# 11 U.S.C. § 365(d)(3): A CONCEPTUAL STATUS ARGUMENT FOR PRORATION

VICTORIA KOTHARI*

Since 1984, section 365(d)(3) of the Bankruptcy Code[1] (hereinafter the "Code") has governed the post order for relief,[2] pre-assumption or rejection duties of the trustee with respect to unexpired leases of nonresidential real property. In layman's terms, it dictates when and how much the trustee must pay under a commercial lease until the assumption or rejection decision is made. Until that decision, the statute provides "the trustee shall timely perform all the *obligations* of the debtor . . . *arising* from and after the order for relief *under any unexpired lease*."[3]

In addressing the deceptively simple "when and how much" question under section 365(d)(3), courts have found sufficient fodder for more than twenty years of split decisions. This article addresses one of the critical determinants–the debate between the performance date or billing approach[4] and the proration or accrual

---

* Victoria Kothari is an associate in Greenberg Traurig's Reorganization, Bankruptcy and Restructuring Practice in Miami. This article was originally submitted as the author's thesis for the LL.M. in Bankruptcy from St. John's University School of Law. The author received her J.D. from St. Thomas University School of Law. The views expressed herein are solely the views of the author and do not necessarily represent the views of Greenberg Traurig or those parties represented by Greenberg Traurig.

The author would like to thank Professor Richard Lieb, who served as professor, thesis advisor and mentor, and who no doubt was called on to exercise considerable patience and skill while attempting to extract some semblance of coherent legal thought from his students; to G. Ray Warner and Robert Zinman for their leadership and development of the LL.M. program and for their roles as professors, mentors and thesis defense firing squad; to my many mentors from south Florida, both educators and bankruptcy attorneys who fed my interest and pointed me north, albeit only for a year; to my family for their sacrifice, and finally to those hardworking members of the *American Bankruptcy Institute Law Review* for their time and effort in making it all happen, may your efforts be rewarded.

[1] 11 U.S.C. §§ 101–1330 (2000). All section references are to the Bankruptcy Code (the "Code"), unless otherwise indicated.

[2] Section 365(d)(3) uses the term "order for relief." *See id.* at § 365(d)(3) ("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 . . . ."). This article uses the more common term "post-petition" interchangeably with post order for relief.

[3] *Id*. (emphasis added).

[4] *See In re* CCI Wireless, L.L.C., 279 B.R. 590, 594 (Bankr. D. Colo. 2002) ("Under the 'performance date approach,' an obligation arises under a lease for the purposes of [s]ection 365(d)(3) when the legally enforceable duty to perform arises under the lease."). In other words, "arising" equates with the concept of "due and payable." *See, e.g.*, Centerpoint Props. v. Montgomery Ward Holding Corp. (*In re* Montgomery Ward Holding Corp.), 268 F.3d 205, 209 (3d Cir. 2001) (stating "[i]n the context of a lease contract, it seems to us that the most straightforward understanding of an obligation is something that one is legally required to perform under the terms of the lease and that such an obligation arises when one becomes legally obligated to perform."); Koenig Sporting Goods, Inc. v. Morse Rd. Co. (*In re* Koenig Sporting Goods, Inc.), 203 F.3d 986, 989 (6th Cir. 2000) (holding section 365(d)(3) requires debtor who rejected lease one day after debtor's monthly rent obligation arose to make payment of full month's rent); *In re* F & M Distribs., Inc., 197 B.R. 829, 832–33 (Bankr. E.D. Mich. 1995) (finding under section 365(d)(3) obligation under lease to pay taxes arose on tax bill due date stipulated in lease); *see also In re* Comdisco, Inc., 272 B.R. 671, 676 (Bankr. N.D.

approach[5] as a measure of amount and timing of payments under section 365(d)(3). Since the advent of section 365(d)(3), this debate has consumed judicial resources, yet has failed to yield a consensus.

This paper jumps into the debate by utilizing a theoretical aid to statutory interpretation, wherein the conceptual legal status of the trustee or debtor in possession ("DIP") is defined as the holder of a right to temporary use and possession of the property, to develop a novel argument for proration. Furthermore, to the extent existing case law can be viewed as a compilation of isolated analyses, it may not represent the full range of potential outcomes. This article endeavors to develop a comprehensive view of the billing date versus proration argument by analyzing three economically similar but structurally diverse lease scenarios. Applying this construct in conjunction with the hypotheticals, this article will show that proration best complies with "the statutory scheme that Congress intended to incorporate in section 365(d)(3)."[6] The result, under proration, is that the DIP's obligations to perform converge with the underlying economic reality and are not distorted by the lease structure as they are under the performance date or billing approach. Thus, in the absence of legislative clarification on the issue, this article adds support to the adoption of the proration or accrual approach under section 365(d)(3).

## INTRODUCTION

Without an appropriate contextual framework, the line between rational and

---

Ill. 2002) (holding section 365(d)(3) requires payment of rent as required by lease and prohibits proration between pre-petition and post-petition).

[5] *See In re CCI Wireless*, 279 B.R. at 593 ("Under the proration approach, the Debtor is required by 11 U.S.C. [section] 365(d)(3) to pay only those amounts due under the lease that pertain to the benefits realized by the estate during the post-petition pre-rejection period."). In other words, "arising" equates with the concept of accrual, which is dictated by the nature of the underlying expense. *See, e.g.*, *In re* Handy Andy Home Improvement Ctrs., Inc., 144 F.3d 1125, 1128 (7th Cir. 1998) (applying proration approach and noting Congress passed section 365(d)(3) "to give relief to landlords," but there is no "indication it meant to give landlords favored treatment for any class of pre-petition debts."); Island's Monthly Income Fund, L.P. v. Duckwall-ALCO Stores, Inc. (*In re* Duckwall-ALCO Stores, Inc.), 150 B.R. 965, 976 (D. Kan. 1993) (noting Congress' intent behind section 365(d)(3) was to ensure landlords would have continuing flow of lease revenue by obtaining payments obligated by lease pending decision by trustee or DIP to assume or reject); Newman v. McCrory Corp. (*In re* McCrory), 210 B.R. 934, 939 (S.D.N.Y. 1997) (stating "neither the language of the statute nor the legislative history reveals a Congressional intent to deviate from the pre-amendment practice of prorating lease obligations pending rejection . . . ."); *In re* Duckwall-ALCO Stores, Inc., 150 B.R. 965, 976 (D. Kan. 1993) (noting Congress' intent behind section 365(d)(3) was to ensure landlords would have continuing flow of lease revenue by obtaining payments obligated by lease pending decision by trustee or DIP to assume or reject); *In re* All for a Dollar, Inc., 174 B.R. 358, 361 (Bankr. D. Mass. 1994) (finding proration approach to coincide "with the policy of preserving the priority and distribution scheme established by the Bankruptcy Code."); *In re* Almac's, Inc., 167 B.R. 4, 8 (Bankr. D.R.I. 1994) (adopting approach where rent is prorated to "cover post-petition, prerejection period."); *In re* Ames Dep't Stores, Inc., 150 B.R. 107, 108–09 (Bankr. S.D.N.Y. 1993) (rejecting billing approach and applying proration approach).

[6] Joshua Fruchter, *To Bind or Not to Bind–Bankruptcy Code § 365(d)(3): Statutory Minefield*, 68 AM. BANKR. L.J. 437, 454 (1994) [hereinafter *Statutory Minefield*].

irrational and between sense and nonsense muddies. Similarly, without an awareness of the time, place and experiences that served as a catalyst giving rise to section 365(d)(3), an understanding of its intent and purpose may likewise become muddied. As Justice Holmes put it "[t]he life of the law has not been logic: it has been experience."[7] Thus we begin with a discussion of the history that gave rise to section 365(d)(3).

When Congress passed the Bankruptcy Amendments and Federal Judgeship Act of 1984[8] ("BAFJA"), it was primarily seeking to remedy the jurisdictional problems raised by the Supreme Court's decision in *Northern Pipeline Construction Co. v. Marathon Pipeline Co*.[9] However, BAFJA provided Congress with an opportunity to resolve other bankruptcy issues; in particular the treatment of shopping center lessors during the sixty day post order for relief, pre-assumption or rejection period.

Under the former Bankruptcy Act[10] (the "Act"), a shopping center lessor ordinarily retained the ability to regain control of the property from a debtor-lessee through enforcement of the lease.[11] Under the Act, when a tenant declared bankruptcy, the pre-Code lessor or landlord was generally able to minimize both his direct risk of loss, as well as indirect collateral damage[12] to the remaining tenants through careful drafting of lease provisions.[13] Automatic stay provisions[14] enacted in the Code significantly curtailed the landlord's options; notwithstanding contractual provisions to the contrary, section 362(a) prevents the lessor or landlord from taking any action to regain control of the property. This considerable shift of power from landlord to debtor-tenant and the resulting economic impact to both landlord and remaining tenants was deemed to be an "unintended consequence of

---

[7] OLIVER W. HOLMES, JR., THE COMMON LAW 1 (1881).

[8] Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98 Stat. 333 (1984) [hereinafter BAFJA] (stating purpose of act was to "amend title 28 of the United States Code regarding jurisdiction of bankruptcy proceedings, to establish new Federal judicial positions [and] to amend title 11 of the United States Code").

[9] 458 U.S. 50, 87 (1982) (finding grant of jurisdiction to bankruptcy courts under 28 U.S.C. § 1471 to be unconstitutional).

[10] Bankruptcy Act of 1898, ch. 541, 30 Stat. 544 (1898).

[11] *See id*. at § 362 (providing for (1) termination of lease; (2) changing lease to a month-to-month tenancy; (3) waiving or terminating an option to renew the lease; or (4) terminating lease of debtor who was unable to maintain certain sales volume or worth, upon initiation of insolvency proceedings); *see also* S. REP. NO. 97-527, 97th Cong., 2d Sess. 2 (1982), at 1 (noting "[p]rior to the enactment of the Code, the interests of the nonbankrupt tenants and the landlord were protected by the contractual power of the lessor to terminate the lease in the case of a tenant bankruptcy."); S. REP. NO. 98-70, 98th Cong., 1st Sess. 1 (1983), at 2.

[12] For example, the loss of a key tenant may produce a ripple effect felt by the remaining tenants. Overall traffic to the shopping center may decline, resulting in an immediate negative impact on the remaining tenants' bottom line. Depending on the degree of synergy between the tenants and the debtor-lessee, and the duration of the void, such collateral damage can be significant, even circling back to inflict harm on the landlord as tenants subsequently default on their leases.

[13] S. REP. NO. 97-527, 97th Cong., 2d Sess. 2 (1982), at 2–3; S. REP. NO. 98-65, 98th Cong., 1st Sess. 27 (1983), at 27; S. REP. NO. 98-70, 98th Cong., 1st Sess. 1 (1983), at 2–3.

[14] *See* 11 U.S.C. § 362(a)(3) (2000) (providing automatic stay prohibits "any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate.").

the 1978 Act."[15] These unintended consequences had resisted previous legislative attempts to remedy them because these attempts failed to muster sufficient Congressional support during the 1982 and 1983 sessions.[16]

Inclusion of the section 365(d)(3) provisions in BAFJA was specifically designed to put an end to one of the unintended consequences which the 1978 Act imposed on shopping center lessors; namely, the problem of the bankrupt tenant failing to pay rent post-petition.[17] By its terms, the provisions of section 365(d)(3) authorizing the debtor-lessee to defer performance applies only to the sixty day period after the entry of the order for relief.[18] Absent cause, section 356(d)(3) read in conjunction with section 356(d)(4)[19] provides the debtor a sixty day window[20] in

---

[15] S. REP. NO. 97-527, 97th Cong., 2d Sess. 2 (1982), at 1; S. REP. NO. 98-65, 98th Cong., 1st Sess. 27 (1983; S. REP. NO. 98-70, 98th Cong., 1st Sess. 1 (1983), at 1. The following excerpt from S. REP. NO. 70 further illuminates one of the problems Congress sought to remedy:

> The Bankruptcy Code, enacted by the Bankruptcy Reform Act of 1978, was the first major revision of the bankruptcy laws of the United States since 1938, and its enactment was the culmination of an effort that extended over a number of years. The Code made numerous substantive changes in the law of bankruptcy as well as in the administration of bankruptcy cases**.** *One of these changes made unenforceable lease clauses permitting a landlord to regain possession of premises leased to a bankrupt tenant.* However, Congress recognized the unique interrelationship between shopping center tenants and the great potential for harm to shopping centers and their solvent tenants arising from the ability of a bankrupt tenant to assume or assign a shopping center lease. To protect this important sector of the economy from unnecessary economic harm, Congress enacted in section 365 of the Code certain protective provisions for shopping centers and their tenants. Unfortunately, these provisions have not accomplished these purposes. As a result, this committee has reported S. 2297 to carry out Congress intent as stated in the 1978 act and to strengthen the protections for shopping centers under the Bankruptcy Code.

