difficult statute to decipher due to its use of a double negative and analytical subparts, "a difficult statute is not necessarily an ambiguous one." *See* Ralph Brubaker, *Preferential Transfers, the Subsequent New Value Defense, and the Requirement*

That the New Value "Remain Unpaid" (or Not), 30/2 Bankr. L. Letter (Feb. 2010), at 4; *Boyd v. The Water Doctor (In re Check Reporting Servs., Inc.)*, 140 B.R. 425, 434 (Bankr. W.D. Mich. 1992).

1. Section 547(c)(4)(B) plainly provides that a creditor's new value defense will be reduced when a debtor makes an otherwise unavoidable transfer after the creditor extends the new value.

The language of section 547(c)(4) contains no language requiring debtor payments on account of new value to be *prepetition* payments for purposes of calculating a creditor's new value defense. *See* 11 U.S.C. § 547(c)(4). Indeed, the only temporal restriction contained in section 547(c)(4) is that an otherwise unavoidable transfer be made by the debtor to the creditor *after* the creditor transferred new value to the debtor. *See id.* Consequently, courts have correctly recognized that postpetition payments can reduce a creditor's new value defense. *See, e.g.*, *TI Acquisition, LLC v. S. Polymer, Inc. (In re TI Acquisition, LLC)* (*TI Acquisition II*), 429 B.R. 377, 385 (Bankr. N.D. Ga. 2010); *MMR Holding Corp. v. C & C Consultants, Inc. (In re MMR Holding Corp.)*, 203 B.R. 605, 609–11 (Bankr. M.D. La. 1996). Nonetheless, other courts have reasoned in part that because the title of section 547 is entitled "Preferences," all calculations of preference liability relate to the prepetition preference period. *See Friedman's Liquidating Tr. v. Roth Staffing Cos. (In re Friedman's Inc.)*, 738 F.3d 547, 555 (3d Cir. 2013). While it may be appropriate to consider the title of a statute to resolve ambiguity, the statute's title cannot eclipse the plain meaning of its text. *See Brotherhood of R.R. Trainmen v. Balt. & O.R. Co.*, 331 U.S. 519, 528–29 (1947). Indeed, using a title to impose a temporal limit on a statute when the text does not so provide would allow the title to trump the statute's text. *See In re Beaulieu Grp.*, 616 B.R. at 873.

Additionally, the argument that the use of the word "debtor" in section 547(c)(4) limits that section to prepetition transfers is unpersuasive for at least two reasons. First, the Code's definition

of debtor fails to define a debtor as a prepetition entity—on the contrary, the definition itself refers to the commencement of a case. *See* 11 U.S.C. § 101(13) (defining a debtor as "a person . . . concerning which a case under this title has been commenced."); *In re Friedman's*, 738 F.3d at 555. Second, other provisions of the Code refer to a debtor in the postpetition context. *See, e.g.*, 11 U.S.C. § 521 (describing a debtor's post-petition duties); *see also In re Friedman's*, 738 F.3d at 555 (noting the same). Accordingly, where the text of section 547(c)(4) does not expressly provide a time limitation for transfers by a debtor, it would be inappropriate for the Court to enlarge the statute by implying one. *See, e.g.*, *Lamie v. United States Tr.*, 540 U.S. 526, 542 (2004) ("If Congress enacted into law something different from what it intended, then it should amend the statute to conform it to its intent . . . . This allows both of our branches to adhere to our respected, and respective, constitutional roles.").

2. Because full payment pursuant to section 503(b)(9) is unavoidable for reasons other than section 547(c)(4) itself, a creditor may not use that same value to reduce its preference exposure.

Creditors may offset their preference liability by extending new value, but that new value must not be followed by an *otherwise unavoidable transfer* by the debtor. *See* 11 U.S.C. § 547(c)(4)(B). Therefore, it is necessary to determine what exactly is meant by the phrase "otherwise unavoidable transfer," including what transfers the word "otherwise" serves to exclude. *See id.*; *see also* 11 U.S.C. § 101(54)(D) (defining a "transfer" as "each mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with . . . property or an interest in property"). Additionally, while the term "avoid" is not defined by the bankruptcy court, it simply means an action that unwinds and renders a transaction of no effect. *See Avoid, Black's Law Dictionary* (11th ed. 2019) (defining "avoid" as "to render void"); *Void*, *Black's Law Dictionary* (11th ed. 2019) (defining "void" as "to render of no validity or effect"). Accordingly,

any transfer that may not be unwound and rendered void is "unavoidable." Further, because section 547(c)(4) itself makes transfers unavoidable and the phrase is contained within that section, the most principled interpretation is that "otherwise unavoidable" refers to any transfer that is unavoidable for reasons other than the section 547(c)(4) defense itself. *See In re BFW Liquidation, LLC*, 899 F.3d at 1198–99; Brubaker, *supra*, at 8–9.

An alternative interpretation—that "otherwise" excludes only those transfers that are avoidable other than as a preference—results in absurd outcomes; for instance, treating a fraudulent transfer under section 548 as unavoidable. *See In re BFW Liquidation, LLC*, 899 F.3d at 1198–99; 11 U.S.C. § 548. Indeed, no court has accepted that interpretation, and several have rejected the interpretation because its application would be wholly inconsistent with the goals of section 547(c)(4). *See In re BFW Liquidation, LLC*, 899 F.3d at 1198–99 (collecting cases and noting the same). In sum, if a debtor's subsequent payments are themselves voidable as preferences *or on any other ground*, then the creditor can still assert a new value defense. Vern Countryman, *The Concept of a Voidable Preference in Bankruptcy*, 38 Vand. L. Rev. 713, 788 (1985) (emphasis added). Conversely, when a debtor's subsequent transfers are not voidable "on any other ground," nor as a preference, a creditor "may keep his payments[,] but has no section 547(c)(4) defense to a trustee's action to recover the earlier preference." *Id.*

Fully funded administrative expenses paid pursuant to section 503(b)(9) are such an otherwise unavoidable transfer. *See* 11 U.S.C. 503(b)(9). On the facts of this case, the only applicable section that expressly provides for avoiding a postpetition transfer is section 549. *See* 11 U.S.C. § 549; *Cir. City Stores, Inc. v. Mitsubishi Dig. Elecs. Am. (In re Cir. City Stores, Inc.)*, 2010 WL 4956022, at *8 (Bankr. E.D. Va. Dec. 1, 2010). Section 549 permits a trustee to avoid a transfer made after the petition date if the transfer was not authorized by the Bankruptcy Code

or by the bankruptcy court. 11 U.S.C. § 549(a). Here, the bankruptcy court authorized the Debtor's postpetition payment to Touch of Grey on account of Touch of Grey's prepetition extension of new value. R. at 13. The Bankruptcy Code also authorizes payment and mandates administrative expense priority for the value of any goods received by the debtor within 20 days before the petition date when sold in the ordinary course of business. 11 U.S.C. § 503(b)(9). The parties here have stipulated that the $200,000 of goods delivered to the Debtor on December 21, 2019 by Touch of Grey satisfied the requirements of an administrative expense under section 503(b)(9). R. at 7 n.2. After the bankruptcy court granted Touch of Grey administrative expense priority and allowed the Debtor to provide immediate payment, the Debtor promptly paid Touch of Grey the full $200,000. *See* R. at 7. Accordingly, because the trustee was, and is, unable to recover debtor's payment for the benefit of the estate, the Thirteenth Circuit properly characterized the payment as an "otherwise unavoidable transfer" that precludes Touch of Grey from offsetting its preference liability under section 547(c)(4)(B). *See* R. at 13.

B. Even though the plain meaning of section 547(c)(4) requires reducing a creditor's new value defense when it has already been fully paid on account of the same value with an unavoidable transfer, statutory context requires the same.

When the language of a statute is plain, judicial inquiry ends, and the court should apply the words as written. *See United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 241 (1989). Indeed, Congress' failure to foresee consequences of a statutory enactment is not a sufficient reason for refusing to give effect to a statute's plain meaning. *See United Bank v. Wolas*, 502 U.S. 151, 158 (1991). That said, the Court has also recognized that "the meaning of statutory language, plain or not, depends on context." *See King v. St. Vincent's Hosp.*, 502 U.S. 215, 221 (1991). Here, in addition to being supported by the plain meaning of section 547(c)(4), reducing a

creditor's new value defense to the extent of a fully paid 503(b)(9) claim on account of the same new value is consistent with the statutory context in which these sections were enacted.

1. Arbitrarily imposing the petition date as a temporal limit would be contrary to Congress' intent when it enacted sections 547(c)(4) and 503(b)(9).

When Congress changes statutory language, such changes generally indicate an intent to replace the statutory language with something substantively different. *See In re BFW Liquidation, LLC*, 899 F.3d at 1191; Antonin Scalia & Bryan A. Garner, *Reading Law: The Interpretation of Legal Texts* 256 (2012) ("[A] change in the language of a prior statute presumably connotes a change in meaning."). While the language of section 547(c)(4) is unambiguous and the Court need not rely on statutory context nor legislative history to resolve the present case, differences between section 547(c)(4) and its predecessor statute further support our interpretation. Section 60(c) of the Bankruptcy Act of 1898, the precursor to section 547(c)(4), codified at 11 U.S.C. § 96(c), provided that:

> 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).

