

## STUB RENT UNDER SECTION 365(d)(3): A CALL FOR A UNIFIED APPROACH

### ABSTRACT

*With the economy in a recession, bankruptcy cases in the United States are booming. Corporations, individuals, and the courts need a succinct and unambiguous Bankruptcy Code to effectively, efficiently, and equitably administer the increased amount of cases. Unfortunately, section 365(d)(3) of the U.S. Bankruptcy Code is ambiguous and, therefore, needs clarification.*

*Circuits are split on its interpretation and hence various bankruptcy courts across the country apply different methods for evaluating "Stub Rent." Stub rent is the rent due for the interim period between the petition date in the bankruptcy case and the end of the debtor's first month in bankruptcy. The Third Circuit, among others, applies the Billing-date method for determining stub rent while the Second Circuit, among others, applies the Proration method. The Billing-date method views the billing date on the lease as the date that determines whether rent is pre-petition (general unsecured claim) or post-petition (administrative claim). The Proration method, on the other hand, treats rent as having accrued each day of the month regardless of the date rent is due. Therefore, a claim can be prorated from the date of the filing through the end of the month. The method adopted by the court is crucial because classification of claims may determine whether a landlord will receive full payment of rent or pennies on the dollar. This determination can have great monetary ramifications on both debtors and landlords.*

*This Note argues that the Proration method should be adopted uniformly across the country. The Proration method eliminates windfalls for debtors and landlords, avoids absurd results, and creates equitable and consistent determinations. Most importantly, the Proration method stays true to one of the fundamental principles of bankruptcy: treat all similarly situated creditors equally. Therefore, the Third Circuit should reconsider its ruling in *Montgomery Ward* in favor of adopting the Proration method.*

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## I. INTRODUCTION

Commentators label the United States as "the most bankrupt nation on Earth," where one in every three hundred Americans files for bankruptcy.<sup>1</sup> With the economy in an extended recession, more and more American citizens and corporations are filing for bankruptcy.<sup>2</sup> An increase in bankruptcies equates to an increase in litigation. Almost undeniably, the need for simple and unambiguous bankruptcy statutes and uniform rulings throughout the country could not be greater.

One area of the United States Bankruptcy Code (the "Code") that causes courts trouble is the proper application of section 365(d)(3).<sup>3</sup> The

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<sup>1</sup>Megan McArdle, *Sink and Swim: Bankruptcy Helps the Undeserving—and That's the Way It Should Be*, THE ATLANTIC, June 2009, at 30.

<sup>2</sup>See DHP Holdings II Corp. v. Peter Skop Indus., Inc (*In re DHP Holdings II Corp.*), 435 B.R. 220, 232 (Bankr. D. Del. 2010) ("The [Delaware Bankruptcy Court's] docket is overburdened especially since the country is 'in the midst of the most severe recession and credit crisis in decades, and the volume of major chapter 11 filings in this Court has risen to an unprecedented level.'" (citations omitted)).

<sup>3</sup>See Michael J. Lichtenstein, *The Payment of "Stub Rent" Under The Bankruptcy Code*, 36 REAL. EST. L.J. 144, 145 (2007) ("Numerous courts have held that 11 U.S.C. § 365(d)(3)[sic] is ambiguous in many respects, and have thus interpreted it differently when it comes to the payment of 'stub' rent.").

problem of "stub rent" under section 365(d)(3) occurs before a corporation even files for bankruptcy. In preparation for an imminent bankruptcy filing, some corporations will not pay their rent, which is typically due on the first of the month,<sup>4</sup> to ultimately provide some liquidity heading into bankruptcy.<sup>5</sup> After a corporation files its bankruptcy petition, its landlord may subsequently ask the bankruptcy court to "compel payment of the 'stub rent' for the portion of the month occurring after the petition date."<sup>6</sup> The bankruptcy court must then interpret and apply section 365 to the facts of the case to determine "whether payment of stub rent is an obligation that must be timely performed at the outset of a bankruptcy case, [or whether] . . . stub rent should be treated as a general unsecured claim."<sup>7</sup> Further, the court must decide whether to use the Proration method<sup>8</sup> or the Billing-date method<sup>9</sup> to determine what type of claim exists against the debtor and the amount of the claim.

"Stub rent" is the rent due for the interim period between the petition date in the bankruptcy case and the end of the debtor's first month in bankruptcy.<sup>10</sup> In order to sufficiently analyze the proper application of stub rent principles, two preliminary concepts must be addressed. First, stub rent payments can be monetarily significant. It would be easy to assume that one month's rent amounts to very little in the grand scheme of things; however, in reality, stub rent payments can grow quite large, especially when dealing

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<sup>4</sup>There are two kinds of lease payment arrangements. The typical lease, described above, is called "payment in advance." In contrast, some leases are paid at the end of occupancy, called "payment in arrears." See, e.g., *Koenig Sporting Goods, Inc. v. Morse Road Co.* (*In re Koenig Sporting Goods, Inc.*), 203 F.3d 986, 990 n.5 (6th Cir. 2000).

<sup>5</sup>See, e.g., David A. Beck, *Sportsman's Warehouse and the Latest From Delaware on Stub Rent*, 29 AM. BANKR. INST. J., May 2010, at 24.

<sup>6</sup>*Id.*

<sup>7</sup>Robert L. LeHane et al., *Stub Rent and the Way Around Montgomery Ward*, 28 AM. BANKR. INST. J., July/Aug. 2009, at 20.

<sup>8</sup>Proration, also called the "accrual method," treats rent as having accrued each day of the month regardless of the date rent is due (typically at the first of the month). Therefore, a claim can be prorated from the date of the filing through the end of the month. See, e.g., Lichtenstein, *supra* note 3, at 144.

<sup>9</sup>The Billing-date method, also called the "Performance-date method," views the billing date on the lease as the date that determines whether rent is pre-petition (general unsecured claim) or post-petition (administrative claim). See, e.g., *id.* "Adoption of this approach favors the debtor/tenant which might choose to file a bankruptcy petition several days after the first of the month to avoid having to pay administrative rent for one entire month." *Id.*

<sup>10</sup>Joel H. Levitin & Richard A. Stieglitz Jr., *The Ticket to Solving the Stub Rent Dilemma*, 28 AM. BANKR. INST. J., Feb. 2009, at 26; see also *In re Stone Barn Manhattan LLC*, 398 B.R. 359, 360 (Bankr. S.D.N.Y. 2008) (explaining that "stub rent" is "the rent for the interim period between the day the order for relief was entered in the bankruptcy case and the end of that month").

with multi-million dollar corporations or national retailers.<sup>11</sup> Second, the classification of stub rent as a general unsecured claim or an administrative expense claim matters a great deal for both landlords and debtors.<sup>12</sup> This classification primarily depends on whether the court uses the Proration or Billing-date method.

Part II discusses the legislative history of section 365(d)(3). In addition, Part II highlights jurisdictional disagreements on the proper reading and application of section 365(d)(3). Part III discusses the basic principles of statutory interpretation and seeks to clarify the ambiguous phrases of the statute. Part IV proposes that courts adopt the Proration method over the Billing-date method in order to unify the application of section 365 among all courts so as to eliminate any jurisdictional splits. Part IV also discusses the various policy implications of each method.