S. REP. NO. 98-70, 98th Cong., 1st Sess. 1 (1983), at 5. (emphasis added)**.**

[16] *See* The Shopping Center Protections Improvements Acts of 1982, 97th Cong., 2d Sess. (1982) and the Omnibus Bankruptcy Improvements Act of 1983, 98th Cong., 1st Sess. (1983). The report accompanying the Shopping Center Improvements Act of 1982 noted three situations wherein actions by the trustee or DIP would threaten the economic health of the entire shopping center:

> (1) To fail to decide whether he wishes to assume or reject the lease for an extended period of time, and to leave the premises unused or partially unused to the detriment of the surrounding businesses and the landlord;
> (2) To fail to perform his obligations under the lease when due, including the payment of rent and other charges; and
> (3) To fail to assign his lease, when he does assign it, to an assignee who will use the premises as the lease requires.
>
> When any one or more of these situations occur, the economic health of the entire shopping center is threatened. S. 2297 strengthens the protections in the 1978 Act against these three situations to make their occurrence less likely.

S. REP. NO. 97-527, 97th Cong., 2d Sess. 2 (1982); S. REP. NO. 98-70, 98th Cong., 1st Sess. 1 (1983), at 1–2.

[17] *See* The Shopping Center Protections Improvements Acts of 1982, 97th Cong., 2d Sess. (1982) (discussing obligations to perform pay rent and other charges).

[18] 11 U.S.C. § 365(d)(3) (2000) (describing obligations of trustee).

[19] *Id.* at (d)(4). This section provides:

> Notwithstanding paragraphs (1) and (2), in a case under any chapter of this title, if the trustee does not assume or reject an unexpired lease of nonresidential real property under which the debtor is the lessee within 60 days after the date for the order for relief,

which to assume or reject a lease on nonresidential real property. While section 365(d)(3) permits the court to 'extend, for cause, the time for performance of any such obligation that arises within 60 days'[21] its extension is quite limited; it mandates that any grant "shall not be extended beyond such 60 day period."[22] So while an obligation under section 365(d)(3) may be deferred, the outer boundaries for payment are firmly set at sixty days after the order for relief. Payment may not be postponed to confirmation as with administrative expenses under section 503(b).[23]

This period, beginning with the entry of the order for relief and extending to the debtor's assumption or rejection of the lease, has been referred to as a "gap period"[24] or "twilight zone."[25] Gone is the relative certainty of the pre-petition landlord-tenant relationship; gone is the power of the landlord to exercise its rights under the lease to regain possession of the property upon default as was its prerogative under the Bankruptcy Act. Still on the horizon is the recapture of the relative certainty of position, of defined roles, once the debtor exercises its right to assume or reject the lease. The landlord's recovery under section 365(d)(3), while theoretically an improvement over its treatment under 503(b)(1)[26] – limited by the benefit to the estate and its additional procedural requirements, is not guaranteed to deliver its intended protection.[27]

A "twilight zone" might equally describe the position of the trustee or DIP during this period. The trustee is instructed to "*timely perform* all the *obligations* of the debtor . . . *arising from and after* the order for relief . . . until such lease is assumed or rejected, *notwithstanding section 503(b)(1)*."[28] Yet uncertainty remains - what is 'timely performance', what is an 'obligation', what does it mean to 'arise

---

> or within such additional time as the court, for cause, within such 60 day period, fixes, then such lease is deemed rejected, and the trustee shall immediately surrender such nonresidential real property to the lessor.

*Id*.

[20] *See id.* at (d)(3) (providing sixty day period). However, it also contains a provision that provides the court with discretion to "extend, for cause, the time for performance of any such obligation that arises within sixtydays after the date of the order for relief, but the time for performance shall not be extended beyond such 60-day period." *Id.*

[21] *Id*.

[22] *Id*.

[23] *See id.* at § 1129(a) (requiring payment (absent consent) as a condition to confirmation).

[24] *See In re* Peaberry's Ltd., 205 B.R. 6, 8 (B.A.P. 1st Cir. 1997) (discussing lease payments after gap period); *In re* Almac's Inc., 167 B.R. 4, 7–8 (Bankr. D.R.I. 1994) (holding landlord's claim for rent accruing in "gap" period between filing and assumption or rejection is not entitled to superpriority treatment).

[25] *See* Glenn R. Schmitt, *The Bankruptcy Code Requirement of Compliance with Lease Obligations – Does "'All'" Mean Everything?*, 10 N. ILL. U. L. REV. 225, 233–34 (1990) (stating period beginning with entry of order for relief and ending with debtor's assumption or rejection is "twilight zone").

[26] 11 U.S.C. § 503(b)(1) (stating "[a] the actual, necessary costs and expenses of preserving the estate, including wages, salaries, or commissions for services rendered after the commencement of the case.").

[27] *See* Appendix A (stating if circuit has adopted performance date or billing approach combination of timing of petition and obligations structured under lease may deny lessor any recovery under section 365(d)(3)).

[28] 11 U.S.C. § 365(d)(3) (2000) (emphasis added) (requiring timeliness in performance of trustee's obligations upon order for relief and permitting the court to extend time for performance for cause).

from and after', and what is the effect of the phrase 'notwithstanding section 503(b)(1)'? Aside from a general consensus that, during this period, a landlord does not have to comply with the procedural requirements imposed under section 503(b),[29] the trustee or DIP in this "zone" is faced with two decades of split circuit decisions under section 365(d)(3) providing conflicting guidance as to what must be timely paid.

Courts remain divided on the issue of whether proration or accrual[30] of post-petition charges is appropriate under section 365(d)(3) or whether the correct interpretation[31] of the statute mandates application of the performance date or billing[32] method. An early article on the subject touched on the interpretive utility of conceptual frameworks, and identified two different treatments for the DIP under section 365(d)(3).[33] The first, classifying the DIP as "a new judicial entity, legally independent of its predecessor"[34] underpins the "nonbinding lease" approach; which, in turn, supports proration or accrual[35] by relying indirectly on 503(b)(1)'s requirement that an expense be "actual and necessary"[36] to be entitled to administrative priority. The second approach, in contrast, classifies the DIP as "the same legal entity"[37] and is the predicate of the "binding lease" approach which requires strict enforcement of the lease; *i.e.*, the billing method.[38]

This article proposes the examination of section 365(d)(3) under a third conceptual framework, that of the DIP as the holder of a sixty day right to temporary use and possession. By utilizing an economic substance analysis to

---

[29] 11 U.S.C. § 503 (requiring creditor to file request for payment, and for notice and hearing to determine allowed administrative expense claim.) Unlike section 365(d)(3), section 503 does not include a provision for timely performance by the trustee.

[30] *See In re* CCI Wireless, L.L.C., 279 B.R. 590, 593–94 (Bankr. D. Colo. 2002) (citing cases and defining debtor's obligations under proration or accrual method to be "only those amounts due under the lease that pertain to the benefits realized by the estate during the post-petition pre-rejection period."). For courts adopting the proration or accrual method, the term "arising", as used in section 365(d)(3), equates with the concept of accrual, which in turn, is dictated by the nature of the underlying expense and not by the particular date an obligation becomes legally enforceable.

[31] Courts advocating this interpretation do so under the auspices of the "plain language" of the statute.

[32] *See CCI Wireless, L.L.C.*, 279 B.R. at 594 (stating under "performance date approach," an obligation arises under lease for purposes of section 365(d)(3) when the "legally enforceable duty to perform arises under the lease."). "Arising" equates with the concept of "due and payable," and due to the ability to manipulate the timing of such obligations, it may fail to reflect the underlying economic substance of both the landlord's costs and the estate's benefit during the sixty day post-petition period; *i.e.*, an annual lease payment arising within the sixty day period would yield a windfall to the landlord. Conversely, a payment arising after the sixty day 365(d)(3) period would yield a windfall to the debtor – tenant and effectively deny the landlord any claim under section 365(d)(3).

[33] *See Statutory Minefield*, *supra* note 6, at 454 (discussing two possible alternatives in treating unexpired leases prior to rejection or assumption).

[34] *Id*. (discussing possible treatment of DIP as new judicial entity with respect to unexpired leases).

[35] *See id*. at 454–55 (discussing proration as appropriate method).

[36] 11 U.S.C. § 503(b)(1)(A) (2000) (stating after notice and hearing, administrative expenses are allowed, including actual and necessary expenses of running estate).

[37] *Statutory Minefield*, *supra* note 6, at 456 (expressing views of "binding lease" approach under which Congress could treat DIP as same legal entity as pre-bankruptcy debtor).

[38] *Id*. (stating same).

recharacterize the "gap period"[39] or "twilight zone" as a sixty day right to continue in possession, in effect to keep the lease alive, the provisions of section 365(d)(3) dictate the 'cost' of that right. To fully explore the effect of the billing date versus proration argument within this conceptual framework, the article develops and analyzes three economically similar, yet structurally diverse, leases.

The article begins with a brief foray into the history of unexpired nonresidential real property leases in bankruptcy, and then addresses the commercial landlord's limited recourse under section 503(b)(1) of the Code, its unintended consequences,[40] and the subsequent legislative attempts to remedy those consequences leading to the 1984 adoption of section 365(d)(3). The article continues with the application of section 365(d)(3) by the courts. Due to the lack of consensus after more than twenty years of court scrutiny, I begin with a discussion of the challenges of statutory versus common law interpretation, as Congress has not elected to clarify section 365(d)(3) through later amendment. To highlight areas for later discussion, this section identifies ambiguities and potential adverse side effects of the billing date and proration interpretations of 365(d)(3).

The article employs a conceptual status paradigm in the analysis of the billing date versus proration argument. While the conceptual model adopted is that of the DIP as the holder of a right to temporary use and possession, I begin the analysis with an examination of the existing models. This section develops an alternative conceptual model by initially identifying two potential contenders: (i) the DIP as an option holder, and (ii) the DIP as the holder of a right to temporary use and possession. The conceptual model adopted for this analysis, the use and possession model, was selected because of its close of fit with legislative history; this choice is further reinforced by the economic substance of the post order for relief, pre-assumption or rejection period.

With the appropriate conceptual model in place, the article moves into the development of three economically similar, yet structurally diverse hypotheticals; namely a gross lease, a net lease, and a hybrid lease or financing scenario. The lease hypotheticals are designed to cover a wide variety of commercial lease structures, thereby awarding a more complete picture of the effect of adopting of the billing date over the proration method. Further, by developing all leases to yield approximately equivalent annual cash outflow any variance in the 'cost' of the sixty day right to temporary use and possession will be the direction result of the method adopted.

The lease hypotheticals are explored to determine which "costing" method, accrual or billing, comports with section 365(d)(3). The analysis considers plain language, statutory interpretation, legislative history and bankruptcy policy to determine whether the accrual or billing method best measures the 'cost' of the right

---

[39] *In re* Almac's Inc., 167 B.R. 4, 7–8 (Bankr. D.R.I. 1994) (discussing language of section 365(d)(3) of the Code, which allows court to give DIP an extra sixty days to determine whether to assume or reject lease). *But see In re* Peaberry's Ltd., 205 B.R. 6, 8 (B.A.P. 1st Cir. 1997) (citing authority which states section 365(d)(3) entitles landlords to immediate full payment of post-petition rent).

[40] *See supra* note 12.

to temporary use and possession. This section concludes that, from an economic substance vantage point, the better conceptual status of the DIP is that of a holder of a right to temporary use and possession. Furthermore, application of the proration or accrual method to determine the "cost" of this right best comports with the statutory scheme Congress intended to implement to determine the post order for relief, pre-rejection obligations of the DIP under section 365(d)(3), as well as with fairness, economic reality, and bankruptcy policy.

## I. HISTORY: TRACING THE TREATMENT OF UNEXPIRED NONRESIDENTIAL REAL PROPERTY LEASES IN BANKRUPTCY

Plainly, the filing of bankruptcy changes the relative power and position of both the landlord and the debtor-tenant. Across time, this shifting of power and risk is, in part, defined by prevailing bankruptcy law. Statutory amendments are not written on a clean slate;[41] as such, tracing the immediate post-petition landlord-debtor relationship from pre-Code practice through section 365(d)(3) provides a historical reference for judicial interpretation of Congressional intent where the plain language does not suffice, and in this case supports adoption of the proration or accrual method.