The fact that the "time of the adjudication" language was excluded when section 547(c)(4) was enacted indicates that Congress intended to eliminate such a temporal limitation from the subsequent new value defense. *See In re Beaulieu Grp.*, 616 B.R. at 872. Indeed, Congress knew how to expressly impose the petition date as a temporal limitation when it enacted the preference defenses, as evidenced by section 547(c)(5)'s limited application to prepetition transfers. *See id.*; 11 U.S.C. § 547(c)(5). Because Congress did not so limit section 547(c)(4), this indicates that the omission was intentional. *See* 11 U.S.C. § 547(c)(4). Instead, Congress replaced the prior

"remaining unpaid at the time of the adjudication" requirement with new language limiting the new value defense; namely, that *after* the transfer of new value "the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor." *Compare* 11 U.S.C. § 96(c) (1976), *with* 11 U.S.C. § 547(c)(4). It is true there is legislative history stating that, under section 547(c)(4), "[i]f the creditor and the debtor have more than one exchange during the 90-day period, the exchanges are netted out according to the formula in paragraph (4)." *See* S. Rep. 95-989 (1978) U.S.C.C.A.N. 5787, 5874. This language, however, does not prohibit reducing a creditor's new value defense with unavoidable postpetition transfers for two reasons. First, the legislative history does not say that all exchanges *must* be within the 90-day preference window to factor into section 547(c)(4), just that *if* the debtor and creditor have multiple exchanges during that period, they are set off against each other. *See id.* Second, when the language of section 547(c)(4) is applied faithfully, such application does not produce a result "fundamentally at odds with the intent of the drafters as expressed in the legislative history," because it balances policies articulated in the legislative history and in subsequent case law, as discussed below. *See Ron Pair*, 489 U.S. at 242. Moreover, a change in statutory language may effect a substantive change even when legislative history is contrary to the plain text of the statute—indeed, "[t]he new text is the law, and where it clearly makes a change, that governs . . . even when the legislative history consisting of the codifiers' report expresses the intent to make no change." *See* Scalia & Garner, *supra*, at 257.

Nearly twenty-five years after section 547(c)(4) was enacted, Congress added section 503(b)(9) to section 503 by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. *See* Pub. L. No. 109-8, 119 Stat. 23 § 1227 (Apr. 20, 2005). While the legislative history regarding the addition of 503(b)(9) is scant, the *TI Acquisition* court noted that its addition reflected a clear congressional intent of insuring that when a debtor receives goods within the twenty days

before the petition date, the ordinary course seller providing the goods must gain priority in payment over most other creditors. *See In re TI Acquisition, LLC* (*TI Acquisition I*), 410 B.R. 742, 745–46 (Bankr. N.D. Ga. 2009); *see also* 11 U.S.C. § 507 (setting out the order of priority). The court explained that the treatment of expenses under section 503(b)(9) appears to be an outgrowth of the policy that first appeared in section 546(c), which preserved the right of reclamation to certain sellers of goods on credit. *See TI Acquisition I*, 410 B.R. at 745–46; 11 U.S.C. § 546(c). This Court should therefore treat fully paid 503(b)(9) claims the same as reclamation claims and preclude Touch of Grey from receiving double credit for the same value.

2. Similarly to reclamation claims, section 503(b)(9) claims increase a creditor's priority status and should likewise reduce a new value defense to the extent of such priority.

While there is a "general understanding that preference law is concerned with prepetition transactions," it is nevertheless necessary to consider postpetition events when evaluating prebankruptcy transactions in certain situations. *See* Christopher W. Frost, *Postpetition Payments and the New Value Defense to Preference Liability*, 34/3 Bankr. L. Letter (March 2014), at 6. This is particularly true when courts use context and policy, rather than a statute's plain text, to justify refusing consideration of postpetition events. *See id.*; *In re Friedman's Inc.*, 738 F.3d at 555–61.

While courts are not unanimous, situations where postpetition events are considered for purposes of a creditor's preference liability include when subsequent advances give rise to reclamation claims and when critical vendor orders are granted. *See In re Phoenix Rest. Grp., Inc.* (*Phoenix II*), 373 B.R. 541 (M.D. Tenn. 2007) (upholding the bankruptcy court's decision to reduce a creditor's new value defense to the extent of such creditor's reclamation right); *TI Acquisition II*, 429 B.R. at 380 (comparing 503(b)(9) claims, reclamation claims, and critical vendor orders as applied in preference actions and finding 503(b)(9) claims more like reclamation

claims than critical vendor orders). *But see In re Phoenix Rest. Grp., Inc.* (*Phoenix I*), 317 B.R. 491 (Bankr. M.D. Tenn. 2004) (refusing to consider a postpetition payment pursuant to a critical vendor order in calculating a creditor's new value defense); *Commissary Operations, Inc. v. Dot Foods, Inc. (In re Commissary Operations, Inc.)*, 421 B.R. 873, 878 (Bankr. M.D. Tenn. 2010) (finding 503(b)(9) claims more like critical vendor orders than reclamation claims). Because 503(b)(9) claims are sufficiently analogous to reclamation claims in that they afford a creditor elevated priority, this Court should reduce Touch of Grey's new value defense to the extent of that enhanced priority. *See TI Acquisition II*, 429 B.R. at 380.

Reclamation under section 546(c) gives creditors a limited right to the return of goods shipped immediately before a bankruptcy petition, and section 503(b)(9) may well represent an extension of the reclamation right. *See id.*; Frost, *supra*, at 8. In *Phoenix II*, the district court upheld the bankruptcy court's decision to reduce a creditor's new value defense by the amount of that creditor's reclamation right. *See* 373 B.R. at 548. In support of its holding, the court reasoned that when a shipment of goods is subject to a reclamation right, the shipment is not new value sufficient to give rise to a preference defense under section 547(c)(4). *Id.*; Frost, *supra*, at 7. The holding in *Phoenix II* was contrary to the court's prior holding in *Phoenix I*, which held that a creditor could receive a payment as a critical vendor and nevertheless use the same, fully paid value to reduce its preference exposure. *See Phoenix I*, 317 B.R. at 497. However, the court in *Phoenix I* incorrectly relied on section 547(c)(4)(B)'s use of the word "debtor," rather than "estate" to indicate that the section does not include postpetition transfers. *See id.* at 496; *In re Friedman's*, 738 F.3d at 555 (recognizing that the term "debtor" is not defined as a prepetition entity and that "many other provisions in the Code refer to debtors in the postpetition context").

Some courts have also incorrectly relied on whether there is a property interest in the goods shipped, rather than focusing on the relative priority of creditors. *See, e.g.*, *In re Commissary Operations, Inc.*, 421 B.R. at 878. In *Commissary Operations*, creditors filed administrative claims under section 503(b)(9) and sought to receive a new value credit on account of the same value. *Id.* at 876. The court allowed the creditors to double-dip, differentiating 503(b)(9) status from reclamation claims and finding 503(b)(9) claims more akin to critical vendor payments because an administrative claim does not constitute a lien or threaten to deprive the debtor of the goods themselves. *See id* at 878. Conversely, in *TI Acquisition II*, the court correctly reasoned that it is not important whether a particular right constitutes a property interest in specific goods, but rather, whether the right affords the creditor a priority status. *TI Acquisition II*, 429 B.R. at 381. Focusing further on the certainty of payment to the 503(b)(9) claimant and the amount of distribution to other creditors, the court reasoned that when estate assets are sufficient to pay 503(b)(9) claims, such a claimant is as protected as a reclamation creditor and distributions to other creditors is also the same. *Id.* While there may be a case where the estate is administratively insolvent such that a creditor would not be fully paid as an administrative expense claimant, those are not the facts before this Court. *See id.* at 385; R. at 6–9. When the purpose of the new value rule is to ensure a creditor's subsequent advance of new value restores a debtor's earlier preferential payment for the benefit of other creditors, the focus on relative priority is more appropriate than whether there is a property interest in goods provided as new value. *See* Frost, *supra*, at 8. That is, preference law seeks to benefit unsecured creditors; from their perspective, neither shipments of goods afforded reclamation rights nor claims fully paid as an administrative expense are truly restorative because neither provides value that can be distributed to those creditors and therefore, neither should negate a prior preferential payment. *See id.*

3. Relying on contextual clues in section 547 to impose the petition date as a time bar for calculating a creditor's new value defense would render statutory language superfluous.

As the Thirteenth Circuit correctly explained, Congress knows how to expressly impose temporal limitations, and it did not do so when it enacted section 547(c)(4). *See* R. at 14. Indeed, other defenses under section 547(c) expressly provide for such time limits, which leads to the "inescapable conclusion that [section 547(c)(4)] contains no temporal component whatsoever." *See id. Compare* 11 U.S.C. § 547(c)(4)(B), *with* 11 U.S.C. § 547(c)(5). Despite the apparent intention not to include a specific time limitation in section 547(c)(4), courts have nevertheless looked to other contextual clues to justify treating the petition date as a "hard stop" for calculating a creditor's new value defense. *See In re Friedman's Inc.*, 738 F.3d at 555–56. However, nothing in the contextual indicators relied on by the *Friedman's* court specifically requires that the new value analysis end on the petition date. Frost, *supra*, at 6.