## II. BACKGROUND

In 1978, Congress enacted the Bankruptcy Reform Act, determining that after ten years of investigation, significant substantive and procedural changes needed to be made to the Code.<sup>13</sup> The Code impacted various groups in different ways, but it initially proved to be specifically hard on landlords.<sup>14</sup> The Code provided that landlords could only receive rent payments from a debtor with notice and a formal hearing pursuant to section 503(b)(1).<sup>15</sup> Furthermore, landlords could only recover "reasonable value" for actual use of property by a debtor.<sup>16</sup> Landlords ultimately had the burden of proving that the rent sought was the "actual, necessary costs and

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<sup>11</sup>For example, in one case the stub rent owed to three landlords totaled \$90,506. *See In re Goody's Family Clothing, Inc.*, 392 B.R. 604, 607 (Bankr. D. Del. 2008). In another case, the amount for one landlord totaled \$426,729.87, for taxes due under the lease alone. *See Centerpoint Props. v. Montgomery Ward Holding Corp. (Montgomery Ward)*, 268 F.3d 205, 207 (3d Cir. 2001).

<sup>12</sup>*See* Josef S. Athanas & Scott A. Semenek, *Pro-ration of Rent Dead in Third and Sixth Circuits—Landlords Won the Battle, But Will They Lose the War?*, 19 BANKR. DEV. J. 123, 125-27 (2002). The difference between a general unsecured claim and an administrative claim to be paid at the outset of the bankruptcy can be significant. Most of the time general unsecured claims are satisfied by "pennies on the dollar" compared to full payment as an administrative claim. *Id.* at 125.

<sup>13</sup>*See* N. Pipeline Constr. Co. v. Marathon Pipe Line Co., 458 U.S. 50, 52-56 (1982) (discussing the procedural and substantive overhaul of the bankruptcy court's jurisdiction and the system).

<sup>14</sup>*See, e.g.*, Athanas & Semenek, *supra* note 12, at 125-26.

<sup>15</sup>Joshua Fruchter, *To Bind or Not to Bind—Bankruptcy Code § 365(d)(3): Statutory Minefield*, 68 AM. BANKR. L.J. 437, 437 (1994). Section 503(b)(1) states: "[a]fter notice and a hearing, there shall be allowed, administrative expenses . . . including—the actual, necessary costs and expenses of preserving the estate . . ." 11 U.S.C. § 503(b)(1) (2006).

<sup>16</sup>Fruchter, *supra* note 15, at 438.

expenses."<sup>17</sup> Further complicating this process was the bankruptcy court's power to hold a debtor liable only for a pro rata portion of the rent, which "correspond[ed] to the percentage of space actually occupied."<sup>18</sup> Moreover, bankruptcy courts had the discretion to delay payment to the landlord until confirmation of the plan.<sup>19</sup> This delay resulted in loss of income for the landlord, "who [was] forced to provide ongoing services and space to the estate without receiving timely payment to satisfy their own cash obligations."<sup>20</sup>

These significant barriers prompted Congress to amend the Code and create sections such as section 365(d)(3) to alleviate some of the landlords' burdens.<sup>21</sup> The relevant portion of section 365(d)(3) states that "[t]he 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."<sup>22</sup> This new section allowed for timely payment of rent obligations presumably at the contract rate without a showing of actual and necessary benefit to the estate under section 503.<sup>23</sup> Senator Orrin Hatch discussed the purpose of the new amendments:

[the] problem is that during the time the debtor has vacated space but has not yet decided whether to assume or reject the lease, the trustee has stopped making payments under the lease. *In this situation, the landlord is forced to provide current services—the use of the property, utilities, security, and other services—without current payment. No other creditor is put in*

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<sup>17</sup>11 U.S.C. § 503(b)(1) (2006).

<sup>18</sup>Fruchter, *supra* note 15, at 438.

<sup>19</sup>*See generally* MARK S. SCARBERRY, ET AL., BUSINESS REORGANIZATION IN BANKRUPTCY 30-34 (Thomson West 3d ed. 2006) (1996) (defining plan confirmation and comparing non-consensual and consensual confirmation).

<sup>20</sup>Fruchter, *supra* note 15, at 438.

<sup>21</sup>*See* Athanas & Semenek, *supra* note 12, at 126 (explaining "[i]n 1984, landlords' lobbyists persuaded Congress to address three of these four problems, substantially evening the playing field between landlords and debtors"). Congress enacted section 365(d)(3) as part of the Bankruptcy Amendments and Federal Judgeship Act of 1984. *See* Fruchter, *supra* note 15, at 438-39. It was enacted "to ameliorate the perceived inequity that landlords were often forced to make their property available to a debtor during postpetition, prerejection period for the lease without receiving adequate compensation in return under § 503(b)(1)." Levitin & Stieglitz, *supra* note 10, at 26.

<sup>22</sup>11 U.S.C. § 365(d)(3) (2006).

<sup>23</sup>*See* Athanas & Semenek, *supra* note 12, at 126. "Virtually all courts have agreed that [section 365(d)(3)] was intended to alleviate the above described burdens of landlords by requiring timely compliance with the terms of the lease." *Montgomery Ward*, 268 F.3d 205, 210 (3d Cir. 2001).

*this position.* In addition, the other tenants often must increase their common area charge payments to compensate for the trustee's failure to make the required payments for the debtor. *The bill would lessen these problems by requiring the trustee to perform all the obligations of the debtor under a lease of nonresidential real property at the time required in the lease. This timely performance requirement will insure that debtor-tenants pay their rent, common area, and other charges on time pending the trustee's assumption or rejection of the lease.*<sup>24</sup>

Most courts agree that section 365(d)(3) is designed to protect landlords and provide them with the ability to recover rent and other charges in a timely manner<sup>25</sup> during the post-petition pre-rejection period.<sup>26</sup> Unfortunately, courts disagree on just about everything else: scope, statutory interpretation, and how section 365 interacts with other bankruptcy statutes.<sup>27</sup> Courts specifically disagree as to: (1) whether the statute is ambiguous;<sup>28</sup> (2) whether proration is appropriate under section 365;<sup>29</sup> (3) whether

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<sup>24</sup>*Montgomery Ward*, 268 F.3d at 210 (citing H.R. REP. No. 882, 95th Cong., 2d Sess., reprinted in 1984 U.S.C.C.A.N. 576).

<sup>25</sup>See Fruchter, *supra* note 15, at 439. "The purpose of § 365(d)(3) was to save landlords the expense and burden of having to file motions for payment of rent and demonstrate under § 503(b)(1) that such rent constitutes an actual, necessary expense of preserving the debtor's estate." LeHane et al., *supra* note 7, at 20; see also Levitin & Stieglitz, *supra* note 10, at 26 ("Congress leveled the playing field with § 365(d)(3)."); *In re Ames Dep't Stores, Inc.*, 306 B.R. 43, 68 (Bankr. S.D.N.Y. 2004) (stating that no one would dispute that the purpose of enacting section 365(d)(3) was to eliminate two injustices: (1) to allow an easier method for landlords to receive rent other than section 503, and (2) to allow landlords to receive the benefit of their lease bargains).

<sup>26</sup>The post-petition pre-rejection period is the time period after the petition date but before debtors have rejected a particular lease. See generally SCARBERRY ET AL., *supra* note 19, at 305-11 (discussing assumption and rejection of executory obligations). The initial time period for assumption or rejection is 120 days, but may be extended by court approval. See 11 U.S.C. § 365(d)(4) (2006).