### *A. Pre-Code: Treatment Under the Bankruptcy Act*

Under the Bankruptcy Act of 1898,[42] landlords maintained a level of control over their property that is but a dream to today's lessor. Even in bankruptcy, a landlord was able to enforce *ipso facto* clauses in a lease, providing it with the ability (1) to terminate the lease, (2) to convert to a month-to-month tenancy, (3) to waive or terminate renewal options, or (4) to terminate a lease for failure to achieve or maintain pre-set financial conditions.[43] The pre-Code landlord was not constrained by the automatic stay[44] and was generally able to accelerate eviction of the debtor-tenant and regain possession. This ability protected not only the landlord, but in the case of shopping centers it also reduced the risk of collateral damage to other tenants.[45] Further, it was pre-Code practice to prorate any post-petition real estate taxes obligations provided for in the lease.[46]

---

[41] Dewsnup v. Timm, 502 U.S. 410, 419 (1992) (discussing amendments to bankruptcy law).

[42] The Bankruptcy (Nelson) Act of 1898, 55 Cong. ch. 541, 30 Stat. 544 (July 1st, 1898).

[43] *Id.; see also* S. REP. NO. 98-70, 98th Cong., 1st Sess. 1 (1983), at 1–2.

[44] *See* 11 U.S.C. § 362(a) (2000) (setting forth codification of automatic stay principle).

[45] *See* Schmitt, *supra* note 25, at 236–37 (discussing negative effects on both landlord and other tenants).

[46] *See In re* Koenig Sporting Goods, Inc., 229 B.R. 388, 393 (B.A.P. 6th Cir. 1999) (finding Congress did not intend to deviate from pre-Code practice of prorating lease obligations pending rejection); *In re* McCrory Corp., 210 B.R. 934, 940 (Bankr. S.D.N.Y. 1997) (stating Congress did not intend to eliminate pre-Code practice of proration when enacting section 365(d)(3) of Code); *see also In re* GC Cos., Inc., 261 B.R. 594, 597–98 (Bankr. D. Del. 2001) (expressing legislative history supports continuation of proration of leases in post-petition, pre-rejection period).

### *B. Treatment Under Section 503(b)(1)*

Under the Code, landlords were permitted to seek payment for rent and other charges under section 503(b)(1)(A) which provided that, after notice and a hearing, the court would allow an administrative expense to the extent that the charges represented "the actual, necessary costs and expenses of preserving the estate."[47] While administrative expenses are designated first priority among unsecured claims,[48] the landlord's total claim under section 503(b)(1) was subject to valuation "under an objective worth standard that measures the fair and reasonable value of the lease."[49]

In practice, courts frequently looked to the base rent and other terms of the lease as a measure of the fair market value of the property.[50] However, changes in the commercial real estate market or in the nature of use or occupancy of the property by the debtor might lead to a significant departure from the terms of the original agreement.[51] Thus, the actual rent awarded under section 503(b)(1) was not necessarily the amount provided for under the terms of the lease;[52] nor was the actual recovery guaranteed to be timely[53] or even paid if the estate was administratively insolvent.

In application, the fair market value standard resulted in "the long-standing practice [under section 503(b)(1)] of prorating debtor-tenant's rent to cover only the post-petition, pre-rejection period, regardless of billing date."[54] Thus, the pre-Code practice of proration continued during the early years of the Code.

---

[47] 11 U.S.C. § 503(b)(1)(A) (2000); *see In re* Dant & Russell, Inc., 853 F.2d 700, 707 (9th Cir. 1998) (discussing grant of administrative expense priority).

[48] *See* 11 U.S.C. § 507(a)(1) (2000) (according administrative expenses allowable under section 503(b) and "any fees assessed against the estate" highest priority).

[49] *Dant & Russell Inc.*, 853 F.2d at 707 (holding amount of administrative expense claim is limited to "portion of the leased property" actually used or occupied and is not valued according to lease term, but under objective worth standard measuring fair and reasonable value of lease).

[50] *Id.* (noting cases where court used rent and other lease terms as measure of fair market value).

[51] *See generally In re* Trans World Airlines, Inc., 145 F.3d 124, 136–38 (3d Cir. 1998) (holding in context of aircraft financing, section 1110 suggests terms of financing agreement be honored rather than reducing payments to fair market value); *In re* Zagata Fabricators, Inc. v. Superior Air Products, 893 F.2d 624, 627 (3d Cir. 1990) (explaining bankruptcy proceedings are equitable, therefore "landlord's right to collect monetary relief is somewhat curtailed: a debtor is generally required to pay only a reasonable value for the use and occupancy of the landlord's property, which may or may not equal the amount agreed up on in the terms of the lease"); Sharon Steel Corp. v. Nat'l Fuel & Gas Distr. Corp., 872 F.2d 36, 42–43 (3d Cir. 1989) (rejecting National Fuel's argument "actual and necessary cost and expense of preserving the estate under [section] 503(b) is presumptively the rate under the service agreement" and concluding bankruptcy court's reliance on LVIS rate, which was rate applicable to all National Fuel's large industrial customers, was not clearly erroneous).

[52] While a landlord might continue to incur expenses on the subject property, recovery was limited to the reasonable value of the use and occupancy of the property. This may or may not be the amount of the rent specified in the lease. *See, e.g.*, *In re* Rhymes, Inc., 14 B.R. 807, 808 (Bankr. D. Conn. 1981).

[53] *Statutory Minefield*, *supra* note 6, at 437 (stating bankruptcy courts' discretion over administrative claims could lead to deferral of payment until date of confirmation).

[54] *In re* Child World, 161 B.R. 349, 352–53 (Bankr. S.D.N.Y. 1993) (refusing to include obligations lessee assumed as part of its replacement lease as damages after rejection of lease).

### *C. Unintended Consequences: Precursor to Change*

Unlike the typical debtor - trade creditor relationship, a shopping center is a holistic enterprise; its character and success is determined by the careful selection of the individual tenants that make up the "center." To a great extent, the financial health of each tenant is dependent on the tenant mix, and the customer base or traffic each tenant can bring to the center.[55] These very synergies mean that the departure, or bankruptcy, of a key tenant can result in serious financial harm[56] to the remaining tenants. Moreover, Congress recognized that the treatment of the debtor does not take place in a vacuum. The impact or adverse side effects on both the landlord and other tenants was too costly; a new solution was called for.

By 1982 the voice of landlord interests had reached Congress; *i.e.*, Congress was made aware that the effect of 503(b)(1) left both the landlord and remaining shopping center tenants particularly vulnerable to injury by a debtor-tenant's bankruptcy. In an effort to provide the debtor with breathing space and the opportunity to reorganize, the very protections of the Code imposed 'adverse side

---

[55] S. REP. NO. 97-527, 97th Cong., 2d Sess. 2 (1982), at 1; S. REP. NO. 98-65, 98th Cong., 1st Sess. 27 (1983); S. REP. NO. 98-70, 98th Cong., 1st Sess. 1 (1983), at 1, 5–6 (1983). The following excerpts from the Senate report clearly illustrate Congressional awareness of the interdependencies:

> As Congress recognized in enacting the 1978 act, shopping center leases are distinct from other leases of real property in that each lease arrangement memorializes not only the bilateral interests of the tenant and the landlord, but the multilateral relationships of every other tenant in the shopping center. The interdependence among the tenants of a shopping center means that the bankruptcy of one tenant will seriously affect the other tenants.
>
> …
>
> These *multifarious symbiotic relationships* in the shopping center are in peril whenever any tenant suffer financial hardship or fails.
>
> …
>
> Under the Bankruptcy Code, the shopping center and its solvent tenants may suffer serious economic harm or even business failure if a bankrupt tenant closes its store for an extended period of time or assigns its lease to a business which does not conform to the lease's use clause thus disrupting the shopping center's tenant mix.

S. REP. NO. 98-65, 98th Cong., 1st Sess. 27 (1983), at 5–6 (emphasis added).

[56] *See* The Shopping Center Protections Improvements Acts of 1982, 97th Cong., 2d Sess. (1982), at 11 (noting effect of tenant mix and closing of key tenant on customer traffic); *see also* S. REP. NO. 98-70, 98th Cong., 1st Sess. 1 (1983), at 7. Stating:

> During this time, the other tenants of a shopping center may be affected dramatically. The closing of even a single store in a shopping center may substantially reduce the revenues and increase the costs of the other tenants. Their revenues are reduced because the closing of a store in a shopping center, especially a major store, reduces the traffic flow through the shopping center. The closing of a major tenant can also significantly increase the costs of the other tenants. In many shopping centers, common area charges are assessed each tenant on the basis of the tenant's percentage of total leased space. The closing of a major tenant substantially reduces the amount of total leased space. This increases the percentage of total leased space of all the remaining tenants and their share of the common area charge.

*Id*.

effects' on non-debtor parties. The "unintended consequences,"[57] or adverse side effects, that Congress identified were:

> [F]irst [. . .] the potential for a long-term vacancy or partial diminution in operation of the space leased by a bankrupt tenant. *The second was that the bankrupt tenant may have stopped paying rent as required under its lease.* The third problem was the damage to a landlord that occurred when a bankrupt tenant assigned its leasehold interest to an entity that disrupted the balance of retail outlets in a shopping center.[58]

Prior to BAFJA in 1984, proposed fixes to these problems were included in The Shopping Center Protections Improvements Acts of 1982,[59] and The Omnibus Bankruptcy Improvements Act of 1983.[60] Thus, little discussion was needed by 1984; indeed, the only legislative history for section 365(d)(3) is found in the remarks of Senator Orrin Hatch which, by this time, echoed a very familiar refrain:

> [The second] 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 due under the lease. These payments include rent due the landlord and common area charges which are paid by all the tenants according to the amount of space they lease. In this situation, the landlord is *forced to provide current services–the use of its property, utilities, security, and other services–without current payment. No other creditor is put in this position.*[61] 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

---

[57] S. REP. NO. 98-527, 98th Cong., 2d Sess., at 1 (1985); S. REP. NO. 98-65, 98th Cong., 1st Sess. 27 (1983); S. REP. NO. 98-70, 98th Cong., 1st Sess., at 1 (1983).

[58] Schmitt, *supra* note 25, at 227 (footnotes omitted) (emphasis added).

[59] The Shopping Center Protections Improvements Acts of 1982, 97th Cong., 2d Sess. (1982).

[60] The Omnibus Bankruptcy Improvements Act of 1983, S. 445, 98th Cong., 1st Sess. (1983).

[61] Senator Hatch defines "current services" as "the use of its property, utilities, security, and other services." 130 CONG. REC. S8894-94 (daily ed. June 29, 1984) (statement of Sen. Hatch). Thus, a key component of current services is "rent," which is defined as "a charge for the use of space." *See* DICTIONARY OF REAL ESTATE TERMS 348, 5th ed. (2000). The other items included in the current services category are characterized as: i) services; and ii) current expenses in the temporal sense. Therefore Senator Hatch appears to view section 365(d)(3) as a means to provide the landlord with rent for the use of the property during the post order for relief period plus reimbursement for any temporal expenses incurred by the landlord during that period. The effect is to freeze the landlord's unsecured claim as of the order for relief, thereby transforming the landlord from involuntary to voluntary status post order for relief creditor. 130 CONG. REC. S8894-94 (daily ed. June 29, 1984) (statement of Sen. Hatch).

> perform *all the obligations of the debtor under a lease*[62] of non-residential 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. For cause the court can extend the time for performance of obligations due during the first 60 days after the order for relief, but not beyond the end of such 60 day period. At the end of this period, the amounts due during the first 60 days would be required to be paid, and thereafter, all obligations must be performed on time. This permissible 60 day grace period is intended to give the trustee time to determine what lease obligations the debtor has and to locate the cash to make the required payments in exceptionally large or complicated cases.[63]

These comments illustrate that Congress was not only aware of the direct harm to the landlord but also of the potential for injury to non-debtor tenants. In a 1982 hearing on The Shopping Center Protections Improvements Act,[64] the National Retail Merchants Association pointed out that common area charges are typically allocated on a prorata basis according to the percentage of leased cost.[65] Thus, the departure of a major tenant could result in an immediate cost shift to other tenants as their relative occupancy of the center increased. This effect is reflected in the comments of Senator Hatch, who noted that "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."[66]

In addition to the harms identified above, section 503(b)(1) proved to be an unsatisfactory arrangement for other reasons.[67] The burdensome process of notice and hearing, the limitation to 'reasonable value of actual use', and the possibility that the court could delay compensation until confirmation of the plan combined to impose additional hardships on landlords who had their own obligations to meet and who were forced to continue to provide "current services" without "current

---

[62] Unfortunately, section 365(d)(3) as enacted perpetuates the ambiguity of the term "obligation" as found in the legislative history.

[63] *In re* By-Rite Dist., Inc., 47 B.R. 660, 664–65 (Bankr. D. Utah 1985) (citing Sen. Hatch's remarks regarding reallocation of burden of fixing reasonable time to assume or reject unexpired leases) (emphasis added).

[64] *Supra*, note 56.