First, the fact that the hypothetical liquidation test in section 547(b)(5) is performed as of the petition date does not unequivocally indicate that postpetition payments made by a debtor are irrelevant to a creditor's new value defense. *See In re Beaulieu Grp.*, 616 B.R. at 874. The hypothetical liquidation test requires determining the extent to which a creditor would receive payment in a chapter 7 case, and accordingly, postpetition facts are necessarily required for proper consideration of 547(b) recovery actions. *Id.* Second, section 547 expressly provides different time periods for different parts of the statute. *See id.* Determining whether the debtor made a preferential transfer in the first instance is indeed expressly limited to those transfers that occurred prepetition. *Id.* The preference defense contained in section 547(c)(5) is also expressly limited to prepetition events, unlike section 547(c)(4)'s new value defense. *See id.*; 11 U.S.C. §§ 547(c)(4), (5). Were the Court to require the petition date as a cutoff for section 547(c)(4) under the reasoning

that statutory context implies such a limitation, such a requirement would render the express language in section 547(c)(5) superfluous, regardless of whether sections 547(c)(4) and 547(c)(5) are "analogous defenses." *See In re Friedman's Inc.*, 738 F.3d at 556–57; *see also Hibbs v. Winn*, 542 U.S. 88, 101 (2004) ("A statute should be construed so that effect is given to all its provisions, so that no part will be inoperative or superfluous, void or insignificant. . . ." (citation omitted)).

Lastly, while the statute of limitations for bringing a preference action begins to run on the petition date, allowing consideration of administrative expense claims paid on account of prepetition new value does not result in a nebulous moving target. *See In re Beaulieu Grp.*, 616 B.R. at 874–75; 11 U.S.C. § 546. First, despite the appeal of having a fixed limitations date for every event that may affect the preference analysis, factors such as the exact payment amounts, when payments clear, and when checks or other payments were initiated are often unresolved on the petition date. *In re Beaulieu Grp.*, 616 B.R. at 874–75. Additionally, Congress expressly provided a different limitations period for avoidance of postpetition transfers in section 549, which would provide an outer limit for determining the avoidability of any postpetition transfer made pursuant to 503(b)(9). *Id.*; 11 U.S.C. §§ 546(a), 549(d). In sum, the contextual indicators relied on by the *Friedman's* court are an insufficient basis to override section 547(c)(4)'s plain text and its interaction with other sections of the Bankruptcy Code, contextual indicators, and policy concerns animating preference law. *But see In re Friedman's Inc.*, 738 F.3d at 556.

C. Precluding double recovery for a creditor that seeks to reduce its preference exposure with the same value that has been fully paid as an administrative expense is consistent with the policy goals of the Bankruptcy Code.

Affirming the court below is the most equitable course and will result in creditors getting credit only once—but getting credit nonetheless—when goods and services are supplied as new value following a debtor's preferential transfer, whether a debtor's subsequent payment is

avoidable or unavoidable, prepetition or postpetition. *See* Countryman, *supra*, at 788. If a debtor's transfer on account of new value is avoidable, the creditor will be able to reduce its preference liability, and if the debtor's transfer is unavoidable the creditor will keep the payment—in either event, the creditor receives the same dollar-for-dollar reduction to what it is owed. *See In re MMR Holding Corp.*, 203 B.R. at 609. Holding to the contrary would result in a windfall to the creditor and frustrate the policies underlying section 547; the limitations contained within 547(c)(4) in particular. *Id.*

To prevent inequities resulting from a debtor improperly favoring certain creditors over others shortly before filing for bankruptcy, the Bankruptcy Code allows a trustee to avoid, or undo, certain pre-bankruptcy transfers. *In re BFW Liquidation, LLC*, 899 F.3d at 1197. This practice promotes "the prime bankruptcy policy of equality of distribution among creditors[.]". *Wolas*, 502 U.S. at 161. A second policy underlying preference law is to discourage creditors from racing to the courthouse to dismember the debtor during its slide into bankruptcy. *See, e.g.*, *In re Friedman's Inc.*, at 558. Conversely, the subsequent new value defense serves two related, but sometimes conflicting, policies: first, to encourage trade creditors to deal with a struggling business so that it may avoid bankruptcy altogether, and second, to treat fairly a creditor who has replenished the estate after receiving a preference. *See id.*

1. The overarching policy goal of providing equitable distribution among creditors is served by precluding double recovery for trade creditors already paid in full for new value.

Equal distribution among creditors weighs heavily in favor of denying new value credit for fully paid administrative expenses—allowing a creditor to receive both new value credit *and* full payment pursuant to 503(b)(9) results in double payment to that creditor and reduces the value available to the estate for distribution among all creditors. *See TI Acquisition II*, 429 B.R. at 385.

Under the facts of the case, equitable distribution requires that Touch of Grey only receive payment on account of its new value once.

While the dissent in the opinion below insists that reducing a creditor's new value defense by the amount of postpetition payments increases the creditor's preference exposure on the petition date, this argument misses the mark by ignoring the statutory command that new value not be paid by an otherwise unavoidable transfer. *See* R. at 27–28; 11 U.S.C. § 547(c)(4)(B). The only reason Touch of Grey's preference exposure on the petition date was $50,000 was *because* it extended $200,000 worth of unsecured new value to the Debtor, thereby replenishing the estate. *See* R. at 5–7. This transfer was made to reduce prior preferential payments and sufficiently served the policy goal of encouraging a trade creditor to engage with a distressed business at the time Touch of Grey decided to extend new value. *See id.* When new value is subsequently paid in full by an otherwise unavoidable transfer, it is as if the subsequent new value had never been extended as related to the prior preferential transfers. Moreover, as far as distribution to other unsecured creditors is concerned, an unavoidable postpetition payment depletes the return to general unsecured creditors the same as if it were made prepetition and not recovered as a preference—from other creditors' perspectives, cutting off the calculation at the petition date makes no sense. *See In re Furr's Supermarkets*, 485 B.R. 672, 734 (Bankr. D. N.M. 2012). This Court should hold that full payment to a 503(b)(9) claimant is an otherwise unavoidable transfer that should reduce such claimant's new value defense under section 547(c)(4). Holding otherwise would read out section 547(c)(4)(B)'s requirement that subsequent new value not be paid by an otherwise unavoidable transfer and would result in Touch of Grey receiving double use of its new value, "once as consideration for the unavoidable transfer which effects a dollar-for-dollar

reduction, and once as an offset to the prior preference which would also reflect a dollar-for-dollar reduction." *See MMR Holding Corp.*, 203 B.R. at 609.

2. When a creditor must be paid in full pursuant to section 503(b)(9), further protection under section 547(c)(4) is unnecessary to encourage or protect trade creditors who continue dealing with a troubled business.

Without the subsequent new value exception, "a creditor who continues to extend credit to the debtor, perhaps in implicit reliance on prior payments, would merely be increasing his bankruptcy loss." *Laker v. Vallette (In re Toyota of Jefferson)*, 14 F.3d 1088, 1091 (5th Cir. 1994). However, when a 503(b)(9) claim is guaranteed payment, the creditor will be paid in full for the value given to the debtor—this is the ultimate method of encouraging a creditor to continue doing business with a debtor. *TI Acquisition II*, 429 B.R. at 384. Providing a creditor with double-credit for the same value is therefore unnecessary. Section 547(c)(4) provides balanced protection that encourages creditors to continue revolving credit arrangements with financially troubled debtors without increasing their bankruptcy losses. *In re Toyota of Jefferson*, 14 F.3d at 1091. However, the policy underlying the subsequent new value defense is to give creditors credit against preferences only to the extent they have repaid them. *See In re MMR Holding Corp.*, 203 B.R. 605, 609 (M.D. La. 1996).

Moreover, while providing prebankruptcy incentives to creditors may be a laudable policy goal, the facts of this case counsel in favor of focusing on equality of distribution and treating fairly a creditor that has continued doing business with a struggling business. First, reclamation claims and 503(b)(9) priority do not exist at the time of the prepetition transfer, so a creditor is unlikely to rely on their existence in making the prepetition decision to advance new credit. Frost, *supra*, at 8. While a creditor may rely on the new value defense as protection, the creditor is not relying on *both* the new value defense *and* priority status. Indeed, Touch of Grey was not primarily

motivated by the inner workings of the bankruptcy code—it was induced to extend new credit when Tell signed a personal guarantee, thus providing a second avenue for Touch of Grey's recovery. By holding that Touch of Grey is entitled to receive credit only once for its extension of new value, this Court will be giving Touch of Grey exactly what it expected to receive when it made its decision to lend. Further, such a holding would strike the correct policy balance by treating fairly creditors that continue dealing with struggling businesses while avoiding unjustified and unexpected windfalls to a preferred creditor to the detriment of others.

II. THE THIRTEENTH CIRCUIT CORRECTLY ADOPTED AND APPLIED THE PRORATION APPROACH TO COMMERCIAL PROPERTY RENT PAYMENTS UNDER 11 U.S.C. § 365(D)(3), ALLOWING THE TRUSTEE TO PRORATE THE DEBTOR'S RENT PAYMENT TO COVER ONLY THE DAYS OCCUPIED BEFORE REJECTION OF THE LEASE.

Following the filing of a bankruptcy petition a debtor continues to pay rent for unexpired leases of nonresidential property under section 365(d)(3). It says:

> The 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, notwithstanding section 503(b)(1) of this title.
>
> 11 U.S.C. § 365(d)(3).

Following a bankruptcy petition, assumption and rejection allow the debtor-in-possession or trustee to decide if an agreement, such as a nonresidential property lease is a "good deal" for the estate. *Mission Prod. Holdings, Inc. v. Tempnology, LLC*, 139 S. Ct. 1652, 1658 (2019). If so, the estate will assume the lease, and if not, the estate will reject the lease. *Id.*

Following rejection of a lease, courts are split on whether a rent payment made in the postpetition period that also covers postrejection rental days should be prorated to only charge the debtor for days occupied until rejection of the lease (the "proration approach"), or if the entire

rental payment, because it became due prior to the debtor's rejection of the lease, should be paid in full to the landlord (the "billing date approach").