<sup>27</sup>See Fruchter, *supra* note 15, at 439; see also Beck, *supra* note 5, at 24 ("Courts have struggled both with how to determine when particular items under a lease 'arise' for purposes of § 365(d)(3) and how § 365(d)(3) interacts with § 503(b)'s general rule concerning administrative-expense status for post-petition claims that benefit the estate."); Levitin & Stieglitz, *supra* note 10, at 26 ("Although courts generally agree on what § 365(d)(3) was designed to accomplish, they have not agreed on its application due to some ambiguities in the statutory language, giving rise to significant conflict among and within the circuits regarding the payment of stub rent and related obligations to landlords.").

<sup>28</sup>See *In re Stone Barn Manhattan LLC*, 398 B.R. 359, 360 (Bankr. S.D.N.Y. 2008) (interpreting section 365 to be ambiguous). But see *Montgomery Ward*, 268 F.3d at 210 (stating that section 365 is unambiguous).

<sup>29</sup>A number of courts have held proration appropriate. See, e.g., *Stone Barn*, 398 B.R. at

proration is appropriate under section 503;<sup>30</sup> (4) whether "timely" means "immediate," at confirmation, or some time in between;<sup>31</sup> and (5) whether section 365 applies to both stub rent and taxes pursuant to the lease.<sup>32</sup> With an abundance of inter-circuit splits<sup>33</sup> and intra-district splits,<sup>34</sup> it is obvious that section 365(d)(3) needs statutory clarification. The adoption of a uniform approach across the country would sufficiently solve these interpretation issues.

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368; *In re Travel 2000, Inc.*, 264 B.R. 444, 450 (Bankr. W.D. Mich. 2001); *El Paso Props. Corp. v. Gonzales (In re Furr's Supermarkets, Inc.)*, 283 B.R. 60, 66 (BAP 10th Cir. 2002); *Child World, Inc. v. Campbell/Mass. Trust*, 161 B.R. 571, 574 (S.D.N.Y. 1993); *In re NETtel Corp.*, 289 B.R. 486, 489-90 (Bankr. D.C. 2002); *In re The Barrister of Delaware, Ltd.*, 49 B.R. 446, 447 (Bankr. D. Del. 1985); *Inland's Monthly Income Fund v. Duckwall-Alco Stores, Inc.*, 150 B.R. 965, 976 (D. Kan. 1993). However, some courts have held proration not appropriate and favored the Billing-date method. *See, e.g., Montgomery Ward*, 268 F.3d at 212; *In re Goody's Family Clothing, Inc.* 392 B.R. 604, 612 (Bankr. D. Del. 2008) (stating that the court cannot prorate rent and will follow plain meaning of the statute); *Koenig Sporting Goods, Inc. v. Morse Road Co. (In re Koenig Sporting Goods, Inc.)*, 203 F.3d 986, 989 (6th Cir. 2000) (adopting the Billing-date method); *HA-LO Indus., Inc., v. Centerpoint Props. Trust*, 342 F.3d 794, 798 (7th Cir. 2003) (rejecting the use of the Proration method in *In re Handy Andy Home Improvement Ctrs., Inc.*, 144 F.3d 1125 (7th Cir. 1998)); *In re the Krystal Co.*, 194 B.R. 161, 163 (Bankr. E.D. Tenn. 1996) (holding proration is inapplicable); *In re Appletree Mkts. Inc.*, 139 B.R. 417, 420 (Bankr. S.D. Tex. 1992).

<sup>30</sup>*See In re DVI, Inc.*, 308 B.R. 703, 708 (Bankr. D. Del. 2004) (prorating stub rent as an actual and necessary expense under section 503(b)). *But see In re HQ Global Holdings, Inc.*, 282 B.R. 169, 174 (Bankr. D. Del. 2002) (prorating stub rent not permitted under section 503(b)(1)); *In re ZB Co.*, 302 B.R. 316, 319-20 (Bankr. D. Del. 2003) (holding that landlords cannot prorate under section 365, but can prorate stub rent under section 503(b)(1)).

<sup>31</sup>*See In re Trak Auto Corp.*, 277 B.R. 655, 669 (Bankr. E.D. Va. 2002) (holding that "timely" does not mean "immediate," but rather the claim should be paid along with all other administrative claims); *In re Circuit City Stores, Inc.*, 2009 Bankr. LEXIS 672, at \*16-\*17 n.5 (Bankr. E.D. Va. Feb. 12, 2009) (stating that timely could mean immediately, pursuant to the lease, or paid with all administrative claims). *But see The Barrister of Delaware*, 49 B.R. at 446-47 (holding prorated payment must be paid immediately); *In re Telesphere Commc'ns, Inc.*, 148 B.R. 525, 532 (Bankr. N.D. Ill. 1992) (holding payment must be paid immediately pursuant to the plain language of section 365(d)(3)); *HQ Global*, 282 B.R. at 173 (holding that the timing of payments is within the discretion of the bankruptcy court).

<sup>32</sup>*Compare Handy Andy*, 144 F.3d at 1127 (holding proration of taxes is more sensible than Billing-date method), with *HA-LO Indus.*, 342 F.3d at 798 (distinguishing *Handy Andy* because that case addressed real estate taxes as opposed to rent expense, which the court holds should follow the Billing-date method).

<sup>33</sup>The Second, Fourth, Ninth, and Tenth Circuits generally favor the proration approach, while the Third and Sixth Circuits favor the Billing-date method. *Compare Stone Barn*, 398 B.R. at 360, *NETtel*, 289 B.R. at 489-90, *Travel 2000*, 264 B.R. at 450, and *Furr's Supermarkets*, 283 B.R. at 66, with *Montgomery Ward*, 268 F.3d at 212; *Koenig Sporting Goods*, 203 F.3d at 987.

<sup>34</sup>The Seventh Circuit supports the Billing-date method for rent, but the proration approach for taxes. *Compare Handy Andy*, 144 F.3d at 1127 (holding proration of taxes is more sensible than the Billing-date method), with *HA-LO Indus.*, 342 F.3d at 798 (distinguishing *Handy Andy* because that case addressed real estate taxes as opposed to rent expense, which the court holds should follow the Billing-date method).

## III. PRINCIPLES OF STATUTORY CONSTRUCTION

A. *Statutory Construction*

A fundamental canon of statutory interpretation is that a court "begins with the language of the statute itself" when analyzing the statute's meaning.<sup>35</sup> Courts should assume, unless congressional authority states otherwise, that "Congress intends the words in its enactments to carry 'their ordinary, contemporary, common meaning.'"<sup>36</sup> The goal of statutory construction is to discover Congress's intent through the plain language of the statute. Furthermore, it is universally held that "[t]he plain meaning of legislation should be conclusive, except in the 'rare cases [in which] the literal application of a statute will produce a result demonstrably at odds with the intentions of its drafters.'"<sup>37</sup> In *Goody's Family Clothing*,<sup>38</sup> a Delaware Bankruptcy Court decision, Judge Sontchi, quoting *Hartford Underwriters Insurance Co. v. Union Planters Bank*,<sup>39</sup> stated that "when the statute's language is plain, the sole function of the courts—at least where the disposition required . . . is not absurd—is to enforce it according to its terms."<sup>40</sup> Generally, if a statute is unambiguous, the court must refrain from considering extrinsic evidence, such as legislative intent.<sup>41</sup>

At the same time, courts have held that bankruptcy statutes should be viewed in context of the overall purpose of the Code.<sup>42</sup> The statutes must be

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<sup>35</sup>Pa. Dep't of Pub. Welfare v. Davenport, 495 U.S. 552, 557 (1990) (citations omitted); see also *In re R.H. Macy & Co.*, 152 B.R. 869, 873 (Bankr. S.D.N.Y. 1993) ("The starting point in any case involving construction of a statute is the language itself.") (citations omitted).