[65] *See* Bankruptcy: The Shopping Center Protection Improvement Act of 1982: Hearing Before the Committee on the Judiciary on S.2297 97th Cong. 134-38 (1982) (highlighting statement of National Retail Merchants Assoc.).

[66] *In re* By-Rite Dist., Inc., 47 B.R. at 664–65 (citing Sen. Hatch's remarks).

[67] *See Statutory Minefield, supra* note 6, at 437–38 (discussing other reasons section 503(b)(1) proved to be an unsatisfactory arrangement). For example, a landlord had to comply with the formal and time-consuming procedure of an application, notice, and hearing and could, upon proper proof, only recover the reasonable value of the DIP's actual use and occupancy of the premises. *Id*.

compensation."[68] Taken together, the harms to both the landlord and remaining tenants and the claims process under section 503(b) explain why the 1984 legislation was needed.

Further, section '503(b)(1) left landlords in the position of being forced to keep a debtor-tenant while other creditors have the option to continue doing business with the debtor or to cease doing business with the debtor."[69] In essence, the landlord was put in the position of an involuntary creditor of the estate.[70]

*D. Treatment Under Section 365(d)(3)*

In response to the "unintended consequences"[71] and involuntary creditor status of the landlord under section 503(b)(1), Congress enacted section 365(d)(3) which provides as follows:

> The trustee shall *timely perform* all the *obligations* of the debtor, except those specified in section 365 (b)(2), *arising from and after* the order for relief under any unexpired lease of nonresidential real property, until such lease is assumed or rejected, *notwithstanding section 503 (b)(1)* of this title. The court may extend, for cause, the time for performance of any such obligation that arises within 60 days after the date of the order for relief, but the time for performance shall not be extended beyond such 60-day period. This subsection shall not be deemed to affect the trustee's obligations under the provisions of subsection (b) or (f) of this section. Acceptance of any such performance does not constitute waiver or relinquishment of the lessor's rights under such lease or under this title.[72]

The courts, reflecting the legislative history, have described the purpose or intent of section 365(d)(3) as follows: (i) "to relieve the burden placed on nonresidential real property lessors (or "landlords") during the period between [the date] a tenant's bankruptcy petition [is filed] and assumption or rejection of a lease,"[73] (ii) to "prevent parties in contractual or lease relationships with the debtor from being left in doubt concerning their status vis-à-vis the estate,"[74] (iii) to "to ameliorate the immediate financial burden borne by lessors of nonresidential real

---

[68] *Id*.

[69] *In re* Phar-Mor, Inc., 290 B.R. 319, 323 (Bankr. N.D. Ohio 2003).

[70] *See In re* Trak Auto Corp., 277 B.R. 655, 662 (Bankr. E.D. Va. 2002) (explaining purpose of section 365(d)(3) as preventing landlord from becoming involuntary creditor of estate).

[71] *Supra* note 46.

[72] 11 U.S.C. § 365(d)(3) (2000) (emphasis added).

[73] *In re* Pudgie's Dev. of N.Y., Inc., 239 B.R. 688, 692 (S.D.N.Y. 1999) (explaining legislative history behind section 365(d)(3)).

[74] *In re* Cannonsburg Envt'l. Assocs., Ltd., 72 F.3d 1260, 1266 (6th Cir. 1996) (finding time limits under section 365 to support conclusion that subsection (c)(2) does not apply to post-petition loans).

property during the time when trustees decide whether to assume lease,"[75] (iv) to "shift burden of indecision to debtor; the debtor must now continue to perform all obligations of lease or make up its mind to reject lease before some onerous payment obligation becomes due during the pre-rejection period,"[76] (v) to "protect commercial landlords from the procedural and substantive burdens faced by claimants of post-bankruptcy administrative expenses,"[77] (vi) to "prevent landlords from becoming involuntary creditors of estate,"[78] and (vii) to "ensure that landlords would not be disadvantaged by providing post-petition services to the debtor. Put another way, Congress intended the subsection to put landlords on an equal footing [with other post-petition creditors], not to grant them a windfall at the expense of other creditors."[79] Common themes of protection, relief from burden, and equality of treatment connect back to the recognized "unintended consequences" of section 503(b)(1). At the same time, comments like "shift[ing] the burden of indecision to the debtor"[80] and reference to potential "windfall[s]"[81] indicate that the remedy may not be without adverse effects of its own.

By 1984 Congress determined that the "unintended consequences" of section 503(b)(1) necessitated a legislative fix. The combination of post filing services provided to the debtor-tenant along with the direct and indirect financial impact on both landlords and third parties was unacceptable; the solution was the adoption of section 365(d)(3). Yet even 365(d)(3) was not without adverse side effects. More than a decade ago section 365(d)(3) was characterized as a "statutory minefield."[82] Its character is resolute; even today courts remain split over the "when and how much" questions under 365(d)(3); namely, what constitutes "timely performance," what is an "obligation," what does it mean to 'arise from and after," and what is the effect of the phrase "notwithstanding section 503(b)(1)."

What can be inferred from twenty years of legislative silence on the issue? In truth, any inferences would be pure speculation. However, the reality – the minefield – remains, and it would seem that further Congressional remedy is not

---

[75] *In re* P.J. Clarke's Rest. Corp., 265 B.R. 392, 396–97 (Bankr. S.D.N.Y. 2001) (citing *In re* Pac.-Atl. Trading Co., 27 F.3d 401, 403 (9th Cir. 1994)).

[76] *In re* Valley Media, Inc., 290 B.R. 73, 75 (Bankr. D. Del. 2003) (citing *In re* Krystal Co., 194 B.R 161, 164 (Bankr. E.D. Tenn. 1996).

[77] *In re* Comdisco, Inc., 272 B.R. 671, 674 (Bankr. N.D. Ill. 2002) (concluding requiring debtor to reimburse expenses incurred before bankruptcy did not serve purposes of section 365(d)(3)).

[78] *In re* Trak Auto Corp., 277 B.R. 655, 662 (Bankr. E.D. Va. 2002) (discussing section 365(d)(3) and calculating what constitutes pre-petition and post-petition charges).

[79] *In re* Best Prods. Co., 206 B.R. 404, 407 (Bankr. E.D. Va. 1997) (holding section 365(d)(3) required debtor-in-possession to pay its share only if such real property taxes as accrued post-petition until such time as its unexpired leases were assumed or rejected); *see also Trak Auto Corp*., 277 B.R. at 662 ("[D]ebtor's obligations become post-petition obligations because they accrued during the post-petition period.").

[80] *Valley Media, Inc*., 290 B.R. at 75 (citing *In re* Krystal Co., 194 B.R 161, 164 (Bankr. E.D. Tenn 1996)).

[81] *Best Products Co*., 206 B.R. at 407 (discussing legislative intent of section 365(d)(3)); *see also Trak Auto Corp*., 277 B.R. at 663–64 (stating same).

[82] *Statutory Minefield*, *supra* note 6, at 439 ("[D]eciphering [section] 365(d)(3) has been akin to navigating a freshly sown battlefield - like hidden mines, each clause construed has triggered considerable debate as to its intent and meaning").

forthcoming. The only course open is left to the courts – to eventually reach a consensus as to its interpretation and application. Accordingly, we move on to statutory interpretation.

## II. APPLICATION AND SIDE EFFECTS UNDER SECTION 365(d)(3)

This article builds on the idea of conceptual frameworks as an interpretive aid, or tool, to "determin[e] the statutory scheme that Congress intended to incorporate in [section] 365(d)(3)."[83] In essence, the correct conceptual framework resembles a theory – one which ties together certain pieces of information in a coherent manner, and which clearly highlights that which does not fit.

Given that section 365(d)(3) has proved resistant to uniform interpretation, we turn to a discussion of traditional statutory interpretation, of plain language, ambiguity, and the role of legislative history and policy in interpretation; we begin at the beginning – with an understanding of the conceptual differences between statutory and common law.

### *A. Interpretation of Statutory Versus Common Law*

Judge Richard Posner addressed the essential differences between statutory and common law which impact interpretation in his 1987 article, *Legal Formalism, Legal Realism, and the Interpretation of Statutes and the Constitution.*[84] In essence, common law is a conceptual system predicated on notions of public policy and free from bondage to a single authoritative statement. Common law doctrines are open

---

[83] *Statutory Minefield*, *supra* note 6, at 454.

[84] Richard A. Posner, *Legal Formalism, Legal Realism, and the Interpretation of Statutes and the Constitution*, 37 CASE W. RES. L. REV. 179 (1987) (discussing differences between "textual" and "realistic" approaches in interpreting statutes). He stated:

> The common law has a logical structure, and its premises are determined by notions of public policy. Statutes and constitutions are fundamentally different. They are communications, and neither logic nor policy is the key to decoding them . . . .
>
> The common law . . . is a conceptual system – not a textual one. The concepts of negligence, of consideration, of reliance, are not tied to a particular verbal formulation, but can be restated in whatever words seem clearest in light of current linguistic conventions. Common law is thus unwritten law in a profound sense. There are more or less influential statements of every doctrine but none is authoritative in the sense that the decision of a new case must be tied to the statement, rather than to the concept of which the statement is one of an indefinite number of formulations. . . .
>
> No matter how clear the text seems, it must be interpreted (or decoded) like any other communication, and interpretation is neither logical deduction nor policy analysis. . . .
>
> A text is clear only by virtue of linguistic and cultural competence. . . .
>
> If a message is unclear we ask the sender to repeat or amplify it until we no longer doubt what he meant to say. . . .Consulting post-enactment legislative history, and even hearing testimony by legislators in cases in which the meaning of legislation is contested, are methods by which courts sometimes try to get legislature, in effect, to repeat unclear messages.

*Id*. at 181, 186–87, 191.

to an indefinite number of formulations.[85]

In contrast, statutory law is a textual system of communications. Each legislative communication (statute) must be interpreted by the courts, applied and tied back to a single authoritative statement. The choice of a word or the placement of a comma[86] cannot be discounted by waving a wand and incanting "policy, policy." Yet, unlike interpersonal communications, we cannot simply ask the "sender to repeat or amplify it [the communication] until we no longer doubt what he meant to say,"[87] nor can we look to some general notion of public policy. Instead, we begin the interpretation of any textual communication (statute) with its plain language. If the communication is unclear we can look to legislative history as a means of seeking clarification.

Where legislative history is lacking, statutory interpretation calls upon courts to examine the alternative interpretations in the context of underlying bankruptcy policies.[88] The interpretation must still be tied back to the statutory language, but bankruptcy policy will be determinative where the selection of one interpretation would yield results in contravention of *e.g.*, the fresh start policy or equal treatment of similarly situated creditors.

### *B. Statutory Interpretation: Plain Language, Legislative History and Policy*

As with any attempt to discern the meaning of a statute, courts should presume that Congress "says in a statute what it means and means in a statute what it says there."[89] It is well established that where "the statute's language is plain, the sole function of the courts is to enforce it according to its terms."[90] Thus, if section 365(d)(3) "has a plain meaning that precludes any other interpretation"[91] our "judicial inquiry is complete."[92]

Twenty years after its enactment section 365(d)(3) continues to resist categorization as a plain and unambiguous statement. While the minority,[93] those courts adopting the performance date or billing method, have held that section 365(d)(3)'s mandate to "*timely* perform all the *obligations* of the debtor, … *arising*

---

[85] *Id*. at 186 ("[T]he concepts which provide the major premises for common law reasoning (whether an overarching premise such as wealth maximization, or particular legal concepts such as negligence that can be deducted from it) could be, and no doubt would be (and to some extent have been), altered by the judges in response to changing perceptions of public policy.").

[86] United States v. Ron Pair Enters., Inc., 489 U.S. 235, 241 (1989) (noting commas allow phrases to stand independently within statutory language).

[87] Posner, *supra* note 84, at 188.

[88] *Id*. at 186–90 (stating unambiguous statutes must be interpreted using plain language).

[89] Connecticut Nat'l Bank v. Germain, 503 U.S. 249, 254 (1992).

[90] *Ron Pair*, 489 U.S. at 241.

[91] *In re* NETtel Corp., 289 B.R. 486, 489 (Bankr. D.D.C. 2002).

[92] *Conn. Nat'l Bank*, 503 U.S. at 254 (1992).

[93] *In re* Dunn Indus., L.L.C., 320 B.R. 86, 88 (Bankr. D. Md. 2005) (noting Third Circuit, in *In re Montgomery Ward Holding Corp.*, 268 F.3d, 208 (3d Cir. 2001), recently adopted minority approach (billing method) which finds terms "obligations" and "arising" to be unambiguous, and thus compelling payment in accordance with terms of lease).