This Court should affirm the Thirteenth Circuit's decision in this case and adopt the proration approach following the rejection of an unexpired non-residential real property lease, as opposed to the billing date approach, which would require the trustee to pay the entirety of the May rent, in this case $25,000. R. at 9. The proration approach is supported by a majority of courts. R. at 16. The text of section 365(d)(3) is ambiguous. Thus, consulting the legislative history of the statute, canons of construction, and policy goals of the Bankruptcy Code is required. The legislative history, canons, and policy goals all favor adoption of the proration approach.

A. The plain meaning of section § 365(d)(3) is ambiguous because the statute is silent regarding when an obligation arises and is unclear on whether the phrase "until such a lease is assumed or rejected" modifies the word "perform" or "obligations."

A statute is ambiguous if it is "capable of being understood in two or more ways." *Chickasaw Nation v. U.S.*, 534 U.S. 84, 90 (2001) (quoting Webster's Ninth New Collegiate Dictionary 77 (1985)). The court must "look to the provisions of the whole law and to its object and policy" when discerning statutory meaning. *Kelly v. Robinson*, 479 U.S. 36, 43 (1986) (internal quotations omitted). "When . . . the terms of a statute [are] unambiguous, judicial inquiry is complete[.]" *Rubin v. United States*, 449 U.S. 424, 430 (1981). Conversely, when a statute is ambiguous, the court considers the causes of the statute's enactment. *Heydenfeldt v. Daney Gold & Silver Mining Co.*, 93 U.S. 634, 638 (1876).

Numerous courts have found the language of section 365(d)(3) to be ambiguous. *See In re NETtel Corp.*, 289 B.R. 486, 492 n. 12 (Bankr. D.D.C. 2002) (compiling cases); *In re Burival*, 406 B.R. 548, 552–53 (BAP 8th Cir. 2009) (compiling other cases); Ralph Brubaker, *Timing Is Everything or "Let's Do the Limbo Rock"*, 20/8 Bankr. L. Letter (Aug. 2000) ("'[U]nambiguous'

is not the first thing that comes to mind in reading section 365(d)(3)"). The statute has two instances of ambiguity.

First, the statute is silent, and thus ambiguous, on how to determine when a debtor's rental payment obligation arises under the statute. *See In re Montgomery Ward Holding Corp.*, 268 F.3d 205, 213 (3d Cir. 2001) (Mansmann, J., dissenting) (arguing "the statute says nothing about how to determine when the obligation arises"); *see also* R. at 17 (ruling that, when the term "arises" is "considered in relation to the term 'obligations,' it is susceptible to more than one meaning"). "Arise" is capable of two meanings and is not defined by the Bankruptcy Code. R. at 17. The word "can be understood in either an absolutist or accrual sense." *In re Ames Dep't Stores, Inc.*, 306 B.R. 43, 67 (Bankr. S.D.N.Y. 2004). The accrual (or proration) approach would require the tenant pay for the rental obligation as it accrues; the obligation arises based on the "corresponding period of occupancy under the lease." *In re NETtel Corp.*, 289 B.R. at 490; *see also In re Handy Andy Home Improvement Ctrs., Inc.*, 144 F.3d 1125, 1127 (1998) (Posner, J.) (noting a payment obligation under section 365(d)(3) "could realistically be said to have arisen piecemeal every day" of the year the payment was due). The absolutist (or billing date) approach holds "that an obligation arises under a lease for the purposes of § 365(d)(3) when the legally enforceable duty to perform arises under the lease." *In re Montgomery Ward*, 286 F.3d at 211.

Second, the phrase "until such a lease is assumed or rejected" in § 365(d)(3) can be construed to modify either "perform" or "obligations." *See* 11 U.S.C. § 365(d)(3); R. at 18. If it were to modify "perform" the statute would be read to require complete payment until the lease has been assumed or rejected, whereas if it were to modify "obligations," the trustee's duty to perform the obligation would end upon rejection. R. at 18; *see In re Ames Dep't Stores*, 306 B.R. at 67 (identifying the same ambiguity); *In re McCrory Corp.*, 210 B.R. 934, 939 (S.D.N.Y. 1997)

(ruling it is not "clear" whether this phrase "limits the 'obligation' in question to those actually accruing before rejection"); *see also In re Montgomery Ward*, 268 F.3d at 213 (Mansmann, J. dissenting) (finding "the statute says nothing about how to determine when the obligation arises"). The inability to discern whether this phrase modifies "perform" or "obligations" creates an ambiguity that cannot be solved by looking only at the text of the statute itself; other sources of statutory interpretation must be consulted, including the legislative history of section 365(d)(3), canons of construction, and the broader context of the Bankruptcy Code.

B. The context of the statute within the Bankruptcy Code, its legislative history, and canons of construction show that Congress intended to adopt the "proration approach" after a trustee rejects an unexpired lease of non-residential real property.

"[S]tatutory language cannot be construed in a vacuum." *Davis v. Michigan Dep't of Treasury*, 489 U.S. 803, 809 (1989). The "words of a statute must be read in their context and with a view to their place in the overall statutory scheme." *Id; see also In re Handy Andy*, 144 F.3d at 1128 (Posner, J.) (ruling section 365(d)(3) "should be read in context" and when it is not "silliness results"). Legislative history should be relied on to resolve a statute's textual ambiguities by helping place the words of a statute within its overall statutory scheme. *United States v. Pub. Utils. Comm'n of Cal.*, 345 U.S. 295, 315 (1953). Canons of construction serve as "rules of thumb that help courts determine the meaning of legislation." *Conn. Nat'l. Bank v. Germain*, 503 U.S. 249, 253 (1992). One such canon is that the Bankruptcy Code should not be read to "erode past bankruptcy practice absent a clear indication that Congress intended such a departure." *Pa. Dep't of Pub. Welfare v. Davenport*, 495 U.S. 552, 563 (1990) (internal citations omitted). Further, the "normal rule of statutory construction is that if Congress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific." *Midlantic Nat'l Bank v. N.J. Dep't of Env't Prot.*, 474 U.S. 494, 501 (1986). The canon preferring strict construction is

"not an inexorable command to override common sense and evident statutory purpose." *United States v. Brown*, 333 U.S. 18, 25 (1948).

To resolve section 365(d)(3)'s ambiguity courts have considered the context of the statute on its own and in relation to the Bankruptcy Code at large. *In re NETtel*, 289 B.R. at 491; *see In re Burival*, 406 B.R. at 552–53 (listing numerous decisions that found section 365(d)(3) to be ambiguous and looked to place the statute in context with the Bankruptcy Code); *see also In re Koenig Sporting Goods, Inc.*, 229 B.R. 388, 395 (B.A.P. 6th Cir. 1999) (Rhodes, J., dissenting) (arguing "it is necessary and appropriate to examine . . . the structure and purposes of the Bankruptcy Code as a whole").

Section 365(d)(3) cannot be "construed or applied without likewise considering *all* of the statutory text." *In re Ames*, 306 B.R. at 66. Sections 365(g) and 502(g) both consider a debtor's obligations after rejection. *See* 11 U.S.C. §§ 365(g), 502(g). These sections agree that claims arising from "an estate's failure to honor obligations after rejection[,]" are treated as general unsecured claims, and not administrative claims. *In re Ames*, 306 B.R. at 68; *see also* R. at 18.

In *NETtel*, the court explained the Bankruptcy Code's treatment of rejection, as opposed to assumption. *In re NETtel*, 289 B.R. at 491. Rejection of a lease is a breach, and the breach arises prepetition. *Id.* By rejecting the lease, the debtor no longer enjoys the benefits of occupancy, but "in exchange," the estate no longer has the liability of an administrative claim. *Id.* Thus, so long as the estate rejects the lease prior to the date of rejection, the landlord is not entitled to full payment of the postrejection rent as an administrative claim, but instead must line up alongside other general unsecured creditors to receive their share pro rata following payment of priority claims. *Id.* Here, the Debtor rejected the lease, effective as of May 5, 2020. Thus, the Debtor is not required to pay Touch of Grey the entire $25,000 rent payment, and instead, the value of rent

amounts allocable to the last 26 days of May 2020 should be disbursed pro rata alongside other general unsecured creditors. R. at 7.

The proration approach is supported by previous jurisprudence interpreting section 365(d)(3). *In re NETtel*, 289 B.R. at 491. This Court has recognized as much. *See Mission Prod. Holdings,* 139 S. Ct. at 1665 (discussing the "powerful tool" of section 365 that allows the debtor, through rejection, to "escape all of its future contract obligations without having to pay much of anything in return").

Courts have also considered "the context . . . of the real-world situation to which the language pertains." *In re Handy Andy*, 144 F.3d at 1128; *see also In re Koenig Sporting Goods*, 229 B.R. at 395 (Rhodes, J., dissenting) (arguing "common sense" should be considered in evaluating section 365(d)(3)'s meaning). The proration approach is sensible in the real-world situation when postpetition prerejection rent becomes an issue. In *Handy Andy*, the Seventh Circuit considered whether a tenant's debt to a landlord for property taxes could be prorated or if the tenant was liable for the entirety of the property tax bill in line with the "billing date" approach. *Handy Andy*, 144 F.3d at 1126–27. Judge Posner adopted the proration approach because otherwise creditors' rights would "turn on the happenstance of . . . the strategic moves of landlords and tenants." *Id.* at 1128. If the Debtor in this case had rejected the lease just five days earlier, other creditors would see $25,000 dispensed among them; because the Debtor strategically decided to reject the lease on the final day under section 365(d)(3), the Creditor should not receive an additional $20,967.74 in rent.