<sup>36</sup>*R.H. Macy*, 152 B.R. at 873 (quoting *Pioneer Investment Servs. Co. v. Brunswick Assoc. Ltd. Partnership*, 113 S.Ct. 1489, 1495 (1993)).

<sup>37</sup>*United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 242 (1989). "In [ambiguous] cases, the intention of the drafters, rather than the strict language, controls." *Id.*

<sup>38</sup>392 B.R. 604 (Bankr. D. Del. 2008).

<sup>39</sup>530 U.S. 1, 6 (2000).

<sup>40</sup>*In re Goody's Family Clothing, Inc.*, 392 B.R. 604, 608 (Bankr. D. Del. 2008) (citations omitted) (internal quotations omitted). *But see In re All For a Dollar, Inc.*, 174 B.R. 358, 361 (Bankr. D. Mass. 1994) (rejecting such a literal reading of section 365 because it produces results that are inconsistent with the priority and distribution scheme under the Code).

<sup>41</sup>See, e.g., *In re Telesphere Commc'ns, Inc.*, 148 B.R. 525, 528 (Bankr. N.D. Ill. 1992) (stating that the plain language of the Code should not be departed from without substantial justification).

<sup>42</sup>See *In re RB Furniture, Inc.*, 141 B.R. 706, 712 (Bankr. C.D. Cal. 1992) ("Section 365(d)(3) should be viewed in light of the overall purpose of § 365."). "[T]he Supreme Court of the United States has recently reminded the profession of the need to back away from the details and 'keep purposes of bankruptcy law in the foreground' . . . ." Douglas O. Tice, Jr., et al., *Bankruptcy Law*, 44 U. RICH. L. REV. 201, 267 (Nov. 2009) (citations omitted); see also *In re Travel 2000, Inc.*, 264 B.R. 444, 448 (Bankr. W.D. Mich. 2001) ("[A] court should not resolve questions of

construed *in pari materia*, meaning one cannot read any section in isolation either from the statute as a whole or from any other provision.<sup>43</sup> Although many courts would look to legislative intent and the overall purpose of the Code to interpret a statute regardless of its ambiguity, all courts agree that when the statute is ambiguous, legislative intent must be taken into consideration to determine its meaning.<sup>44</sup> It is therefore essential to determine whether section 365(d)(3) is ambiguous.

### B. *Ambiguity as a Means to Determine the Appropriate Method*

Courts are split on whether section 365(d)(3) is ambiguous.<sup>45</sup> Generally, courts that view the statute as unambiguous, thereby ignoring legislative intent, policies, equity, or the Code's purpose, favor the Billing-date method.<sup>46</sup> On the other hand, courts that find the statute ambiguous, and who consider the aforementioned factors, favor the Proration method.<sup>47</sup> Not surprisingly, when a statute's ambiguity leads to two divergent outcomes, statutory construction becomes extremely important. Given the aforementioned split in interpreting the statute, and the undeniable confusion in applying it, section 365(d)(3) is facially ambiguous. Nevertheless, it is in our best interest to analyze the most common disputed phrases within the statute to determine if more than one plausible interpretation exists.

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statutory interpretation so that a particular Bankruptcy Code section conflicts and disturbs the overall purpose and function of the Code." (citations omitted)).

<sup>43</sup>See *In re Ames Dep't Stores, Inc.*, 306 B.R. 43, 65-66 (Bankr. S.D.N.Y. 2004).

<sup>44</sup>*Newman v. McCrory Corp.*, 210 B.R. 934, 937-38 (S.D.N.Y. 1997) (stating that when ambiguous, the court relies heavily on legislative intent and when unambiguous, courts do not consider any equitable or policy considerations).

<sup>45</sup>See, e.g., *Ames*, 306 B.R. at 66-67 (discussing the split among jurisdictions and holding section 365(d)(3) to be ambiguous).

<sup>46</sup>See, e.g., *Montgomery Ward*, 268 F.3d 205, 209-10 (3d Cir. 2001). "Finding a straightforward interpretation that produces a rational result and no other reasonable interpretation consistent with the text, we are constrained to hold that § 365(d)(3) is not ambiguous. We thus have no justification for consulting legislative history." *Id.* at 210; see also *In re Appletree Mkts., Inc.*, 139 B.R. 417, 421 (Bankr. S.D. Tex. 1992) (stating that the plain language of the statute is clear).

<sup>47</sup>See, e.g., *In re Mr. Gatti's, Inc.*, 164 B.R. 929, 931 (Bankr. W.D. Tex. 1994) (holding that proration should be used because the statute is ambiguous). "This ambiguity is evidenced not merely by its being the subject of disagreement between these self-interested litigants, but also by the large number of reported decisions by trial and appellate courts that have struggled with its meaning." *Id.*; see also *In re Stone Barn Manhattan LLC*, 398 B.R. 359, 367 (Bankr. S.D.N.Y. 2008) (holding that courts must construe the provision for plain purpose of the law and proration is the only method that accomplishes that result).

### C. "Obligation"

Courts seem to struggle with the term "obligation," and are unclear what sort of lease commitments it constitutes.<sup>48</sup> The pertinent part of section 365(d)(3) states "[t]he trustee shall timely perform all the obligations of the debtor."<sup>49</sup> In Delaware, for instance, Judge Sontchi concluded that the definition of "obligation" is well settled in the Third Circuit and is "something that one is legally required to perform under the terms of the lease."<sup>50</sup> In support of this proposition, other courts have agreed that "obligation" is unambiguous and rent must be paid in full when due under the lease without proration.<sup>51</sup>

A significant number of courts, especially those in the Second Circuit, have ruled "obligation" to be ambiguous and adopted the Proration method upon examination of legislative intent.<sup>52</sup> Some of these courts interpret "obligation" to mean a "claim."<sup>53</sup> As the Third Circuit contends in *Montgomery Ward*, however, if Congress intended the courts to use the word "claim," then the statute would include "claim."<sup>54</sup>

Although courts differ on the meaning of "obligation" in the text of section 365(d)(3), the more logical conclusion suggests that the term is fairly straightforward and unambiguous. "Obligation" should simply fall directly in line with the Third Circuit's understanding: "something that one is legally required to perform under the terms of the lease."<sup>55</sup>

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<sup>48</sup> See Fruchter, *supra* note 15, at 441.

<sup>49</sup> 11 U.S.C. § 365(d)(3) (2006). It is important to note that the phrase "timely perform all of [its] obligations" in section 365(d)(3) has received a number of ambiguous interpretations. Compare *In re Telesphere Commc'ns, Inc.*, 148 B.R. 525, 528 (Bankr. N.D. Ill. 1992) (reasoning that payment is made immediately when it becomes due), with *In re HQ Global Holdings, Inc.*, 282 B.R. 169, 173 (Bankr. D. Del. 2002) (reasoning that payment is due at the bankruptcy court's discretion). This ambiguity is not specifically addressed because "timely" deals with a slightly different issue: when certain claims are paid, instead of the classification of the claims. See, e.g., *In re DVI, Inc.*, 308 B.R.703, 708 (Bankr. D. Del. 2004) (reasoning that payment is due by confirmation hearing, when obligations are classified as administrative expenses under section 503(b), rather than immediately due under section 365(d)(3)).