*from and after* the order for relief . . . *notwithstanding section 503(b)(1)*"[94] is a clear and unambiguous statement,[95] the majority concludes that the statute is ambiguous.[96]

Courts advocating a "performance date" or "billing date" method point to well established principles of statutory construction to support a plain language interpretation construct of section 365(d)(3). While acknowledging that the billing method is a significant departure from prior practice, these courts contend that statutory interpretation begins with 'the existing statutory text . . . and not [with] predecessor statutes."[97] Additionally, they argue that in attributing to the words in the statute their "ordinary, contemporary, common meaning"[98] the statutory text is unambiguous. Under this interpretation, application of section 365(d)(3) is absolute, a bright line rule - any payment that comes due by the terms of the lease after the order for relief and pre-rejection is an "obligation[] arising from and after"[99] and must be timely paid by the DIP.

In 1994, ten years after the enactment of section 365(d)(3), a commentator noted that circuit courts espousing the "performance date" or "billing" method[100]–a "plain language" interpretation of section 365(d)(3)–represented the majority. Over time the tide shifted. By 2002, other commentators identified a new majority;[101] now represented by circuit courts adopting the "accrual or proration" method.[102] While the majority and minority reversed roles between 1994 and 2002, a concern was voiced that significant recent decisions favoring the performance or billing date method (minority), in *Koenig Sporting Goods, Inc. v. Morse Road Co*.[103] and *Centerpoint Properties v. Montgomery Ward Holding Corp*.,[104] might portend

---

[94] 11 U.S.C. § 365(d)(3) (2000) (emphasis added).

[95] *See, e.g*., *In re Montgomery Ward Holding Corp*., 268 F.3d at 208 (interpreting statute on its face as limiting trustee's obligations and disagreeing with majority of courts).

[96] *See, e.g*., *In re* Trak Auto Corp., 277 B.R. 655 (Bankr. E.D. Va. 2002) (agreeing with majority of courts regarding accrual method).

[97] Lamie v. U.S. Tr., 540 U.S. 526, 534 (2004); *see also* Toibb v. Radloff, 501 U.S. 157, 162 (1991) ("Where, as here, the resolution of a question of federal law turns on a statute and the intention of Congress, we look first to the statutory language and then to the legislative history if the statutory language is unclear."); Blum v. Stenson, 465 U.S. 886, 896 (1984) (stating same as *Toibb*).

[98] Pioneer Inv. Servs. v. Brunswick Assoc., 507 U.S. 380, 388 (1993) (citing Perrin v. United States, 444 U.S. 37, 44 (1979)); *see also* Field v. Mans, 516 U.S. 59, 69 (1989) (discussing Congress' use of terms with settled meaning).

[99] 11 U.S.C. § 365(d)(3) (2000); *see* John C. Murray, *Percentage Rent Provisions in Shopping Center Leases: A Changing World*, 35 REAL PROP. PROB. & TR. J. 731, 780 (2001) (discussing bright line rule of section 365(d)(3) requiring debtors to pay rental payments in full if they become due during post-petition period without proration for amounts due but unpaid before bankruptcy filing).

[100] *Statutory Minefield*, *supra* note 6, at 456 (referring to "binding lease" approach).

[101] Dunn Indus. L.L.C., 320 B.R. at 89 (noting "majority of courts addressing this issue have found that the term 'obligation' is ambiguous in relation to the term 'arising' under [s]ection 365(d)(3), and they have found that an obligation may arise as it accrues. This approach is known as the accrual method.").

[102] Josef S. Athanas & Scott A. Semenek, *Pro-ration of Rent Dead in the Third and Sixth Circuits – Landlords Won the Battle, But Will They Lose the War?*, 19 BANKR. DEV. J. 123, 129 (2002) (discussing accrual method).

[103] 203 F.3d 986, 989 (6th Cir. 2000).

[104] 268 F.3d 205, 211 (3d Cir. 2001).

abandonment by the courts of proration or accrual and a return to the billing method.[105]

Given twenty years of split[106] decisions applying section 365(d)(3), it is fair to state that notwithstanding invocation of statutory text and ordinary meaning arguments by advocates of the billing date approach, a significant number of courts find ambiguity in its provisions.[107] In contrast, the current majority, adopting a proration or accrual approach, holds there is "[n]othing in the legislative history [to indicate] that Congress intended [section] 365(d)(3) to overturn the long-standing practice under [section] 503(b)(1) of prorating debtor-tenants' rent to cover only the postpetition, prerejection period, regardless of billing date."[108] From this vantage point, these courts find an ambiguity[109] in the language of section 365(d)(3) arguing an "obligation" can "arise" either when it becomes due and payable, or as it accrues.[110] Their reasoning is supported by *Cohen v. de la Cruz*[111] in which the Supreme Court stated "[w]e. . . will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure."[112] In essence both positions are beset with linguistic or textual

---

[105] Athanas & Semenek, *supra* note 98, at 137 (opining accrual rate is preferable).

[106] *In re* S. Star Foods, Inc., 122 F.3d 712, 715 (10th Cir. 1998) (noting "existence of a split in the circuits in the interpretation of [section] 365(d)(3) is, in itself, evidence of the ambiguity in the language.").

[107] *See, e.g.*, *In re* Ames Dep't Stores, Inc., 306 B.R. 43, 66–67 (Bankr. S.D.N.Y. 2004) (examining statutory construction); *In re* McCrory Corp., 210 B.R. 934, 939 (S.D.N.Y. 1997) (examining legislative history of section 365(d)(3)); Nat'l Terminals Corp. v. Handy Andy Home Improvement Ctrs., Inc., 222 B.R. 149, 155–56 (N.D. Ill. 1997), *aff'd In re* Handy Andy Home Improvement Ctrs., Inc., 144 F.3d 1125 (7th Cir. 1998) (analyzing case law relating to section 365(d)(3); *In re* William Schneider, Inc., 175 B.R. 769, 772 (S.D. Fla. 1994) (discussing conflicting case law); *In re* Child World, Inc., 161 B.R. 571, 574 (S.D.N.Y. 1993) (determining section 365(d)(3) is ambiguous relating to payment of real estate taxes); *In re* NETtel Corp., 289 B.R. 486, 489 (Bankr. D.D.C. 2002); In re Learningsmith, Inc., 253 B.R. 131, 133–34 (Bankr. D. Mass. 2000) (discussing split in courts); *In re* Best Prods. Co., 206 B.R. 404, 407 (Bankr. E.D. Va. 1997) (considering interests of debtor, landlord and other creditors).

[108] *Child World, Inc.*, 161 B.R. at 575–76.

[109] *In re* Learningsmith, Inc., 253 B.R. at 134. The court explained the ambiguity as follows:

> If obligation were interpreted to refer to the entire amount that matures and becomes payable on a given date, without regard to whether any part of the amount accrued pre-petition, then … [section] 365(d)(3) would conflict with and constitute an exception to, the provisions governing claims. Section 365(d)(3) expressly indicates that it is meant to constitute an exception to the provisions of the Code governing administrative expenses, which are strictly post-petition in nature, but it does not state that it is meant to constitute an exception to the provisions governing claims. Therefore, without looking behind the language of the Code itself, one can fairly question whether Congress intended [section] 365(d)(3) to require payment of amounts that accrued pre-petition. The statutory language is inherently ambiguous; and courts are well justified in looking beyond it to understand the legislative intent.

*Id*.

[110] *In re* Phar-Mor, Inc., 290 B.R. 319, 324 (Bankr. N.D. Ohio 2003) (stating majority of courts find section 365(d)(3) ambiguous as to when debtor's obligation to reimburse landlord for real estate taxes arises under lease); *accord In re* Dunn Indus., L.L.C., 320 B.R. 86, 89 (Bankr. D. Md. 2005) (noting "term 'obligation' is ambiguous in relation to term 'arising' under [s]ection 365(d)(3)" and finding "obligation may arise as it accrues.").

[111] 523 U.S. 213 (1998).

[112] *Id*. at 221 (citing Penn. Dep't of Pub. Welfare v. Davenport, 495 U.S. 552, 563 (1990)).

difficulties. Advocates of the performance or billing date hold to a plain language interpretation of section 365(d)(3) despite twenty years of decisions to the contrary. Meanwhile proponents of the proration or accrual approach continue to search for sufficient support in legislative history, prior practice, and policy to support their interpretation and convince the advocates of the billing approach the error of their ways.

The position of courts adopting the proration or accrual approach, represented in *In re R.H. Macy & Co*.[113] echoes the idea that statutory interpretation should "avoid untenable distinctions and unreasonable results whenever possible,"[114] asserting "even within the fluctuating walls of the 'plain meaning' fortress . . . a court should not resolve questions of statutory interpretation so that a particular Bankruptcy Code section conflicts and disturbs the overall purpose and function of the Code."[115] Stated another way, "[t]he court must look beyond the language of the statute … when the text is ambiguous or when, although the statute is facially clear, a literal interpretation would lead to internal inconsistencies, an absurd result, or an interpretation inconsistent with the intent of Congress."[116]

The Code does not provide a definition of when an obligation "arises" under section 365(d)(3).[117] Common usage of the term does not more dearly support an "accrual" over "billing date" interpretation, or its converse. Thus, courts have struggled with the question of what is an absurd result in the context of section 365(d)(3)? Arguably, in any individual matter the results produced by the billing method may not be absurd. This fact is discussed below under the hypothetical lease analysis,[118] and is further illustrated in Appendix 1. As the lease scenarios will illustrate, the "when and how much" question, *i.e.*, when obligations "arise" under the performance or billing date approach is driven entirely by structure. The approach produces drastic swings across economically identical leases based solely on the appearance or structure of the lease. The crucial question is what should courts do when that which is absurd is not always so – tailor individual rulings to

---

[113] 170 B.R. 69, 73 (Bankr. S.D.N.Y. 1994).

[114] Am. Tobacco Co. v. Patterson, 456 U.S. 63, 71 (1982).

[115] *In re R.H. Macy & Co., Inc*., 170 B.R. at 73.

[116] Vergos v. Gregg's Enters., Inc., 159 F.3d 989, 990 (6th Cir. 1998); *see also* Thinking Mach. Corp. v. Mellon Fin. Servs. Corp. #1 (*In re* Thinking Machs. Corp.), 67 F.3d 1021, 1025 (1st Cir. 1995) (stating "when Congress' words admit more than one reasonable interpretation, 'plain meaning' becomes an impossible dream, and an inquiring court must look to the policies, principles and purposes underlying that statute in order to construe it. Congress, after all, does not legislate in a vacuum.") (citations omitted).

[117] *In re* Dunn Indus., L.L.C., 320 B.R. 86, 90 (Bankr. D. Md. 2005) (positing inherent ambiguity of term obligations in conjunction with arises might be caused by lack of definition for term obligation in Code).

[118] Depending on the particular structure of a lease the results may never be so. However, a potential problem arises where precedent has been set, and the circuit has adopted the performance date or billing method based on leases that did not produce absurd results and is subsequently faced with a lease where application of precedent might result in grossly inequitable treatment of creditors and deprivation of a 'fresh start' in contravention of bankruptcy policy.

avoid distorting fundamental principles of bankruptcy policy?[119]

Thus, one has to caution against a piecemeal "plain language" interpretation of statutory text. In the end, "courts must be wary not to examine one section of a statute in isolation because 'statutory construction . . . is a holistic endeavor.'"[120] Courts should clearly examine whether "a literal interpretation would lead to internal inconsistencies, an absurd result, or an interpretation inconsistent with the intent of Congress."[121] As will be shown in this article, first interpretations can be deceiving; despite what may initially appear to be a reasonable result based on a "plain language" interpretation of section 365(d)(3) a closer look may reveal certain inconsistencies or potentially absurd results that advocate looking to legislative history and policy for support of their interpretation.[122]

At times, even reference to legislative history is unavailing; either it is non existent or equally ambiguous. What then? *In re Bankvest Capital Corp.*[123] provides some guidance for statutory interpretation in the absence of significant legislative history.[124] In *Bankvest*, the court was faced with interpreting section 365(b)(2)(D) to answer the question of whether the DIP could assume an unexpired equipment lease absent cure of non-monetary defaults.[125] The court found that section "365(b)(2)(D) [could] plausibly be interpreted in at least two ways,"[126] and that it was "hard-pressed to endorse any 'plain meaning' argument where, as here, other federal courts have reached conflicting answers . . . based on the same plain language."[127] The *Bankvest* court initially looked to legislative history to establish Congressional intent,[128] but the single sentence legislative history of section

---

[119] *See In re* Koenig Sporting Goods, Inc., 203 F.3d 986, 989 (6th Cir. 2000) (discussing split of authority in courts). For examples of the performance date or billing methods–those absurd and those seemingly rational, see Appendix 1.