The enactment of section 365(d)(3) lacks much legislative history that helps to resolve the textual ambiguity. *See In re Child World*, 161 B.R. 571, 575 n.6 (S.D.N.Y. 1993) (noting "[n]o

Senate report or House report was submitted with the legislation, nor did the House conference report contain a joint explanatory statement"); *see also* R. at 19.

The legislative history that does exist favors the proration approach. Senator Orrin Hatch, the sole legislator to speak on the record regarding section 365(d)(3), said the statute sought to ensure the landlord received payment for "current services" in the postpetition, prerejection period as the debtor continues to use the property before rejecting or assuming the lease. *See In re Child World*, 161 B.R. at 575 n.6; H. R. Conf. Rep. No. 98–882, at 598–99 (1984), *as reprinted in* 1984 U.S.C.C.A.N. 576. Prior to the enactment of section 365(d)(3), Senator Hatch further noted that, unlike other creditors, landlords extended credit during the postpetition period as the debtor decided whether to assume or reject the lease, while not making rent payments. *See In re At Home Corp.*, 392 F.3d 1064, 1068 (9th Cir. 2004) (citing 130 Cong. Rec. S8891 (1984), *reprinted in* 1984 U.S.C.C.A.N. 590, 599 (statement of Sen. Hatch)). Section 365(d)(3) sought to remedy this inequity by having debtors pay rent in the postpetition, prerejection period, until the lease is rejected. *Id.* at 1068–69.

Crucially, Senator Hatch labeled the issue landlords faced as a need to provide "current services" while being unable to receive "current payment" under the existing Bankruptcy Code. H.R. Conf. Rep. No. 98–882, at 598–99 (1984) *as reprinted in* 1984 U.S.C.C.A.N. 576. The legislative history makes no mention of payment after the debtor rejects the lease. After rejection, the landlord no longer provides current services. The statute sought to redress the burden that creditor-landlords faced postpetition and prerejection, and nothing more. *See In re Handy Andy*, 144 F.3d at 1128 ("To give relief to landlords, Congress passed section 365(d)(3), which . . . allows them during that awkward postpetition prerejection period to collect the rent fixed in the lease. There is no indication . . . that it meant to give landlords favored treatment for any class of

prepetition debts.") But, the Debtor in this case turned over the keys on May 5; the Debtor no longer required "current services" after that date and thus should pay rent *only* for those five days of May when they used the property and its services. The remaining twenty-six days should be treated as a general unsecured claim and share prorata distribution with other unsecured creditors. Section 365(d)(3) sought to ensure these five days are paid for, along with each month between the petition filing date and the rejection date, which the debtor timely paid.

Prior to the enactment of section 365(d)(3) in 1984, courts applied the proration approach to postpetition, prerejection rent payments. *See In re Child World Inc.*, 161 B.R. at 574–75 (compiling cases prior to 1984 applying the proration approach). Congress made no mention of altering the proration approach, neither before nor after rejection of the property lease. *See id.* at 575–76 ("Nothing in the legislative history indicates that Congress intended section 365(d)(3) to overturn the long-standing practice . . . of prorating debtor-tenants' rent to cover only the postpetition, prerejection period, regardless of billing date"). Lacking any evidence of congressional intent to the contrary, section 365(d)(3) should be read to maintain the proration approach to commercial property leases following rejection of the lease, thus allowing the trustee to pay rent only for the days occupied prerejection, and not postrejection. *Pa. Dep't of Pub. Welfare*, 495 U.S. at 563 (ruling past bankruptcy practice should not be "erode[d] . . . bankruptcy absent a clear indication that Congress intended such a departure). A majority of courts agree. *In re Koenig Sporting Goods*, 229 B.R. at 398 (Rhodes, J., dissenting).

The circuit court decisions adopting the billing-date approach fail to point to any legislative history conclusively supporting that approach. *See In re Koenig Sporting Goods*, 203 F.3d at 989 (conceding the goal of the statute was "to relieve the burden placed on nonresidential real property lessors (or 'landlords') during the period between a tenant's bankruptcy petition and assumption or

rejection of a lease") (internal citations omitted); *In re Montgomery Ward*, 268 F.3d at 211 (noting Senator's Hatch's comments "seem[ed to the court]" to confirm Congress intended to adopt the billing date approach while "acknowledg[ing] that there are aspects to a proration approach that Congress might have found desirable").

Context, provided by both the Bankruptcy Code and real-world situations in which section 365(d)(3) arises, favor the proration approach. The legislative history indicates Congress intended to embrace the proration approach. Even if the legislative history fails to resolve the ambiguity, the pre-Code practice of applying the proration approach should be adopted in this case. *See Dewsnup v. Timm*, 502 U.S. 410, 419 (1992) (noting "this Court has been reluctant to accept arguments that would interpret the [Bankruptcy] Code, however vague the particular language under consideration might be, to effect a major change in pre-Code practice that is not the subject of at least some discussion in the legislative history"). Moreover, the policy goals of the statute and the Bankruptcy Code also favor this approach.

C. Allowing the trustee to prorate their rent payment properly balances the interests of other creditors, the landlord, and the estate, and is consistent with the policy goals of the Bankruptcy Code.

"[H]istorically, one of the prime purposes of bankruptcy law has been to bring about a ratable distribution among creditors of a bankrupt's assets." *Young v. Higbee Co.*, 324 U.S. 204, 210 (1945). "[P]referential treatment of a class of creditors is in order only when clearly authorized by Congress." *Howard Delivery Serv., Inc. v. Zurich Am. Ins. Co.*, 547 U.S. 651, 655 (2006).

The billing date approach would provide an inequitable windfall to one Creditor-Landlord, Touch of Grey, at the expense of other creditors. This preferential treatment has not been "clearly authorized" by Congress under section 365(d)(3), an ambiguous statutory provision. *Id.* Under the billing date approach, Touch of Grey would receive an entire month of rent for a property that

was occupied for only the first five days of May 2020. R. at 8. The property sat unoccupied for the remaining 26 days of May 2020, and Touch of Grey could have leased or utilized the property during that time. If the debtor's payment covers the entire month, Touch of Grey would ostensibly be granted a "double-dip." *See R.* at 20 (holding "the proration approach carefully adheres to one of the fundamental tenets of the Bankruptcy Code by circumscribing any windfall to the landlord). The Landlord would have their $25,000 rent payment for May in hand and be able to rent the property to another tenant at the same time. This is inequitable to other creditors. R. at 18; *see also In re Montgomery Ward*, 268 F.3d at 213 (Mansmann, J., dissenting) (arguing section 365(d)(3) should align with the "overarching policy of treating all creditors in a class . . . alike").

The landlord may argue that the billing date approach is in fact equitable because the property could not feasibly be relet on such short notice, and thus they would lose out on over 84% of the monthly rent as the property remained vacant. The dissent in the Thirteenth Circuit's decision expressed this view. *See* R. at 33 (arguing even though the debtor "returned the keys" on May 5th, "Touch of Grey likely would not have been able to locate a new tenant that month"). While this may be true, part of the business of being a landlord is handling tenant turnover. At times, the property may be without a tenant for the month between two leases. Further, Touch of Grey could use this time to make necessary repairs or upgrades to the property.

Lastly, the debtor's rejection of the lease did not come as a complete surprise to Touch of Grey. The Debtor filed for bankruptcy on January 5, 2020 and rejected the lease on May 5, 2020. R. at 6–8. Under section 365(d)(4) a debtor has 120 days from the petition date to assume or reject the lease.[3] *See* 11 U.S.C. § 365(d)(3) (West 2019). Indeed, inaction would have resulted in an

[3] In light of the COVID-19 pandemic § 365(d)(4) was amended to increase this time period to 210 days. This amendment was passed into law in December of 2020 and is thus not relevant to the present action. *See* Consolidated Appropriations Act of 2021, Pub. L. 116-260, 134 Stat. 1182.

automatic rejection of the lease. As the calendar turned to May, Touch of Grey, an international chain of coffee shops, saw what was coming. R. at 3. The landlord will be, and should be, compensated for the five days the debtor occupied the property, but anything more would result in an inequitable windfall that would significantly reduce the recovery of other equally deserving creditors.

The proration approach provides an equitable outcome for the estate. The debtor only occupied the property for five days of the May rental period, and thus only enjoyed its benefits for those days. Payment for the remaining days of May would force the debtor to pay for a property it no longer occupied nor received the benefit of using.

The proration approach is a sensible policy that is applicable to all types of lease arrangements, whereas the billing date approach would be highly prejudicial to debtors in longer-term lease agreements. This is a case of first impression in the Supreme Court, and the ruling here will reverberate throughout bankruptcy and appeals courts throughout the United States. Though the lease in this case is for one-month, some retail leases can be for three-months, six-months or even a year. R. at 21. Applying the billing date approach in these cases would lead to an even more absurd result than in the present case. A debtor may be on the hook for hundreds of thousands of dollars in rent if they happen to reject the lease shortly after the start of a quarter or year. Congress did not intend to force a debtor to pay thousands, or even hundreds of thousands of dollars for occupying a property for just five days of a rental period. *See* R. at 21 (ruling Congress "cannot possibly" have intended this "absurd" result).