<sup>50</sup> *In re Goody's Family Clothing, Inc.*, 392 B.R. 604, 609 (Bankr. D. Del. 2008) (citations omitted); see also *Montgomery Ward*, 268 F.3d at 213.

<sup>51</sup> See, e.g., *In re the Krystal Co.*, 194 B.R. 161, 162 (Bankr. E.D. Tenn. 1996) (holding that both "obligation" and "arises" are unambiguous and thus, proration is inapplicable).

<sup>52</sup> See, e.g., *Child World, Inc. v. Campbell/Mass Trust*, 161 B.R. 571, 574 (S.D.N.Y. 1993) (holding "obligation" is ambiguous because it could have many meanings; therefore, legislative history must be considered).

<sup>53</sup> See *Montgomery Ward*, 268 F.3d at 209.

<sup>54</sup> See *id.*; see also *In re R.H. Macy & Co.*, 152 B.R. 869, 873 (Bankr. S.D.N.Y. 1993) (stating that Congress chose to use the term "obligation" and not "claim").

<sup>55</sup> See *Montgomery Ward*, 268 F.3d at 209; see also BLACK'S LAW DICTIONARY 1179 (9th

## D. "Arises"

Courts also have difficulty interpreting the phrase "arising from and after the order for relief under any unexpired lease of nonresidential real property . . . of this title."<sup>56</sup> Courts are confused as to whether an obligation "arises" every day on a pro rata basis or "arises" when billed, typically at the beginning of the month.<sup>57</sup> Black's Law Dictionary defines "arise" as "[t]o originate; to stem (from) . . . [t]o emerge in one's consciousness; to come to one's attention."<sup>58</sup> This definition provides little guidance in the bankruptcy context. To make things more difficult, the Code does not offer its own definition, ultimately causing us to turn to the case law.

In *Krystal*, the court noted that jurisdictions adopting the Proration method mistakenly interpret "arising from" to mean that the obligation must somehow arise from the pre-rejection period before the obligation is payable.<sup>59</sup> In contrast, courts utilizing the Billing-date method argue that the obligation arises when payment is due, typically at the beginning of the month and pre-petition, not when the future consideration is provided.<sup>60</sup> Therefore, if the debtor files anytime after the first of the month—when rent is due—the entire month's rent would be considered pre-petition under the Billing-date method because the date billed for the entire month's rent was pre-petition. The landlord would only be entitled to a general unsecured claim, which is a significant penalty to the landlord.

In proration jurisdictions, the obligation is thought to "arise" "piecemeal every day."<sup>61</sup> In *Handy Andy*, Judge Posner opined that "since death and taxes are inevitable and Handy Andy's obligation under the lease to pay the taxes was clear, that obligation could realistically be said to have arisen piecemeal every day."<sup>62</sup> Courts finding the term "arise" to be ambiguous believe that it can be interpreted either in an absolutist or accrual sense, and the modifiers surrounding "arise" help to create obvious

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ed. 2009) (defining obligation as "[a] legal or moral duty to do or not do something. . . . anything that a person is bound to do or forbear from doing, whether the duty is imposed by law, contract, promise, social relations, courtesy, kindness, or morality").

<sup>56</sup>11 U.S.C. § 365(d)(3) (2006).

<sup>57</sup>See *Montgomery Ward*, 268 F.3d at 209.

<sup>58</sup>BLACK'S LAW DICTIONARY 122 (9th ed. 2009).

<sup>59</sup>See *In re the Krystal Co.*, 194 B.R. 161, 163 (Bankr. E.D. Tenn. 1996).

<sup>60</sup>See *In re Comdisco, Inc.*, 272 B.R. 671, 676 (Bankr. N.D. Ill. 2002) (holding proration inappropriate because the obligation arose in full pre-petition at the beginning of the month).

<sup>61</sup>See *In re Handy Andy Home Improvement Ctrs., Inc.*, 144 F.3d 1125, 1127 (7th Cir. 1998).

<sup>62</sup>*Id.* Judge Posner writes, the "'billing date' approach is a possible reading of section 365(d)(3), but it is neither inevitable nor sensible." *Id.*

ambiguity and confusion.<sup>63</sup> It is apparent, therefore, that "arise" can reasonably be construed in two ways.<sup>64</sup> As the court in *Ames* stated:

(1) "Arises" can be construed to mean having arisen in (a) absolutist terms or (b) in an accrual sense. And (2) "until such lease is assumed or rejected" can be construed to modify (a) "perform"—in which case it would support an absolutist view, inconsistent with prorating—or (b) equally or more plausibly, "obligations"—in which case prorating would be necessary and appropriate.<sup>65</sup>

Not only do other courts find this interpretation highly persuasive,<sup>66</sup> it also confirms the ambiguity of the phrase "arise" and subjects courts to consider legislative history and policies when construing section 365(d)(3) as a whole.

#### E. "Notwithstanding Section 503(b)(1)"

Similar to "arises," the phrase "notwithstanding section 503(b)(1)" has been reasonably interpreted in multiple ways.<sup>67</sup> Some courts hold that the phrase indicates a congressional mandate to create a super-priority for a section 365 claim, higher even than an administrative claim.<sup>68</sup> In these jurisdictions, payment must be immediate regardless of whether the debtor has the money to pay other administrative expense claims in full.<sup>69</sup> Other courts only order full immediate payment where it appears reasonably certain that the debtor can pay all other administrative claims in full.<sup>70</sup> A minority of

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<sup>63</sup>See, e.g., *In re Ames Dep't Stores, Inc.*, 306 B.R. 43, 67 (Bankr. S.D.N.Y. 2004); see also *Montgomery Ward*, 268 F.3d 205, 208 (3d Cir. 2001) (agreeing that there is an obvious "syntactical ambiguity" in the text and therefore, is not clear).

<sup>64</sup>See *Ames*, 306 B.R. at 67; *Newman v. McCrory Corp.*, 210 B.R. 934, 939 (S.D.N.Y. 1997) (stating that "'arising from' . . . is far from clear"); *In re 1/2 Off Card Shop, Inc.*, 2001 Bankr. LEXIS 988, at \*7 (Bankr. E.D. Mich. March 7, 2001) (holding that "arise" is ambiguous because reasonable minds can differ and indeed have differed on the construction of section 365(d)(3)).

<sup>65</sup>*Ames*, 306 B.R. at 67.

<sup>66</sup>The courts in *NETtel* and *McCrory* also found this interpretation persuasive.

<sup>67</sup>See Fruchter, *supra* note 15, at 440.

<sup>68</sup>See, e.g., *In re Telesphere Commc'ns, Inc.*, 148 B.R. 525, 532 (Bankr. N.D. Ill. 1992) (giving the landlord a super-priority by immediate payment of rent).

<sup>69</sup>See Fruchter, *supra* note 15, at 440.

<sup>70</sup>See *id.*

courts reject this mindset altogether and hold that the landlord still must go through the tedious requirements of 503(b)(1).<sup>71</sup>

To illustrate the ambiguity even further, in *Goody's*, Judge Sontchi held that "notwithstanding" means "in spite of," which is the literal definition in the *Oxford English Dictionary*.<sup>72</sup> More support for this interpretation comes from the case of *Valley Media* where Judge Walsh opined that "aside from administrative expenses provided for in § 503(b)(1), § 365(d)(3) creates a new and different kind of 'obligation'—one that does not necessarily rest on the administrative expense concept."<sup>73</sup> It is reasonable to conclude that with multiple competing interpretations of the same phrase, "notwithstanding § 503(b)(1)" is sufficiently and facially ambiguous.