[120] United Sav. Ass'n of Tex. v. Timbers of Inwood Forest Assocs., 484 U.S. 365, 371 (1988)); *In re* McSheridan, 184 B.R. 91, 101 n.11 (9th Cir. 1995) (citing *In re* R.H. Macy & Co., Inc., 170 B.R. 69, 73 (Bankr. S.D.N.Y. 1994); *see also*, Cablevision of Boston, Inc. v. Pub. Improvement Comm'n, 184 F.3d 88, 101 (1st Cir.1999) ("[T]he task of statutory interpretation involves more than the application of syntactic and semantic rules to isolated sentences.").

[121] Vergos v. Gregg's Enters., Inc., 159 F.3d 989, 990 (6th Cir. 1998).

[122] Lamie v. U.S. Trus., 540 U.S. 526 (2004) ("History and policy considerations lend support both to petitioner's interpretation and to the holding we reach based on the plain language of the statute.").

[123] Eagle Ins. Co. v. Bankvest Capital Corp. (*In re* Bankvest), 360 F.3d 291 (1st Cir. 2004).

[124] *Id*. at 296 (asserting language of section 365(b)(2)(D) can have multiple interpretations).

[125] *Id*. at 293.

[126] *Id*. at 296.

[127] *Id*. at 297; *see also* Cablevision of Boston, Inc. v. Pub. Improvement Comm'n, 184 F.3d 88, 101 (1st Cir. 1999). Further commenting on the statutory text and interpretation, the court stated:

> [t]he text of [section] 365(b)(2)(D) is awkward and ungrammatical on any reading . . . it proves nothing to say that the statute remains syntactically flawed when whole clauses are omitted. In any event, 'the task of statutory interpretation involves more than the application of syntactic and semantic rules to isolated sentences."

*Id*. at 101. The wiser methodology, and the one we employ here, is to interpret Congress' words in light of the goals of the underlying policies of the statute as a whole. Nieves-Marquez v. Puerto Rico, 353 F.3d 108, 116 (1st Cir. 2003); *In re* Weinstein, 272 F.3d 39, 48 (1st Cir. 2001).

[128] Eagle Ins. Co. v. Bankvest Capital Corp. (*In re* Bankvest), 360 F.3d 291, 298 (1st Cir. 2004) (referring to Congress' words in statutory interpretation).

365(b)(2)(D) failed to offer "guidance on the question that divides the parties."[129]

The general rule is that absent any guidance from the legislative history, courts should turn to "goals and underlying policies of the statute as a whole"[130] to aid in interpreting congressional intent. Following *Nieves-Marquez*, the *Bankvest* court reasoned the best approach to interpreting section "365(b)(2)(D) focuse[d] on practical considerations of bankruptcy policy and Congress's overarching purposes in the Bankruptcy Code."[131] The court ultimately determined that "Congress meant [section] 365(b)(2)(D) to excuse debtors from the obligation to cure non-monetary defaults as a condition of assumption."[132] To hold otherwise, and require the debtor to cure the incurable, would be "tantamount to barring the debtor from assuming any lease or contract in which a default has occurred–no matter how essential that contract might be to the debtor's reorganization in bankruptcy."[133] Finding that Congress's primary purpose in enacting section 365 was to promote "the successful rehabilitation of the business for the benefit of both the debtor and all its creditors,"[134] the court held that any interpretation to the contrary would undermine this purpose and would be in contravention of Congressional intent.[135]

### *C. Statutory Interpretation of Section 365(d)(3)*

Now to the specifics of section 365(d)(3). The choices are two-fold: section 365(d)(3) can be considered unambiguous–supporting a performance date or billing methodology; alternatively section 365(d)(3) can be considered ambiguous–ultimately calling for application of a proration or accrual methodology to define and quantify the DIP's obligations under the statute. *In re Montgomery Ward Holding Corp.*[136] provides a good example of the billing date approach.[137] In *Montgomery Ward* the court stated that section 365(d)(3) supports "a

---

[129] *Id*.
[130] *Id*. at 297 n.11 (citing *Nieves-Marquez*, 353 F.3d at 116).
[131] *Id*. at 299.
[132] *Id*. at 300.
[133] *Id*. at 299.
[134] *Id*. at 300 (citing FBI Distrib. Corp., 330 F.3d 36, 45 (1st Cir. 2003)).
[135] *In re Bankvest*, 360 F.3d at 300 (holding interpretation plainly inconsistent with Congress' purpose).
[136] Centerpoint Props. v. Montgomery Ward Holding Corp. (*In re* Montgomery Ward Holding Corp.), 268 F.3d 205, 213 (3d Cir. 2001). Note: I have elected to use this one case to illustrate both sides of the section 365(d)(3) coin. The holding itself supports the billing date approach while there is a strong dissent supporting accrual. For additional cases in support of the performance date or billing method see, e.g., *In re Koenig Sporting Goods, Inc.*, 203 F.3d 986, 989–90 (6th Cir. 2000) which holds debtor must pay month's rent when lease was rejected day after rent became due. *See also, e.g., In re* Duckwall-ALCO Stores, 150 B.R. 965, 976 n.23 (D. Kan.1993) (discussing rejection of debtor's argument relating to payment of taxes); *In re* R.H. Macy and Co., 152 B.R. 869, 874 (S.D.N.Y. 1993) (discussing legislative history). For additional cases in support of the accrual or proration method see *In re Child World, Inc.*, 161 B.R. 571, 574 (S.D.N.Y.1993) (stating statute is ambiguous and discussing legislative history) and *In re Handy Andy*, 144 F.3d 1125, 1127 (7th Cir.1998) (finding billing date approach is not "sensible").
[137] *In re Montgomery Ward Holding Corp*., 268 F.3d at 209 (finding no other reasonable interpretation consistent with text of section 365(d)(3)).

straightforward interpretation that produces a *rational result*[138] and no other reasonable interpretation [is] consistent with the text."[139] Thus, the court continued, "we are constrained to hold that section 365(d)(3) is not ambiguous."[140] While the court recognized some of the potential adverse side effects of the billing method such as strategic filing behavior[141] on the part of the debtors, and strategic billing for taxes and common area maintenance charges on the part of the landlord,[142] it minimized the problem by remarking that "[t]ax reimbursement obligations are only a *small constellation* in the universe of obligations coming within the scope of section 365(d)(3),"[143] and that the impact of these strategic behaviors "can be constrained by forethought and careful drafting."[144]

The court did not explain how drafting could cure these ills, but as will be discussed later, these behaviors could be entirely eliminated if all commercial leases were written as gross leases. Another alternative that would minimize, though not guaranteed to entirely eliminate the problem, would be to structure a net lease with a monthly installment representing one-twelfth of the estimated annual taxes and common area maintenance charges. Under this approach the landlord could include an annual accounting and adjustment billing provision to deal with any shortfall between the budgeted figures and actual expenses. Depending on the accuracy of the monthly estimates, this approach may very well eliminate any incentive for strategic filing behavior.

The *Montgomery Ward* court's observation that taxes are "only a *small constellation* in the universe of [lease] obligations coming within the scope of

---

[138] *See* Appendix 1.

[139] *In re Montgomery Ward Holding Corp*., 268 F.3d at 210.

[140] *Id*. *But see* Allapattah Servs., Inc., v. Exxon Corp., 362 F3d. 739, 747 (11th Cir. 2004) (J. Tjoflat, dissenting). Judge Tjoflat commented as follows on the meaning of section 1367 but his comments are equally applicable to the meaning of section 365(d)(3):

> Such dissention among federal judges should make one reluctant to conclude that the statute's meaning is as "plain" as both sides insist that it is. While the statute's meaning may appear obvious to an individual reader, a court cannot possibly declare the language to be "clear" when, as a matter of empirical reality, significant numbers of jurists have reasonable, good-faith disputes over its meaning. A judicial fiat declaring a statute to be unambiguous does not make it so."

*Id*.

[141] *In re* Dunn Indus., L.L.C., 320 B.R. 86, 93 (Bankr. D. Md. 2005). In ultimately adopting the proration or accrual method, the court made the following comments:

> While Montgomery Ward may provide a bright line rule, it will also promote the type of lawyering that should not be encouraged in our bankruptcy system. The billing method would prompt Maryland lessors to time their presentation of tax bills to tenants they anticipate might file bankruptcy in hope of making the entire bill a post-petition priority expense, while prospective Debtors would time their bankruptcy filings based on the receipt of tax bills in order to render an entire years' tax obligation an unsecured pre-petition debt. Both behaviors are solely to obtain advantage and do nothing to preserve the relative positions of the parties on a level playing field while reorganizing.

*Id*.

[142] *Id*. at 212 ("[W]e acknowledge that the result we reach may in some cases leave room for strategic behavior on the part of the landlords and tenants.").

[143] *Id*. (emphasis added).

[144] *Id*. (noting strategic behavior can be limited, even though some decisions leave room for it).

section 365(d)(3)"[145] intimates that size matters, and its conclusion begs the question whether section 365(d)(3) has a materiality provision or *de minimus* exception?[146] Moreover, its proffered solution of using extra care in drafting is an evolutionary back step and arguably is at odds with the original intent of section 365(d)(3): namely, to relieve the landlord of his or her substantive and procedural burdens[147] and to shift the burden of indecision to the debtor.[148] Applying this logic, Congress, with one hand, expressly relieves the burden on landlords in the post order for relief period while with the other hand, but remaining unexpressed, it increases their burden at the negotiation and drafting stage.[149] For without additional action by the landlord at inception of the lease, drafting to the minority–those courts adopting the performance or billing approach–it will not be guaranteed receipt of full benefits under section 365(d)(3). As the court in *Montgomery Ward* stated: "[i]t seems clear to us. . . that Congress enacted [section] 365(d)(3) for the purpose of altering a pre-Code practice that had created a problem for landlords of non-residential property."[150] Without advanced planning and successful implementation of contractual safeguards by landlords at the drafting stage–thereby eliminating the opportunity for strategic manipulation by debtor-tenants–Congress' intent under section 365(d)(3) would fully benefit only a subsection of landlords.[151] Thus, a landlord may have to alter its current business practice, at least in certain jurisdictions, in order to reap the intended benefit of section 365(d)(3). Landlords, however, are not always in a position to dictate these terms. Shouldn't section 365(d)(3) provide a uniform rule and not create vastly different results depending on the structure of the contract?

In *Montgomery Ward*, the opposing view, as advanced by the dissent, relied on economic reality to advocate adoption of the accrual method. The dissent stated: The majority today holds that, because the billing took place within the eight-week administrative period between entry of an order for relief and expiration of the lease (before assumption or rejection thereof), the entire twenty months' worth of tax obligations "arose" during that eight-week period. In so holding, the majority elevates the accident or artifice of the billing date above the *economic reality* of the accrual, and thereby inappropriately burdens the administration of the bankrupt estate and unfairly favors landlords over similarly situated pre-petition creditors.

---

[145] *Id*. (emphasis added).

[146] A rhetorical question.

[147] *In re* Comdisco, Inc., 272 B.R. 671, 674 (Bankr. N.D. Ill. 2002) (stating section 365(b)(3)'s purpose is to help commercial landlords receive payment for current services).

[148] *In re* Valley Media, Inc., 290 B.R. 73, 75 (Bankr. D. Del. 2003) (citing *In re* Krystal Co., 194 B.R 161, 164 (Bankr. E.D. Tenn. 1996)) (discussing how debtor must decide whether to continue its lease or reject it before building up expenses).

[149] It also assumes that the landlord will always have the power to impose such provisions on the debtor-tenant and conversely that the debtor-tenant will be able to impose his or her will on the landlord.

[150] Centerpoint Props. v. Montgomery Ward Holding Corp. (*In re* Montgomery Ward Holding Corp.), 268 F.3d 205, 213 (3d Cir. 2001) (acknowledging Code is generally not to be read to alter pre-Code practices, but here this was Congress's purpose).

[151] *See* Appendix 1: Its benefit would be limited to those landlords whose lease characteristics would not produce absurd results. Others would either be harmed or receive a windfall.

The majority's holding is predicated on its view that the "fundamental tenet" of [section] 365(d)(3) is that "it is the terms of the lease that determine the obligation and when it arose". While I agree that the terms of the lease determine the obligation, the statute says nothing about how to determine when the obligation arises. Nothing in the text is inconsistent with the common-sense view that when an obligation arises may be fixed by its intrinsic nature and/or by the extrinsic circumstances of its accrual. An obligation attributable to a particular time may well be said to "arise" at that time, and an obligation that accrues over time may be said to "arise" as it accrues, without doing violence to the statutory language.