The proration approach grants the debtor the maximal opportunity to reorganize and avoid liquidation without facing dire consequences. The debtor sought to reorganize amidst closures and uncertainty prompted by the COVID-19 pandemic. R. at 7. The debtor waited until the last

possible opportunity to reject the lease, a full 120 days from their petition date. R. at 7. The proration approach allows reorganizing debtors to spend the entirety of the 180-day period between the petition date and the automatic rejection date to attempt to reorganize, assume the lease, and avoid liquidation. *See In re Montgomery Ward*, 268 F.3d at 213 (Mansmann, J., dissenting) (arguing the proration approach to section 365(d)(3) maintains the policy "of giving priority to post-petition claims to enable the debtor to keep operating for as long as its current revenues cover current costs"). The billing date approach would force reorganizing debtors to cut reorganization efforts short before a significant rent payment came due. This is especially problematic when a commercial lease is for six or twelve months. The debtor may have less incentive to spend the first few months of the lease period attempting to reorganize if they know a failure to do so would lead to their paying a full twelve months of rent. This Court should promote policies that encourage reorganization, not liquidation.

The proration approach to § 365(d)(3) provides a more equitable outcome for all parties involved in a bankruptcy proceeding. The debtor would pay the landlord for only the time spent occupying the property and the landlord would receive rent for the time occupied. Importantly, and in line with the goals of bankruptcy as a whole, other creditors would not be unduly prejudiced by the landlord receiving their rent payment, while other, equally deserving creditors receive less.

CONCLUSION

The Bankruptcy Code provides mechanisms to achieve orderly and equitable distribution to creditors. Affirming the courts below ensures these mechanisms are served without providing inequitable windfalls to certain creditors at the expense of others. For the foregoing reasons, we ask that the Court AFFIRM.

APPENDIX

11 U.S.C. § 365. Executory contracts and unexpired leases.

(a) Except as provided in sections 765 and 766 of this title and in subsections (b), (c), and (d) of this section, the trustee, subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor.

(b)(1) If there has been a default in an executory contract or unexpired lease of the debtor, the trustee may not assume such contract or lease unless, at the time of assumption of such contract or lease, the trustee--

> **(A)** cures, or provides adequate assurance that the trustee will promptly cure, such default other than a default that is a breach of a provision relating to the satisfaction of any provision (other than a penalty rate or penalty provision) relating to a default arising from any failure to perform nonmonetary obligations under an unexpired lease of real property, if it is impossible for the trustee to cure such default by performing nonmonetary acts at and after the time of assumption, except that if such default arises from a failure to operate in accordance with a nonresidential real property lease, then such default shall be cured by performance at and after the time of assumption in accordance with such lease, and pecuniary losses resulting from such default shall be compensated in accordance with the provisions of this paragraph;
>
> **(B)** compensates, or provides adequate assurance that the trustee will promptly compensate, a party other than the debtor to such contract or lease, for any actual pecuniary loss to such party resulting from such default; and
>
> **(C)** provides adequate assurance of future performance under such contract or lease.

(2) Paragraph (1) of this subsection does not apply to a default that is a breach of a provision relating to--

> **(A)** the insolvency or financial condition of the debtor at any time before the closing of the case;
>
> **(B)** the commencement of a case under this title;
>
> **(C)** the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement; or
>
> **(D)** the satisfaction of any penalty rate or penalty provision relating to a default arising from any failure by the debtor to perform nonmonetary obligations under the executory contract or unexpired lease.

(3) For the purposes of paragraph (1) of this subsection and paragraph (2)(B) of subsection (f), adequate assurance of future performance of a lease of real property in a shopping center includes adequate assurance--

> **(A)** of the source of rent and other consideration due under such lease, and in the case of an assignment, that the financial condition and operating performance of the proposed assignee and its guarantors, if any, shall be similar to the financial condition and operating performance of the debtor and its guarantors, if any, as of the time the debtor became the lessee under the lease;
>
> **(B)** that any percentage rent due under such lease will not decline substantially;

(C) that assumption or assignment of such lease is subject to all the provisions thereof, including (but not limited to) provisions such as a radius, location, use, or exclusivity provision, and will not breach any such provision contained in any other lease, financing agreement, or master agreement relating to such shopping center; and

(D) that assumption or assignment of such lease will not disrupt any tenant mix or balance in such shopping center.

(4) Notwithstanding any other provision of this section, if there has been a default in an unexpired lease of the debtor, other than a default of a kind specified in paragraph (2) of this subsection, the trustee may not require a lessor to provide services or supplies incidental to such lease before assumption of such lease unless the lessor is compensated under the terms of such lease for any services and supplies provided under such lease before assumption of such lease.

(c) The trustee may not assume or assign any executory contract or unexpired lease of the debtor, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties, if--

(1)(A) applicable law excuses a party, other than the debtor, to such contract or lease from accepting performance from or rendering performance to an entity other than the debtor or the debtor in possession, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties; and

(B) such party does not consent to such assumption or assignment; or

(2) such contract is a contract to make a loan, or extend other debt financing or financial accommodations, to or for the benefit of the debtor, or to issue a security of the debtor; or

(3) such lease is of nonresidential real property and has been terminated under applicable nonbankruptcy law prior to the order for relief.

(d)(1) In a case under chapter 7 of this title, if the trustee does not assume or reject an executory contract or unexpired lease of residential real property or of personal property of the debtor within 60 days after the order for relief, or within such additional time as the court, for cause, within such 60-day period, fixes, then such contract or lease is deemed rejected.

(2) In a case under chapter 9, 11, 12, or 13 of this title, the trustee may assume or reject an executory contract or unexpired lease of residential real property or of personal property of the debtor at any time before the confirmation of a plan but the court, on the request of any party to such contract or lease, may order the trustee to determine within a specified period of time whether to assume or reject such contract or lease.

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

(B) In a case under subchapter V of chapter 11, the time for performance of an obligation described in subparagraph (A) arising under any unexpired lease of nonresidential real

property may be extended by the court if the debtor is experiencing or has experienced a material financial hardship due, directly or indirectly, to the coronavirus disease 2019 (COVID-19) pandemic until the earlier of--

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

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

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

(4)(A) Subject to subparagraph (B), an unexpired lease of nonresidential real property under which the debtor is the lessee shall be deemed rejected, and the trustee shall immediately surrender that nonresidential real property to the lessor, if the trustee does not assume or reject the unexpired lease by the earlier of--

(i) the date that is 210 days after the date of the order for relief; or

(ii) the date of the entry of an order confirming a plan.

(B)(i) The court may extend the period determined under subparagraph (A), prior to the expiration of the 210-day period, for 90 days on the motion of the trustee or lessor for cause.

(ii) If the court grants an extension under clause (i), the court may grant a subsequent extension only upon prior written consent of the lessor in each instance.

(5) The trustee shall timely perform all of the obligations of the debtor, except those specified in section 365(b)(2), first arising from or after 60 days after the order for relief in a case under chapter 11 of this title under an unexpired lease of personal property (other than personal property leased to an individual primarily for personal, family, or household purposes), until such lease is assumed or rejected notwithstanding section 503(b)(1) of this title, unless the court, after notice and a hearing and based on the equities of the case, orders otherwise with respect to the obligations or timely performance thereof. This subsection shall not be deemed to affect the trustee's obligations under the provisions of subsection (b) or (f). Acceptance of any such performance does not constitute waiver or relinquishment of the lessor's rights under such lease or under this title.

(e)(1) Notwithstanding a provision in an executory contract or unexpired lease, or in applicable law, an executory contract or unexpired lease of the debtor may not be terminated or modified, and any right or obligation under such contract or lease may not be terminated or modified, at any time after the commencement of the case solely because of a provision in such contract or lease that is conditioned on--

(A) the insolvency or financial condition of the debtor at any time before the closing of the case;

(B) the commencement of a case under this title; or

(C) the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement.

(2) Paragraph (1) of this subsection does not apply to an executory contract or unexpired lease of the debtor, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties, if--

(A)(i) applicable law excuses a party, other than the debtor, to such contract or lease from accepting performance from or rendering performance to the trustee or to an assignee of such contract or lease, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties; and

(ii) such party does not consent to such assumption or assignment; or

(B) such contract is a contract to make a loan, or extend other debt financing or financial accommodations, to or for the benefit of the debtor, or to issue a security of the debtor.

(f)(1) Except as provided in subsections (b) and (c) of this section, notwithstanding a provision in an executory contract or unexpired lease of the debtor, or in applicable law, that prohibits, restricts, or conditions the assignment of such contract or lease, the trustee may assign such contract or lease under paragraph (2) of this subsection.

(2) The trustee may assign an executory contract or unexpired lease of the debtor only if--

(A) the trustee assumes such contract or lease in accordance with the provisions of this section; and

(B) adequate assurance of future performance by the assignee of such contract or lease is provided, whether or not there has been a default in such contract or lease.

(3) Notwithstanding a provision in an executory contract or unexpired lease of the debtor, or in applicable law that terminates or modifies, or permits a party other than the debtor to terminate or modify, such contract or lease or a right or obligation under such contract or lease on account of an assignment of such contract or lease, such contract, lease, right, or obligation may not be terminated or modified under such provision because of the assumption or assignment of such contract or lease by the trustee.

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

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

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

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

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

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

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

(h)(1)(A) If the trustee rejects an unexpired lease of real property under which the debtor is the lessor and--

(i) if the rejection by the trustee amounts to such a breach as would entitle the lessee to treat such lease as terminated by virtue of its terms, applicable nonbankruptcy law, or any agreement made by the lessee, then the lessee under such lease may treat such lease as terminated by the rejection; or

(ii) if the term of such lease has commenced, the lessee may retain its rights under such lease (including rights such as those relating to the amount and timing of payment of rent and other amounts payable by the lessee and any right of use,

possession, quiet enjoyment, subletting, assignment, or hypothecation) that are in or appurtenant to the real property for the balance of the term of such lease and for any renewal or extension of such rights to the extent that such rights are enforceable under applicable nonbankruptcy law.