#### IV. WHY PRORATION SHOULD BE ADOPTED AS A UNIFORM APPROACH TO STUB RENT

As Part III demonstrated, there are words and phrases in section 365(d)(3) that are ambiguous. In light of this ambiguity, it is necessary to evaluate legislative history, intent, and any policy considerations that may affect the interpretation of the statute to decide which method is more appropriate for application purposes: the Proration method or the Billing-date method.<sup>74</sup>

##### A. *Billing-Date Method and its Flaws*

The Billing-date method provides that the date on the lease acts "as the operative date to determine whether rent is a pre-petition or post-petition expense."<sup>75</sup> Therefore, if payment is due on the first of the month and the

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<sup>71</sup>*See id.* Thus, this method is obviously flawed as against the generally agreed upon purpose of the statute: to save landlords the expense and burden of having to file motions for payment of rent and demonstrate under section 503(b)(1) that such rent constitutes an actual, necessary expense of preserving the debtor's estate. LeHane et al., *supra* note 7, at 20.

<sup>72</sup>*See In re Goody's Family Clothing, Inc.*, 392 B.R. 604, 611 (Bankr. D. Del. 2008) (citations omitted); *accord In re Washington Manu. Co.*, 1993 WL 156083, at \*9 (Bankr. M.D. Tenn. May 11, 1993). "The 'notwithstanding' phrase means that the obligations in question are to be paid 'in spite of' the operation of § 503(b)(1), which would otherwise limit postpetition payments to those necessary for 'preserving the estate.'" *In re the Krystal Co.*, 194 B.R. 161, 163 (Bankr. E.D. Tenn. 1996) (citations omitted); *In re Comdisco, Inc.*, 272 B.R. 671, 675 (Bankr. N.D. Ill. 2002) ("'Notwithstanding' means 'in spite of' and in § 365(d)(3) modifies 'timely perform.'").

<sup>73</sup>*In re Valley Media, Inc.*, 290 B.R. 73, 77 (Bankr. D. Del. 2003).

<sup>74</sup>*See Newman v. McCrory Corp.*, 210 B.R. 934, 937-38 (S.D.N.Y. 1997) (stating that when ambiguous, the court relies heavily on legislative intent and when unambiguous, courts do not consider any equitable or policy considerations).

<sup>75</sup>Lichtenstein, *supra* note 3, at 144.

petition date is some time afterwards, then the entire rent for the month will be pre-petition. The ramifications of strict adherence to the Billing-date method are highlighted by some of the courts that employ this flawed methodology.<sup>76</sup> In *Montgomery Ward*, the Third Circuit understood that proration was not only the pre-code practice, but proration also limited the "strategic behavior" of debtors and landlords.<sup>77</sup> The debtor should not be able to wait until the second day of the month to file their petition, most likely forcing landlords to receive one month's rent as an unsecured pre-petition claim.<sup>78</sup> Similarly, the debtor's liability should not turn solely on the billing date because under this method landlords have the potential to manipulate when bills are due.<sup>79</sup>

Moreover, the Billing-date method does not adhere to a fundamental principle of bankruptcy: treating similarly situated creditors equally.<sup>80</sup> All post-petition creditors are supposed to be treated equally, but in following the strict Billing-date method, landlords will have a pre-petition claim for the month of the filing even though most of the month is technically post-petition.<sup>81</sup> Conversely, the Billing-date method could work in the landlord's favor, treating a pre-petition claim like an administrative claim.<sup>82</sup>

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<sup>76</sup>See, e.g., *Montgomery Ward*, 268 F.3d 205, 211 (3d Cir. 2001) ("We reach the conclusion that §365(d)(3) is unambiguous with some reluctance . . . We acknowledge that there are aspects to a proration approach that Congress might have found desirable.").

<sup>77</sup>*Id.* at 211-12. *Koenig* is a perfect example of "strategic behavior" (or lack thereof by the debtor). In *Koenig*, the debtor rejected the lease on December 2 with the billing date for the rent on December 1. *Koenig Sporting Goods, Inc. v. Morse Road Co. (In re Koenig Sporting Goods, Inc.)*, 203 F.3d 986, 989 (6th Cir. 2000). The court ruled that the entire month's rent was due to the landlord even though the debtor rejected the lease for thirty of the thirty-one days. *Id.* The court stated "[i]f the debtor had rejected the lease effective November 30, 1997, rather than December 2, it would not have been obligated to pay rent for December under 11 U.S.C. § 365(d)(3)." *Id.* This is a good example of the harsh and nonsensical outcomes of using the Billing-date method.

<sup>78</sup>Rent should be prorated regardless of the "fortuity of the billing date." *Child World, Inc. v. Campbell/Mass. Trust* 161 B.R. 571, 576 (S.D.N.Y. 1993); *In re NETtel Corp.*, 289 B.R. 486, 489-90 (Bankr. D.D.C. 2002) ("[I]t is undesirable to interpret § 365(d)(3) as operating in a manner . . . [to depend] on the fortuity of the time of the month of the order for relief or rejection of the lease.").

<sup>79</sup>*In re Trak Auto Corp.*, 277 B.R. 655, 663 (Bankr. E.D. Va. 2002).

<sup>80</sup>See *Athanas & Semenek*, *supra* note 12, at 140; see also *Montgomery Ward*, 268 F.3d at 213 ("§ 365(d)(3) should be read in light of the overarching policy of treating all creditors within a class (such as unsecured pre-petition trade creditors) alike." (Mansmann, J. dissenting)).

<sup>81</sup>The landlords claim will, most likely, be bifurcated into a pre-petition claim for the first month of rent and post-petition claim for the months following until assumption or rejection of the lease. See *SCARBERRY ET AL.*, *supra* note 19, at 25.

<sup>82</sup>See *NETtel*, 289 B.R. at 492-93 ("The performance date approach in applying § 365(d)(3) often converts what would be prepetition debt . . . into an administrative claim, thereby violating the principle of creditor equality and distorting the priority and distribution provisions of other sections of the Bankruptcy Code.").

Nevertheless, in both instances, the statutory priority scheme laid out by Congress in the Code is violated.<sup>83</sup> Additionally, because debtors control when they file the petition, they can consistently treat landlords worse than any other post-petition creditor by creating unsecured pre-petition claims to their own benefit.<sup>84</sup>

Proponents of the Billing-date method argue that Congress, not the courts, should decide arbitrary outcomes created by a new statutory enactment.<sup>85</sup> These proponents, including some courts, urge others not to read ambiguity into the statute.<sup>86</sup> This argument is severely flawed, as ambiguity already flows throughout the statute.

The proponents' second argument is that it would be inappropriate for courts to read a proration requirement into the statute.<sup>87</sup> They argue that neither the statute, nor the legislative history, expressly require proration.<sup>88</sup> Furthermore, if Congress wanted proration, they could have added the word "accrual," but they did not.<sup>89</sup> This argument must fail. All courts agree that the pre-code practice was to prorate.<sup>90</sup> To alter a well-established rule, Congress must explicitly state its intention to do so.<sup>91</sup> The legislation need not explicitly state that courts should continue using pre-amendment practices; rather, it must explicitly state a departure from those practices. Congress simply has not done so. Thus, there is no reason to believe Congress intended to deviate from the simple Proration method.<sup>92</sup>

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<sup>83</sup>*Id.*

<sup>84</sup>See Athanas & Semenek, *supra* note 12, at 140-41.