I believe that the true "fundamental tenet" of [section] 365(d)(3) is that landlords, like other post-petition creditors, should receive full and timely payment for post-petition services. This is in keeping with the *policy* of the Bankruptcy Code of giving priority to post-petition claims to enable the debtor to keep operating for as long as its current revenues cover current costs (so that the debtor's business is yielding a net economic benefit). Moreover, [section] 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. Both of these policies are disserved by requiring the debtor or trustee to repay back taxes, a pre-petition "sunk cost", as a condition of ongoing operations.[152]

The dissent highlights many of the reasons the majority of circuits now interpret section 365(d)(3) as requiring application of the proration or accrual methodology. The *Montgomery Ward* dissent highlights the economic incongruity that application of the billing method yields in this case when "twenty months' worth of tax obligations "arose" during that eight-week period."[153] The form over substance result achieved here is clearly in contradiction to practice under sections 365(d)(3) and 365(d)(4)'s "true lease" analysis which emphasizes substance over form.

Next, the dissent discusses the specific interpretation of "arises" within the context of the statute. Judge Mansmann points out that "[n]othing in the text is inconsistent with the common-sense view that when an obligation arises may be fixed by its intrinsic nature and/or by the extrinsic circumstances of its accrual."[154] Proponents of the billing method argue that if Congress had intended "arises" to mean "accrue" it could have used that term; thus using negative inference to argue in support of the billing method.[155] However, this argument is easily countered by its twin; i.e., if Congress had intended "arises" to mean "due and payable" they could have used that term–they did neither. Consequently, these arguments amount to nothing more than posturing; they do not provide any useful input to the interpretive question. While some courts adopting proration have stated that there is an inherent economic difference between rent and taxes, holding that "[a] tax is

---

[152] *In re Montgomery Ward Holding Corp*., 268 F.3d at 213 (Mansmann, J. dissenting) (Mansmann, J. dissenting).

[153] *Id*.

[154] *Id*.

[155] *Statutory Minefield*, *supra* note 6, at 452–53 (analyzing legislative meaning).

incurred on the date it accrues, not on the date of assessment or the date on which it is payable,"[156] other courts have countered this argument by pointing out that the debtor-tenant is not the taxpayer; its liability is derived from the lease and not from ownership interest in the property; thus, it arises under the contract on the date billed.[157]

The dissent in *Montgomery Ward* then moves on to policy; identifying the "fundamental tenet" of section 365(d)(3) as equal treatment of post-petition creditors.[158] Under this view, a landlord should not be entitled to "the entire twenty months' worth of tax obligations. . . during that eight-week period,"[159] for to do so "inappropriately burdens the administration of the bankrupt estate and unfairly favors landlords over similarly situated pre-petition creditors"[160] in contravention of the policy of equal treatment. Obligations of the landlord that arose pre-petition should be classified and treated in the same manner as any other pre-petition creditor.

As noted earlier, operation of section 503(b)(1) relegated the landlord to the position of "involuntary creditor"[161] forced to provide "current services" without "current compensation."[162] Prior to the adoption of section 365(d)(3) the policy of equal treatment of creditors was not upheld; likewise, the *Montgomery Ward* dissent argues that application of the billing method in association with section 365(d)(3) does not fix the problem.[163] The goal of section 365(d)(3), to place the landlord on equal footing with other post order for relief creditors, is not achieved, at least not on a consistent basis. In essence, section 365(d)(3) replaced the landlord's position as "involuntary creditor" under section 503(b) with one of three potential positions under section 365(d)(3): as (i) an ongoing involuntary creditor,[164] as (ii) an equal creditor achieving section 365(d)(3)'s intended "current payment" for "current services,"[165] or as (iii) a 'jackpot' winner as in *Montgomery Ward*.[166] The ultimate

---

[156] *In re* Bondi's Valu-King, Inc., 102 B.R. 108, 110 (Bankr. N.D. Ohio 1989) (internal quotes omitted).

[157] *Statutory Minefield*, *supra* note 6, at 454–56 (discussing proration).

[158] Centerpoint Props. v. Montgomery Ward Holding Corp. (*In re* Montgomery Ward Holding Corp.), 268 F.3d 205, 213 (3d Cir. 2001) (Mansmann, J. dissenting) (stating landlords should receive "full and timely payment for post-petition services.").

[159] *Id*.

[160] *Id*.

[161] *In re* Trak Auto Corp., 277 B.R. 655, 662 (Bankr. E.D. Va. 2002) (discussing status of landlord post-petition).

[162] *Id*.

[163] *Montgomery Ward Holding Corp.*, 268 F.3d at 213 (Mansmann, J. dissenting) (describing billing date as accident, or date landlord gets around to sending bill).

[164] If the underlying lease provides for quarterly or annual payments, either in arrears or advance, the period covered by section 365(d)(3) might fall between payments dates. Thus, the landlord fails to receive any benefit from section 365(d)(3) and is limited to a claim under section 503(b)(1).

[165] On the chance that the lease is a gross lease, or that the filing date coincides with the order for relief.

[166] *Montgomery Ward Holding Corp*., 268 F.3d at 213. The landlord is a jackpot winner since the billing method awarded twenty months of tax within an eight week period. Taxes are attributable to the pre-petition period. Alternatively, the landlord might be a jackpot winner if he or she is able to claim an extended stub period section 503(b)(1) claim in addition to having a quarterly rent payment due towards the end of the sixty day period.

status of the landlord under section 365(d)(3) is determined by the "artifice of the billing date."[167]

## III. CONCEPTUAL STATUS OF THE TRUSTEE OR DIP

### *A. Conceptual Status as an Aid in Statutory Interpretation*

As noted earlier, a commentator as a tool to aid in statutory interpretation used the conceptual status of the DIP.[168] That author posited a conceptual status dichotomy; the DIP can be classified as either "a new judicial entity, legally independent of its predecessor,"[169] or as "the same legal entity."[170]

As stated earlier, this article proposes a third alternative, that of the DIP as the holder of a right to temporary use and possession. Prior to delving into the interpretive utility of proposed classification–the DIP as the holder of a right–it is beneficial to begin with an understanding of the comparative utilities and limitations of the earlier approaches which classified the DIP as either the same as the pre-petition debtor or as a new entity.

Rather like a scientist testing a new theory, utilizing a conceptual status framework as an aid in interpreting Congress's intent allows us to forecast or predict the results of section 365(d)(3) as applied by the courts. This prediction can then be compared with existing case law to determine the fit or accuracy of the conceptual framework.[171] Moreover, the degree of fit between the predictions and the statutory text readily highlights areas of ambiguity and provides another point to contrast with legislative history, policy and others indicators of Congressional intent.

### *B. DIP: The New Entity Approach*

The idea of the conceptual status of the DIP as a wholly a new entity is not novel.[172] Under this hypothesis the post-petition DIP is treated as a legally independent entity; while the pre-petition debtor would be bound by the terms of the lease, the post-petition DIP is not bound until and unless it assumes the lease. *Statutory Minefield* refers to this as the "nonbinding lease"[173] approach.

---

[167] *Id.* at 213.

[168] *Statutory Minefield*, *supra* note 6, at 454 (asserting knowledge of conceptual alternatives describing legal status of DIP may assist in determining whether Congress intended to incorporate proration of post of post-petition charges into section 365(d)(3)).

[169] *Id*.

[170] *Id*. at 456.

[171] This step is important. In evaluating which conceptual framework to employ as an interpretive aid one should seek the one that best fits because it will provide the greatest utility.

[172] *See, e.g.*, NLRB v. Bildisco & Bildisco, 465 U.S. 513, 527 (1984) (discussing whether, in employment context, DIP should be properly characterized as "alter ego" or "successor employer" of pre-bankruptcy debtor); *In re* CRS Architectural Metals Corp., 1 B.R. 729, 731 (Bankr. E.D.N.Y. 1979) ("It appears to be the rule in this circuit that a debtor-in-possession under Chapter XI is not the same entity as the pre-bankruptcy company; but is a new entity with its own rights and duties.")

[173] *Statutory Minefield*, *supra* note 6, at 454.

Ultimately, the logical progression of this argument supports application of the standards of section 503(b)(1) limiting the liability of the DIP to payment for the actual benefit received post-petition.[174] To hold otherwise and mandate payment for any invoice received post-petition would, in effect, shift costs from the pre-petition debtor to the new entity without regard for benefit received[175] and in contravention of bankruptcy's "fresh start" [176] policy. Application of the "nonbinding lease" approach is accomplished via a proration of post-petition costs; 'proration' is simply a method of "enforcing the actual use standard."[177]

Joshua Fruchter writes that the "nonbinding lease" or proration paradigm "most accurately describes the courts' treatment of landlords' administrative claims under the Bankruptcy Act and the pre-1984 Code."[178] In support of the "nonbinding lease" or proration approach, his article examines *In re CRS Architectural Metals, Inc.*,[179] a Bankruptcy Act case. In that case, the bankruptcy court ordered the debtor to pay rent "on the same terms and on the same rental as set forth in the original Lease. . . plus all real estate taxes."[180] In effect, the *CRS* court ordered the estate to prorate rent and taxes based on the terms of the lease. This result more closely supports later practice under section 365(d)(3) by directing the parties to the terms of the lease and in turn bolsters the argument that section 503(b), in shifting to an "actual and necessary"[181] standard produced "unintended consequences."[182]

The issue in *CRS*, as in many cases post enactment of section 365(d)(3), was whether the bankruptcy court's order mandated payment in full of a post-petition tax bill, or whether the DIP was only obligated to pay the taxes on a prorated basis. Relying on the nature of the DIP as a separate legal entity "with its own rights and duties,"[183] and on the equitable principle of unjust enrichment, the court held that the DIP's liability was not defined by the terms of the lease; rather the DIP was responsible for the "fair value of the benefit conferred."[184] The manner

---

[174] *Id*. at 454–55 (stating with DIP as new entity, landlord's pre-rejection period recovery would be limited to reasonable value of DIP's actual use and benefits received).

[175] *Id*. at 455 (asserting it is unfair to hold DIP liable for economic benefits received by different party, such as prebankruptcy debtor).

[176] *Id*.

[177] *Id*. at 455.

[178] *Id*.

[179] 1 B.R. 729 (Bankr. E.D.N.Y. 1979).

[180] *Id*. at 731 (citing order previously issued by court).

[181] *See* 11 U.S.C. § 503(b)(1)(A) (2000) ("After notice and a hearing, there shall be allowed, administrative expenses. . .including. . .the actual, necessary costs and expenses of preserving the estate. . . .").

[182] *See supra* note 56 (excerpting from Senate report).

[183] *See In re CRS Architectural Metals, Inc.*, 1 B.R. at 731 ("It appears to be the rule in this circuit that a debtor-in-possession under Chapter XI is not the same entity as the pre-bankruptcy company; but is a new entity with its own rights and duties, subject to the supervision of the Bankruptcy Court.").

[184] *Id*. at 732 (citing Am. A. & B. Coal Corp. v. Leonardo Arrivabene, 280 F.2d 119, 126 (2d. Cir. 1960), for proposition it is

> [M]ost apparent from those cases which hold that the measure of compensation to which the lessor is entitled is not the amount due under the contract or lease but the fair value of the benefit conferred upon the estate that the purpose of according priority in these cases is fulfillment of the equitable principle of preventing unjust

in which the post-petition tax liability would be determined was by proration.

Joshua Fruchter then states "[t]he CRS case *confirms the legal results expected* under a "nonbinding lease" approach."[185] This very comment, 'confirms the legal results expected' implies there was a good fit between theory–the "nonbinding lease" or proration, and practice as evidenced by case law. At least under the Act, the role of proration was clearly defined.

The independence of the DIP, with respect to its obligations under unexpired nonresidential real property leases, was, if anything, more pronounced under section 503(b)(1). While the "nonbinding lease" or proration approach governed under the Act, courts looked to the terms of the lease to define the "pie" or the "obligations" to be prorated. The key distinction between practice under the Act and practice under section 503(b)(1) was not the allocation method; proration remained the practice, it was the 'pie' that changed.

Ultimately, a landlord's recovery under section 503(b)(1) was limited to "the actual and necessary expenses of preserving the estate."[186] Thus, the litmus test for recovery was the reasonable or fair market value of the debtor's actual use of the premises and not the terms of the lease. In practice, the terms of the lease were frequently used as a logical measure of "reasonable" rent for the property.[187] However, should the DIP change the nature and use of the occupancy by either temporary closure, scaling back square footage occupied or shifting from retail to storage, or should outside events such as a recession in the real estate market occur, section 503(b)(1)'s provisions would act to shrink the "pie" from its lease defined maximum. Yet under section 503(b)(1) the "pie," albeit a different recipe than the pre-Code version, was allocated in the same manner, via proration.[188]

### *C. DIP: The Same Entity Approach*

In sharp contrast to the new entity–"nonbinding lease" approach is the conceptual treatment of the DIP as the same entity. Under this premise, the debtor and the DIP can be thought of as the yin and yang of a single entity. Thus, it follows that the DIP would be bound by the terms of lease as written until such time as the DIP formally rejects the lease.[189] A commentator labels this the "binding

---

> enrichment of the debtor's estate, rather than the compensation of the creditor for the loss to him.