(B) If the lessee retains its rights under subparagraph (A)(ii), the lessee may offset against the rent reserved under such lease for the balance of the term after the date of the rejection of such lease and for the term of any renewal or extension of such lease, the value of any damage caused by the nonperformance after the date of such rejection, of any obligation of the debtor under such lease, but the lessee shall not have any other right against the estate or the debtor on account of any damage occurring after such date caused by such nonperformance.

(C) The rejection of a lease of real property in a shopping center with respect to which the lessee elects to retain its rights under subparagraph (A)(ii) does not affect the enforceability under applicable nonbankruptcy law of any provision in the lease pertaining to radius, location, use, exclusivity, or tenant mix or balance.

(D) In this paragraph, "lessee" includes any successor, assign, or mortgagee permitted under the terms of such lease.

(2)(A) If the trustee rejects a timeshare interest under a timeshare plan under which the debtor is the timeshare interest seller and--

(i) if the rejection amounts to such a breach as would entitle the timeshare interest purchaser to treat the timeshare plan as terminated under its terms, applicable nonbankruptcy law, or any agreement made by timeshare interest purchaser, the timeshare interest purchaser under the timeshare plan may treat the timeshare plan as terminated by such rejection; or

(ii) if the term of such timeshare interest has commenced, then the timeshare interest purchaser may retain its rights in such timeshare interest for the balance of such term and for any term of renewal or extension of such timeshare interest to the extent that such rights are enforceable under applicable nonbankruptcy law.

(B) If the timeshare interest purchaser retains its rights under subparagraph (A), such timeshare interest purchaser may offset against the moneys due for such timeshare interest for the balance of the term after the date of the rejection of such timeshare interest, and the term of any renewal or extension of such timeshare interest, the value of any damage caused by the nonperformance after the date of such rejection, of any obligation of the debtor under such timeshare plan, but the timeshare interest purchaser shall not have any right against the estate or the debtor on account of any damage occurring after such date caused by such nonperformance.

(i)(1) If the trustee rejects an executory contract of the debtor for the sale of real property or for the sale of a timeshare interest under a timeshare plan, under which the purchaser is in possession, such purchaser may treat such contract as terminated, or, in the alternative, may remain in possession of such real property or timeshare interest.

(2) If such purchaser remains in possession--

(A) such purchaser shall continue to make all payments due under such contract, but may,[1] offset against such payments any damages occurring after the date of the rejection of such contract caused by the nonperformance of any obligation of the debtor after such date, but such purchaser does not

have any rights against the estate on account of any damages arising after such date from such rejection, other than such offset; and

(B) the trustee shall deliver title to such purchaser in accordance with the provisions of such contract, but is relieved of all other obligations to perform under such contract.

(j) A purchaser that treats an executory contract as terminated under subsection (i) of this section, or a party whose executory contract to purchase real property from the debtor is rejected and under which such party is not in possession, has a lien on the interest of the debtor in such property for the recovery of any portion of the purchase price that such purchaser or party has paid.

(k) Assignment by the trustee to an entity of a contract or lease assumed under this section relieves the trustee and the estate from any liability for any breach of such contract or lease occurring after such assignment.

(l) If an unexpired lease under which the debtor is the lessee is assigned pursuant to this section, the lessor of the property may require a deposit or other security for the performance of the debtor's obligations under the lease substantially the same as would have been required by the landlord upon the initial leasing to a similar tenant.

(m) For purposes of this section 365 and sections 541(b)(2) and 362(b)(10), leases of real property shall include any rental agreement to use real property.

(n)(1) If the trustee rejects an executory contract under which the debtor is a licensor of a right to intellectual property, the licensee under such contract may elect--

(A) to treat such contract as terminated by such rejection if such rejection by the trustee amounts to such a breach as would entitle the licensee to treat such contract as terminated by virtue of its own terms, applicable nonbankruptcy law, or an agreement made by the licensee with another entity; or

(B) to retain its rights (including a right to enforce any exclusivity provision of such contract, but excluding any other right under applicable nonbankruptcy law to specific performance of such contract) under such contract and under any agreement supplementary to such contract, to such intellectual property (including any embodiment of such intellectual property to the extent protected by applicable nonbankruptcy law), as such rights existed immediately before the case commenced, for--

(i) the duration of such contract; and

(ii) any period for which such contract may be extended by the licensee as of right under applicable nonbankruptcy law.

(2) If the licensee elects to retain its rights, as described in paragraph (1)(B) of this subsection, under such contract--

(A) the trustee shall allow the licensee to exercise such rights;

(B) the licensee shall make all royalty payments due under such contract for the duration of such contract and for any period described in paragraph (1)(B) of this subsection for which the licensee extends such contract; and

(C) the licensee shall be deemed to waive--

(i) any right of setoff it may have with respect to such contract under this title or applicable nonbankruptcy law; and

(ii) any claim allowable under section 503(b) of this title arising from the performance of such contract.

(3) If the licensee elects to retain its rights, as described in paragraph (1)(B) of this subsection, then on the written request of the licensee the trustee shall--

(A) to the extent provided in such contract, or any agreement supplementary to such contract, provide to the licensee any intellectual property (including such embodiment) held by the trustee; and

(B) not interfere with the rights of the licensee as provided in such contract, or any agreement supplementary to such contract, to such intellectual property (including such embodiment) including any right to obtain such intellectual property (or such embodiment) from another entity.

(4) Unless and until the trustee rejects such contract, on the written request of the licensee the trustee shall--

(A) to the extent provided in such contract or any agreement supplementary to such contract--

(i) perform such contract; or

(ii) provide to the licensee such intellectual property (including any embodiment of such intellectual property to the extent protected by applicable nonbankruptcy law) held by the trustee; and

(B) not interfere with the rights of the licensee as provided in such contract, or any agreement supplementary to such contract, to such intellectual property (including such embodiment), including any right to obtain such intellectual property (or such embodiment) from another entity.

(o) In a case under chapter 11 of this title, the trustee shall be deemed to have assumed (consistent with the debtor's other obligations under section 507), and shall immediately cure any deficit under, any commitment by the debtor to a Federal depository institutions regulatory agency (or predecessor to such agency) to maintain the capital of an insured depository institution, and any claim for a subsequent breach of the obligations thereunder shall be entitled to priority under section 507. This subsection shall not extend any commitment that would otherwise be terminated by any act of such an agency.

(p)(1) If a lease of personal property is rejected or not timely assumed by the trustee under subsection (d), the leased property is no longer property of the estate and the stay under section 362(a) is automatically terminated.

(2)(A) If the debtor in a case under chapter 7 is an individual, the debtor may notify the creditor in writing that the debtor desires to assume the lease. Upon being so notified, the creditor may, at its option, notify the debtor that it is willing to have the lease assumed by the debtor and may condition such assumption on cure of any outstanding default on terms set by the contract.

(B) If, not later than 30 days after notice is provided under subparagraph (A), the debtor notifies the lessor in writing that the lease is assumed, the liability under the lease will be assumed by the debtor and not by the estate.

(C) The stay under section 362 and the injunction under section 524(a)(2) shall not be violated by notification of the debtor and negotiation of cure under this subsection.

(3) In a case under chapter 11 in which the debtor is an individual and in a case under chapter 13, if the debtor is the lessee with respect to personal property and the lease is not assumed in the plan confirmed by the court, the lease is deemed rejected as of the conclusion of the hearing on confirmation. If the lease is rejected, the stay under section 362 and any stay under section 1301 is automatically terminated with respect to the property subject to the lease.

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11 U.S.C. § 503. Allowance of administrative expenses

(a) An entity may timely file a request for payment of an administrative expense, or may tardily file such request if permitted by the court for cause.

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

(1)(A) the actual, necessary costs and expenses of preserving the estate including—

(i) wages, salaries, and commissions for services rendered after the commencement of the case; and

(ii) wages and benefits awarded pursuant to a judicial proceeding or a proceeding of the National Labor Relations Board as back pay attributable to any period of time occurring after commencement of the case under this title, as a result of a violation of Federal or State law by the debtor, without regard to the time of the occurrence of unlawful conduct on which such award is based or to whether any services were rendered, if the court determines that payment of wages and benefits by reason of the operation of this clause will not substantially increase the probability of layoff or termination of current employees, or of nonpayment of domestic support obligations, during the case under this title;

(B) any tax—

(i) incurred by the estate, whether secured or unsecured, including property taxes for which liability is in rem, in personam, or both, except a tax of a kind specified in section 507(a)(8) of this title; or

(ii) attributable to an excessive allowance of a tentative carryback adjustment that the estate received, whether the taxable year to which such adjustment relates ended before or after the commencement of the case;

(C) any fine, penalty, or reduction in credit relating to a tax of a kind specified in subparagraph (B) of this paragraph; and

(D) notwithstanding the requirements of subsection (a), a governmental unit shall not be required to file a request for the payment of an expense described in subparagraph (B) or (C), as a condition of its being an allowed administrative expense;

(2) compensation and reimbursement awarded under section 330(a) of this title;

(3) the actual, necessary expenses, other than compensation and reimbursement specified in paragraph (4) of this subsection, incurred by—

(A) a creditor that files a petition under section 303 of this title;

(B) a creditor that recovers, after the court's approval, for the benefit of the estate any property transferred or concealed by the debtor;