<sup>85</sup>Fruchter, *supra* note 15, at 468-69.

<sup>86</sup>*Id.*

<sup>87</sup>See *In re Comdisco, Inc.*, 272 B.R. 671, 675-76 (Bankr. N.D. Ill. 2002).

<sup>88</sup>*In re Appletree Mkts., Inc.*, 139 B.R. 417, 420 (Bankr. S.D. Tex. 1992).

<sup>89</sup>See *In re the Krystal Co.*, 194 B.R. 161, 164 (Bankr. E.D. Tenn. 1996) (noting the legislative history behind section 365(d)(3) makes "no mention of the concepts of accrual or proration of charges"); *In re F&M Distribs., Inc.*, 197 B.R. 829, 832 (Bankr. E.D. Mich. 1995) ("Congress . . . could have used the term 'accrual' as would more clearly point the way. It did not.")

<sup>90</sup>See *Montgomery Ward*, 268 F.3d 205, 214 (3d Cir. 2001) ("The proration approach is in keeping with what had been, prior to enactment of § 365(d)(3), the well-established rule." (Mansmann, J., dissenting)).

<sup>91</sup>*Pa. Dep't of Pub. Welfare v. Davenport*, 495 U.S. 552, 563 (1990) (stating that courts should not read legislation to change established practices without clear indication that Congress intended to change the rule).

<sup>92</sup>See *Newman v. McCrory Corp.*, 210 B.R. 934, 939 (S.D.N.Y. 1997) ("[N]either the language of the statute nor the legislative history reveals a Congressional intent to deviate from the pre-amendment practice of prorating lease obligations . . ."); see also *Child World, Inc. v. Campbell/ Mass. Trust*, 161 B.R. 571, 576 (S.D.N.Y. 1993) (concluding that there is no express departure from the longstanding principle of prorating rent regardless of the billing date).

The proponents' final argument is that many remedies still exist to the landlord under other Code provisions.<sup>93</sup> Surely, landlords are able to utilize other sections of the Code to obtain payment of stub rent.<sup>94</sup> Circumventing section 365(d)(3) by other means, however, defeats the purpose of the statute's enactment. All courts, in both billing date and proration jurisdictions, agree that "Congress intended § 365(d)(3) to nullify the requirement of § 503(b) that a creditor prove benefit to the estate before it can obtain administrative expense status for a post-petition rent claim."<sup>95</sup> With that purpose in mind, courts cannot continue to disallow proration of stub rent through section 365(d)(3), yet continue to allow proration through other means.<sup>96</sup> The Billing-date method essentially puts landlords through unnecessary hardship in proving their stub rent claims, "a result § 365(d)(3) was intended to avoid."<sup>97</sup> Therefore, the billing-date proponents' final argument must also fail.<sup>98</sup>

#### B. Proration Method Explained, Examined, and Adopted

The Proration method provides that lease obligations relating to pre-petition, yet billed post-petition, or vice versa, are prorated per day in the month of the filing.<sup>99</sup> If rent is due on December 1st, and the debtor files for bankruptcy on December 15th, proration jurisdictions hold that the debtor

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<sup>93</sup>See Fruchter, *supra* note 15, at 470-71. "When, however, a claim for lease obligations happens to miss the payment scheme under § 365(d)(3), the Code does not foreclose the possibility of recovering such claim either as a prepetition claim pursuant to §§ 365(g) and 502(b)(6) or as an administrative claim under § 503(b)." *Id.*

<sup>94</sup>See generally *In re Goody's Family Clothing, Inc.*, 392 B.R. 604, 618 (Bankr. D. Del. 2008) (allowing landlords to recover under section 503(b)(1)). The Third Circuit's *Montgomery Ward* ruling has put a stranglehold on Delaware bankruptcy courts. Delaware judges have had to find alternative ways to allow stub rent payment to landlords through section 503(b)(1) and other sections. See, e.g., *In re DVI*, 308 B.R. 703, 708 (Bankr. D. Del. 2004). At times, the Delaware judges seem reluctant to follow *Montgomery Ward* and often do not fully examine the arguments for the Proration method because of the Third Circuit's binding authority. See, e.g., *In re HQ Global Holdings, Inc.*, 282 B.R. 169, 172 (Bankr. D. Del. 2002). "We conclude that the Landlords' pro-rata argument must be rejected because of the Third Circuit's ruling in *Montgomery Ward*." *Id.*

<sup>95</sup>*In re Stone Barn Manhattan, LLC*, 398 B.R. 359, 367 (Bankr. S.D.N.Y. 2008).

<sup>96</sup>See *id.* ("The billing date approach thus contradicts the plain purpose of the statute, a result to be avoided.").

<sup>97</sup>*In re NETtel Corp.*, 289 B.R. 486, 491 (Bankr. D.D.C. 2002).

<sup>98</sup>One bankruptcy court, in adopting the Billing-date method, acknowledged that the Billing-date method risks undermining bankruptcy reorganizations by sometimes imposing costs based on strict adherence to the billing date. *In re Comdisco, Inc.*, 272 B.R. 671, 675 (Bankr. N.D. Ill. 2002). "[T]o the extent the prospect for reorganization is impaired, not only creditors, but also current employees and other suppliers of inputs may be harmed. Proration, on the other hand, would not defeat the purpose of § 365(d)(3) or seriously injure the landlords . . ." *Id.*

<sup>99</sup>See Athanas & Semenek, *supra* note 12, at 124.

must pay the landlord 16/31 of the total month's rent "timely," and the landlord would obtain an unsecured pre-petition claim for the first fifteen days of December's rent.<sup>100</sup> This method prevents windfalls, avoids absurd results,<sup>101</sup> and protects landlords from becoming involuntary creditors.<sup>102</sup> In addition, proration leads to equitable and consistent results.<sup>103</sup>

### 1. Windfalls

The Proration method prevents windfalls for either debtors or landlords by calculating per day what the lease obligations would be pre-petition and post-petition, regardless of the billing date.<sup>104</sup> The Billing-date method, on the other hand, "ensures that either a landlord or a debtor will receive an unfair windfall not once in a while, but in practically every case."<sup>105</sup> The debtor controls the petition date when it rejects leases and, therefore, can opt, and often does opt, for a windfall at the landlord's expense.<sup>106</sup> Moreover, even some billing-date jurisdictions have acknowledged that their method creates a windfall.<sup>107</sup> A handful of billing-date courts seem willing to accept the windfalls that occur because they "can cut both ways."<sup>108</sup> This idea is illogical and is wholly rejected by an overwhelming number of courts.<sup>109</sup> It follows, then, that proration should be adopted to eliminate the possibility of windfalls.

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<sup>100</sup>*See id.*

<sup>101</sup>*See, e.g., Stone Barn*, 398 B.R. at 366.

<sup>102</sup>*See, e.g., In re Circuit City Stores, Inc.*, 2009 Bankr. LEXIS 672, at \*14 (Bankr. E.D. Va. Feb. 12, 2009) (noting that proration prevents windfalls and landlords from becoming involuntary creditors).

<sup>103</sup>*See Athanas & Semenek, supra* note 12, at 137.

<sup>104</sup>*See Stone Barn*, 398 B.R. at 366.

<sup>105</sup>*Athanas & Semenek, supra* note 12, at 138.

<sup>106</sup>*Id.* at 138. The windfall for the debtor, in this case, would be to have the entire month's rent that the petition is filed, be limited to a pre-petition unsecured claim for the landlords that would be paid at pennies on the dollar. *Id.* at 125.

<sup>107</sup>*See In re Comdisco, Inc.*, 272 B.R. 671, 675 (Bankr. N.D. Ill. 2002) (stating that using the Billing-date method will "often result in windfalls to the landlord, at the expense of other creditors and stakeholders (including other landlords) with equally worthy claims" and noting that proration solves this problem).

<sup>108</sup>*In re 1/2 Card Shop, Inc.*, 2001 Bankr. LEXIS 988, at \*8 (Bankr. E.D. Mich. Mar. 7, 2001). This bankruptcy court explains that filing at the beginning of the month creates a windfall for the debtor; however, filing toward the end of the month, which allegedly is not unusual because the debtor does not normally control the petition date, creates a windfall for the landlord. *Id.*

<sup>109</sup>*See, e.g., In re Circuit City Stores, Inc.*, 2009 Bankr. LEXIS 672, at \*14 (Bankr. E.D. Va. Feb. 12, 2009) ("[A]dopting a method where debtor's liability would turn solely on when bills are issued has the potential to create a windfall for a landlord who decides to manipulate when it bills the debtor."); *see also supra* note 77 and accompanying text (discussing the strategic behavior debtors conduct to favor the estate going into bankruptcy).

## 2. Absurd Results

Numerous courts have described the Billing-date method as resulting in "absurd results."<sup>110</sup> These courts characterize the Billing-date method as too literal an approach that "leads to a near-absurdity when obligations billable to the tenant are allocable to periods going far in advance."<sup>111</sup> Additionally, the Billing-date method poorly construes debtor-landlord rights. Courts supporting the Billing-date method often apply different rules for different types of lease obligations and lengths of leases.<sup>112</sup> The Proration method, on the other hand, avoids all of these problems and provides consistent rulings.<sup>113</sup> The bankruptcy court in *Ames* persuasively writes:

Rather than articulating a principle of such illogical breadth that courts need to be apologizing for it in advance, or need to immediately limit holdings to their particular facts, this Court believes it *more appropriate to consider whether such a potentially illogical and unjust rule was really what Congress intended when it enacted section 365(d)(3)*.<sup>114</sup>

A rule that obstructs the bankruptcy code's priority scheme and results in illogical holdings is not what Congress intended when adopting section 365(d)(3).<sup>115</sup> Therefore, the Proration method should be adopted to avoid these absurd results.

## 3. Involuntary Creditors

Congress additionally intended to protect landlords with the enactment of section 365(d)(3).<sup>116</sup> This protection is almost non-existent if courts adopt the Billing-date method.<sup>117</sup> The Billing-date method forces landlords to be

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<sup>110</sup>See, e.g., *In re Stone Barn Manhattan LLC*, 398 B.R. 359, 366 (Bankr. S.D.N.Y. 2008) ("The facts of this case illustrate that failure to prorate leads to an absurd result.").

<sup>111</sup>*In re Ames Dep't Stores, Inc.*, 306 B.R. 43, 71 (Bankr. S.D.N.Y. 2004).

<sup>112</sup>See *id.* at 71-72. "Cases wrestling with this have come out in different ways, with those adopting the literalistic approach saying or implying that the courts can address inequitable situations when they arise, or that different rules might apply with respect to rental obligations . . . or tax obligations." *Id.* at 72.

<sup>113</sup>See *id.*

<sup>114</sup>*Ames*, 306 B.R. at 72 (emphasis added).

<sup>115</sup>See *In re NETtel Corp.*, 289 B.R. 486, 490 (Bankr. D.D.C. 2002) ("Congress did not likely intend such absurd results.").

<sup>116</sup>See Fruchter, *supra* note 15, at 439.

<sup>117</sup>See *In re Circuit City Stores, Inc.*, 2009 Bankr. LEXIS 672, at \*14 (Bankr. E.D. Va. Feb.

involuntary creditors, essentially stripping them of any possible advantages flowing from section 365(d)(3).<sup>118</sup> The Proration method is much more ideal because it "is more consistent with the legislative purpose underlying § 365(d)(3)'s enactment—the provision of current relief for lessors who find themselves as 'involuntary' creditors."<sup>119</sup>

#### 4. Equitable, Consistent Results

Finally, the Proration method leads to certain and fair results while staying true to section 365(d)(3) and the rest of the Code.<sup>120</sup> Even some of the billing-date jurisdictions "recognize that their interpretation of § 365(d)(3) may be fundamentally unfair."<sup>121</sup> These courts have discussed the aforementioned problem that the Billing-date method creates, among other problems: yearly versus monthly leases, arrears versus in advance payment, and taxes versus rent obligations.<sup>122</sup> Many courts have agreed that proration is "relatively simple to apply, equitable and consistent."<sup>123</sup> The Proration method should be adopted for fairness and equity principles, foundations upon which the Code is so heavily based.

### V. CONCLUSION

Although the Billing-date method can be reasonably extracted from section 365(d)(3), it is far from ideal in terms of application. In contrast, the Proration method proves to be the best solution to section 365(d)(3)'s ambiguity in light of legislative intent and other policy considerations. The Billing-date method arbitrarily produces poor results for both debtors and landlords and often forces courts to rule inconsistently with other provisions of the Code.<sup>124</sup>

It reasonably follows that the Third Circuit should reconsider its ruling in *Montgomery Ward*. Currently, in trying to find equitable alternatives to the Third Circuit's rigid holding, courts must go so far as to expressly violate

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12, 2009) ("The 'intent behind the enactment of § 365(d)(3) was to prevent landlords from becoming involuntary creditors of the debtor's estate . . . ." (citations omitted)).

<sup>118</sup>*See id.*

<sup>119</sup>*El Paso Props. Corp. v. Gonzales (In re Furr's Supermarkets, Inc.)*, 283 B.R. 60, 68 (BAP 10th Cir. 2002).

<sup>120</sup>*See Athanas & Semenek, supra* note 12, at 137.

<sup>121</sup>*Id.*

<sup>122</sup>*See supra* note 110-115 and accompanying text (discussing the absurd results of the Billing-date method).

<sup>123</sup>*In re Stone Barn Manhattan LLC*, 398 B.R. 359, 366 (Bankr. S.D.N.Y. 2008).

<sup>124</sup>*See id.* at 367 (stating that the Billing-date method "would directly contradict 'the policies of flexibility and equity built into Chapter 11 of the Bankruptcy Code.'" (citations omitted)).

section 365(d)(3) to avoid the holding's adverse effect in bankruptcy proceedings.<sup>125</sup>

In a perfect world, Congress should either amend or clarify what it actually envisioned in section 365(d)(3). Unfortunately, it has not, and has created a jurisdictional split ripe for review by the United States Supreme Court.<sup>126</sup> The issue should be resolved in favor of the Proration method.

*Aaron H. Stulman*

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<sup>125</sup>Some Delaware judges must allow a prorated administrative claim under section 503(b) because *Montgomery Ward* does not allow them to order proration under the proper section of the Code: 365(d)(3). See *supra* note 94.

<sup>126</sup>See LaHane et al., *supra* note 7, at 71 ("Unless Congress intervenes in the interim and clarifies a debtor's payment obligations with respect to stub rent, the inconsistent approaches to payment of stub rent are ripe for resolution by the U.S. Supreme Court.").