(C) a creditor in connection with the prosecution of a criminal offense relating to the case or to the business or property of the debtor;

(D) a creditor, an indenture trustee, an equity security holder, or a committee representing creditors or equity security holders other than a committee appointed under section 1102 of this title, in making a substantial contribution in a case under chapter 9 or 11 of this title;

(E) a custodian superseded under section 543 of this title, and compensation for the services of such custodian; or

(F) a member of a committee appointed under section 1102 of this title, if such expenses are incurred in the performance of the duties of such committee;

(4) reasonable compensation for professional services rendered by an attorney or an accountant of an entity whose expense is allowable under subparagraph (A), (B), (C), (D), or (E) of paragraph (3) of this subsection, based on the time, the nature, the extent, and the value of such services, and the cost of comparable services other than in a case under this title, and reimbursement for actual, necessary expenses incurred by such attorney or accountant;

(5) reasonable compensation for services rendered by an indenture trustee in making a substantial contribution in a case under chapter 9 or 11 of this title, based on the time, the nature, the extent, and the value of such services, and the cost of comparable services other than in a case under this title;

(6) the fees and mileage payable under chapter 119 of title 28;

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

(8) the actual, necessary costs and expenses of closing a health care business incurred by a trustee or by a Federal agency (as defined in section 551(1) of title 5) or a department or agency of a State or political subdivision thereof, including any cost or expense incurred—

(A) in disposing of patient records in accordance with section 351; or

(B) in connection with transferring patients from the health care business that is in the process of being closed to another health care business; and

(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) Notwithstanding subsection (b), there shall neither be allowed, nor paid—

(1) a transfer made to, or an obligation incurred for the benefit of, an insider of the debtor for the purpose of inducing such person to remain with the debtor's business, absent a finding by the court based on evidence in the record that—

(A) the transfer or obligation is essential to retention of the person because the individual has a bona fide job offer from another business at the same or greater rate of compensation;

(B) the services provided by the person are essential to the survival of the business; and

(C) either—

(i) the amount of the transfer made to, or obligation incurred for the benefit of, the person is not greater than an amount equal to 10 times the amount of the mean transfer or obligation of a similar kind given to nonmanagement employees for any purpose during the calendar year in which the transfer is made or the obligation is incurred; or

(ii) if no such similar transfers were made to, or obligations were incurred for the benefit of, such nonmanagement employees during such calendar

year, the amount of the transfer or obligation is not greater than an amount equal to 25 percent of the amount of any similar transfer or obligation made to or incurred for the benefit of such insider for any purpose during the calendar year before the year in which such transfer is made or obligation is incurred;

(2) a severance payment to an insider of the debtor, unless—

(A) the payment is part of a program that is generally applicable to all full-time employees; and

(B) the amount of the payment is not greater than 10 times the amount of the mean severance pay given to nonmanagement employees during the calendar year in which the payment is made; or

(3) other transfers or obligations that are outside the ordinary course of business and not justified by the facts and circumstances of the case, including transfers made to, or obligations incurred for the benefit of, officers, managers, or consultants hired after the date of the filing of the petition.

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11 U.S.C. § 547. Preferences

(a) In this section—

(1) "inventory" means personal property leased or furnished, held for sale or lease, or to be furnished under a contract for service, raw materials, work in process, or materials used or consumed in a business, including farm products such as crops or livestock, held for sale or lease;

(2) "new value" means money or money's worth in goods, services, or new credit, or release by a transferee of property previously transferred to such transferee in a transaction that is neither void nor voidable by the debtor or the trustee under any applicable law, including proceeds of such property, but does not include an obligation substituted for an existing obligation;

(3) "receivable" means right to payment, whether or not such right has been earned by performance; and

(4) a debt for a tax is incurred on the day when such tax is last payable without penalty, including any extension.

(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) to the extent that such transfer was—
(A) intended by the debtor and the creditor to or for whose benefit such transfer was made to be a contemporaneous exchange for new value given to the debtor; and
(B) in fact a substantially contemporaneous exchange;

(2) to the extent that such transfer was in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee, and such transfer was—
(A) made in the ordinary course of business or financial affairs of the debtor and the transferee; or
(B) made according to ordinary business terms;

(3) that creates a security interest in property acquired by the debtor—
(A) to the extent such security interest secures new value that was—
(i) given at or after the signing of a security agreement that contains a description of such property as collateral;
(ii) given by or on behalf of the secured party under such agreement;
(iii) given to enable the debtor to acquire such property; and
(iv) in fact used by the debtor to acquire such property; and
(B) that is perfected on or before 30 days after the debtor receives possession of such property;

(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) that creates a perfected security interest in inventory or a receivable or the proceeds of either, except to the extent that the aggregate of all such transfers to the transferee caused a reduction, as of the date of the filing of the petition and to the prejudice of other creditors holding unsecured claims, of any amount by which the debt secured by such security interest exceeded the value of all security interests for such debt on the later of—
(A)(i) with respect to a transfer to which subsection (b)(4)(A) of this section applies, 90 days before the date of the filing of the petition; or
(ii) with respect to a transfer to which subsection (b)(4)(B) of this section applies, one year before the date of the filing of the petition; or
(B) the date on which new value was first given under the security agreement creating such security interest;

(6) that is the fixing of a statutory lien that is not avoidable under section 545 of this title;

(7) to the extent such transfer was a bona fide payment of a debt for a domestic support obligation;

(8) if, in a case filed by an individual debtor whose debts are primarily consumer debts, the aggregate value of all property that constitutes or is affected by such transfer is less than $600; or

(9) if, in a case filed by a debtor whose debts are not primarily consumer debts, the aggregate value of all property that constitutes or is affected by such transfer is less than $5,000.

(d) The trustee may avoid a transfer of an interest in property of the debtor transferred to or for the benefit of a surety to secure reimbursement of such a surety that furnished a bond or other obligation to dissolve a judicial lien that would have been avoidable by the trustee under subsection (b) of this section. The liability of such surety under such bond or obligation shall be discharged to the extent of the value of such property recovered by the trustee or the amount paid to the trustee.

(e)(1) For the purposes of this section—

(A) a transfer of real property other than fixtures, but including the interest of a seller or purchaser under a contract for the sale of real property, is perfected when a bona fide purchaser of such property from the debtor against whom applicable law permits such transfer to be perfected cannot acquire an interest that is superior to the interest of the transferee; and

(B) a transfer of a fixture or property other than real property is perfected when a creditor on a simple contract cannot acquire a judicial lien that is superior to the interest of the transferee.

(2) For the purposes of this section, except as provided in paragraph (3) of this subsection, a transfer is made—

(A) at the time such transfer takes effect between the transferor and the transferee, if such transfer is perfected at, or within 30 days after, such time, except as provided in subsection (c)(3)(B);

(B) at the time such transfer is perfected, if such transfer is perfected after such 30 days; or

(C) immediately before the date of the filing of the petition, if such transfer is not perfected at the later of—

(i) the commencement of the case; or

(ii) 30 days after such transfer takes effect between the transferor and the transferee.

(3) For the purposes of this section, a transfer is not made until the debtor has acquired rights in the property transferred.

(f) For the purposes of this section, the debtor is presumed to have been insolvent on and during the 90 days immediately preceding the date of the filing of the petition.

(g) For the purposes of this section, the trustee has the burden of proving the avoidability of a transfer under subsection (b) of this section, and the creditor or party in interest against whom recovery or avoidance is sought has the burden of proving the nonavoidability of a transfer under subsection (c) of this section.

(h) The trustee may not avoid a transfer if such transfer was made as a part of an alternative repayment schedule between the debtor and any creditor of the debtor created by an approved nonprofit budget and credit counseling agency.

(i) If the trustee avoids under subsection (b) a transfer made between 90 days and 1 year before the date of the filing of the petition, by the debtor to an entity that is not an insider for the benefit

of a creditor that is an insider, such transfer shall be considered to be avoided under this section only with respect to the creditor that is an insider.

(j)(1) In this subsection:

(A) The term "covered payment of rental arrearages" means a payment of arrearages that—

(i) is made in connection with an agreement or arrangement—

(I) between the debtor and a lessor to defer or postpone the payment of rent and other periodic charges under a lease of nonresidential real property; and

(II) made or entered into on or after March 13, 2020;

(ii) does not exceed the amount of rental and other periodic charges agreed to under the lease of nonresidential real property described in clause (i)(I) before March 13, 2020; and

(iii) does not include fees, penalties, or interest in an amount greater than the amount of fees, penalties, or interest—

(I) scheduled to be paid under the lease of nonresidential real property described in clause (i)(I); or

(II) that the debtor would owe if the debtor had made every payment due under the lease of nonresidential real property described in clause (i)(I) on time and in full before March 13, 2020.

(B) The term "covered payment of supplier arrearages" means a payment of arrearages that—

(i) is made in connection with an agreement or arrangement—

(I) between the debtor and a supplier of goods or services to defer or postpone the payment of amounts due under an executory contract for goods or services; and

(II) made or entered into on or after March 13, 2020;

(ii) does not exceed the amount due under the executory contract described in clause (i)(I) before March 13, 2020; and

(iii) does not include fees, penalties, or interest in an amount greater than the amount of fees, penalties, or interest—

(I) scheduled to be paid under the executory contract described in clause (i)(I); or

(II) that the debtor would owe if the debtor had made every payment due under the executory contract described in clause (i)(I) on time and in full before March 13, 2020.

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

(A) a covered payment of rental arrearages; or

(B) a covered payment of supplier arrearages.