*Id*.

[185] *Statutory Minefield*, *supra* note 6, at 458 (emphasis added) (explaining what happens when court treats DIP as new legal entity with respect to its unexpired leases).

[186] *See* 11 U.S.C. § 503(b)(1).

[187] *Statutory Minefield*, *supra* note 6, at 460 ("As a practical matter, courts generally used the rent reserved in the lease as a guideline to what was "reasonable," (as did the court in CRS), but were not required to do so.").

[188] *Id*. (indicating courts prorate rent, taxes, common area charges, and other items over pre-rejection period).

[189] *Id*. at 456 ("[F]rom the petition date the DIP is fully bound by any unexpired lease, and remains so bound until it informs the landlord otherwise with a formal rejection.").

lease" approach.[190]

Proration is inapposite under this thesis. If the terms of the lease dictate the DIP's post order for relief liability, it follows that there is no need for an allocation methodology.[191] Accordingly, if the "nonbinding lease" approach equates with proration, then the "binding lease" approach can be equated with the performance date or billing method.

The "binding lease"–performance date or billing approach is characterized by ease of application; it is a bright-line process. The DIP's liabilities are solely determined by the lease; provisions relating to rent or additional rent items, such as taxes and common area maintenance must be strictly enforced.[192] Concepts underlying the "nonbinding lease"–proration or accrual approach such as unjust enrichment play no role in a "binding lease" construct. Receipt by the DIP of a post order for relief invoice complying with provisions in the lease must be paid even though the economic benefit was partially or entirely received pre-petition.

Under the "binding lease"–performance date or billing approach, form rules over substance. Matching payment with economic benefit received is fortuitous. Assume our debtor, X Inc., originally signed a gross lease[193] providing for equal monthly payments. Further assume that X Inc. is able to maintain uninterrupted post-petition operations and that the real estate market has not changed since lease inception. Under these limited circumstances, the post-petition liability of the DIP would be unaffected by characterization as either a "binding lease" or a "nonbinding lease." In addition, under these parameters the liability would be constant over time; applicability of the Bankruptcy Act, of section 503(b)(1) or of section 365(d)(3) would render almost identical results.[194] Where payments made are matched with economic benefit received all paths arrive at the same destination.

More common in today's commercial real estate market are net or triple net leases.[195] The economic benefit received by the tenant for utilization of the premises remains constant from month to month.[196] However, these leases are

---

[190] *Id*. (referring to "binding lease" approach and to how it makes proration logically inappropriate).

[191] *Id*. ("Since proration only serves as a means of implementing an actual use standard, and the preeminence of the lease . . . under a 'binding lease' approach renders actual use irrelevant, it follows that proration is inconsistent with a "binding lease" approach.").

[192] *Id*. (explaining when a DIP assumes a lease, it is thereafter bound by all terms of lease).

[193] *See* Murray, *supra* note 99, at 780 (discussing bright line rule of section 365(d)(3)).

[194] Assume that the lease called for monthly payments of $3,000 ($36,000 per year) due on the 1st of each month. Furthermore, let us assume that the debtor filed for bankruptcy in the March 16th. Under section 365(d)(3), during the sixty day post-petition period, under the nonbinding lease or accrual method rent would be $6,000 ($36,000 rent per year / 360 days per year x 60 days in the post-petition period). Under the binding lease or billing method, rent would again be $6,000 (representing the monthly installments of $3,000 due April 1st and May 1st). Note-under the assumptions stated above the rent under 503(b)(1) would be the same as we have assumed that the market rate and use of the property is unchanged.

[195] Terence Floyd Cuff, 570 Practicing Law Institute: *Tax Planning for Domestic & Foreign Partnerships, LLCs, Joint Ventures & Other Strategic Alliances 2003, Section 1031 Exchanges Involving Tenancies-In-Common*, 411, 441 (2003) (noting triple-net leases are very common in real-estate industry).

[196] You might have a good argument to the contrary in certain cases, *i.e.*, in a highly seasonable business you might argue that greater economic benefit is received during peak months, but for ease of discussion we will assume a uniform benefit.

commonly structured to provide for a base rent–payable in equal monthly installments, and other amounts due periodically labeled "additional" or "further rent."[197] Common additional rent provisions include payments for *ad valorem* or real estate taxes and for common area maintenance charges.[198] These additional charges to the tenant are triggered by external acts of the landlord and are not directly tied to the tenant's economic benefit; there is a split between the timing of the benefit received and payments made.

Fortuity enters the scene under the "binding lease"–performance or billing approach once the timing of the economic benefit received and payments made by the tenant are uncoupled. In our earlier example, assume instead X Inc. had signed a net lease which provided base rent to be paid quarterly in advance, and contained a provision for additional rent which called for taxes and common area maintenance charges to be paid within thirty days of billing by the landlord. Under a "binding lease" approach, the post-petition liability of the debtor is determined by the lease. Depending on the time of filing the DIP may have zero liability.[199] In contrast, he may be faced with three months of base rent, one or more bills for taxes (that may or may not relate to the current year) and an additional liability for common area maintenance charges. Form trumps substance.

Joshua Fruchter compared the status of the DIP under a "binding lease"–performance or billing approach to his or her status post-assumption under section 365(a). Specifically he states that "one of the cardinal principles governing assumption of an unexpired lease is that the debtor assumes the lease *cum onere*: that is, the DIP must accept all the burdens of the lease in addition to the benefits."[200] The pre-rejection DIP is similarly bound; the DIP bears the burden of indecision.[201]

### *D. DIP: Holder of an Option or Holder of a Right*

The court in *In re UAL Corp*.[202] used the term "option phase" to describe "the period during which the debtor in possession or trustee. . . is allowed to decide whether or not a lease should be assumed."[203] This is the same for all executory contracts.[204] This breathing space or option phase is unrelated to the actual use of

---

[197] See *In re* Handy Andy Home Improvement Ctrs., Inc., 144 F.3d 1125, 1127 (7th Cir. 1998) (finding commercial tenant responsible for property's real estate taxes via installment payments to lessor).

[198] *See id*. (discussing obligations of debtor tenant).

[199] *See* Appendix 1, scenarios 2, 4, and 5.

[200] *Statutory Minefield*, *supra* note 6, at 456.

[201] *See In re* Valley Media, Inc., 290 B.R. 73, 75 (Bankr. D. Del. 2003) ("Congress intended [section] 365(d)(3) to shift the burden of indecision to the debtor: the debtor must now continue to perform all the obligations of its lease or make up its mind to reject it before some onerous payment comes due during the pre-rejection period.") (citing *In re* Krystal Co., 194 B.R 161, 164 (Bankr. E.D. Tenn. 1996)).

[202] 291 B.R. 121 (Bankr. N.D. Ill. 2003).

[203] *Id*. at 124.

[204] NLRB v. Bildisco & Bildisco, 465 U.S. 513, 528 (1984) ("[T]he authority to reject an executory contract is vital to the basic purpose of a [c]hapter 11 reorganization, because rejection can release the debtor's estate from burdensome obligations that can impede a successful reorganization.").

the premises. Accepting the idea that the DIP bears the burden of indecision in real estate leases during the sixty day period, it follows that the power to avoid certain post order for relief liabilities of the debtor is within its control. The DIP can choose to reject the lease at an earlier date and thereby avoid the statute's imposition of onerous costs. This additional description–the "option phase," when taken in conjunction with the idea that the DIP "bears the burden of indecision," hints at the existence of an alternative conceptual status.

There are more meaningful choices than trying to define the conceptual status of the DIP in the sixty day post order for relief period as either a "new entity" or the "same entity." There are two potential contenders: (i) the DIP as an option holder, providing a sixty day period for the DIP to undertake a cost-benefit analysis resulting a decision to assume or reject the lease, and (ii) the DIP as the holder of a right to temporary use and possession of the property. In *UAL*, Judge Wedoff used the term "option phase" as descriptive of the period covered by section 365(d)(3), defining the time as the period in which the debtor "is allowed to decide whether or not a lease should be assumed."[205] This supports the concept of the DIP as an option holder. By contrast, viewing the DIP as the holder of a right to temporary use and possession has an innate appeal; the debtor can continue to operate his or her business, for which he receives current benefit and should make current payment. Which conceptual status more aptly describes the nature of the DIP? My view is the latter, but I will analyze each approach below.

1. DIP as Holder of a Sixty Day Option

In addition to the decision-making focus of the "option phase" identified in *UAL*, other strong arguments can be made in support of the DIP as the holder of a sixty day option. This conceptual status is bolstered by the definition of an option itself. An option can be defined as "[t]he right of election to exercise a privilege,"[206] in turn, a right can be defined as "a capacity residing in one man of controlling, with the assent or assistance of the state,[207] the actions of others."[208] This definition closely parallels the effect of section 365(d)(3); the DIP has the right but not the obligation to assume or reject unexpired nonresidential real property leases, and in a sense the characteristic of that right reflects back to the involuntary creditor status of the landlord that Congress sought to remedy. Options are typically for a defined period; they are not open-ended. Likewise, section 365(d)(3) provides the debtor with a sixty day period in which to make his or her decision. As one court put it, the purpose of section 365(d)(3) is to "shift the burden of indecision to debtor: the debtor must now continue to perform all the obligations of its lease or make up its mind to reject it before some onerous payment comes due

---

[205] *In re UAL Corp*., 291 B.R. at 124.

[206] BLACK'S LAW DICTIONARY 1121 (8th ed. 2004).

[207] In this case the assent and assistance is not that of the state, rather it of the Federal government via Congressional enactment of section 365(d)(3).

[208] BLACK'S LAW DICTIONARY, *supra* note 206, at 1322.

during the pre-rejection period."[209]

The suggested option paradigm appears to closely fit the economic realities of the section 365(d)(3) period. The next question is how we determine the cost of that option: the answer is that section 365(d)(3) is the option pricing model; the price of a sixty day option is the total cost of "all the obligations of the debtor . . . arising from and after the order for relief. . . until such lease is assumed or rejected, notwithstanding section 503(b)(1) of this title."[210]

2. DIP as Holder of a Right to Temporary Use and Possession

Filing bankruptcy gives the debtor-tenant a temporary breathing spell, time to make critical decisions and develop a plan of reorganization. Who should pay for this time however? Should the landlord be required to fund the debtor-tenant's consumption of resources while the decision is being made–in essence, should we force the landlord to subsidize the post-petition operating costs of the debtor? Congress said no; Senator Hatch stated the problem clearly "the landlord is *forced to provide current services–the use of its property, utilities, security, and other services–without current payment. No other creditor is put in this position.*"[211] If the landlord has an ongoing obligation to provide services to the DIP, those services should be compensated. Thus, the legislative history seems to support the concept of the DIP as the holder of a right to temporary use and possession. It recognizes that the debtor-tenant has a continued right to the benefits under the lease–and a continued obligation to pay for such use and possession. The formula to determine the cost of this right is identical to that of the option holder, it is determined by section 365(d)(3) and includes "all the obligations of the debtor. . . arising from and after the order for relief. . . until such lease is assumed or rejected, notwithstanding section 503(b)(1) of this title."[212]

In essence, the filing of bankruptcy creates a temporary right under section 365(d)(3) to keep possession under the lease alive until the DIP can make the decision to assume or reject the lease. The fundamental nature of this right is the continued possession of the property–and not the ultimate decision the DIP may elect. The question under this concept is how the debtor should pay for the right to

---

[209] *In re* Valley Media, Inc., 290 B.R. 73, 75 (Bankr. D. Del. 2003) (citing *In re* Krystal Co., 194 B.R 161, 164 (Bankr. E.D. Tenn.1996)).

[210] 11 U.S.C. § 365(d)(3) (2000).

[211] 130 CONG. REC. S8994-95 (daily ed. June 29, 1984) (statement of Sen. Hatch) (as quoted in *In re* By-Rite Dist., Inc. 47 B.R. 660, 664–65 (Bankr. D. Utah 1985)). Senator Hatch defines 'current services' as "the use of its property, utilities, security, and other services." Thus, a key component of current services is "rent" which is defined as "a charge for the use of space." *See* DICTIONARY OF REAL ESTATE TERMS, 5th ed., 348 (2000). The other items included in the current services category are all characterized as: (i) services; and (ii) current expenses in the temporal sense. Therefore, Senator Hatch appears to view section 365(d)(3) as a means to provide the landlord with of rent for the use of the property during the post order for relief period plus reimbursement for any temporal expenses incurred by the landlord during that period. The effect is to freeze the landlord's unsecured claim as of the order for relief, thereby transforming the landlord from involuntary to voluntary post order for relief creditor.

[212] 11 U.S.C. § 365(d)(3) (2000).

retain his interest in the lease?

3. The Decision: DIP as Holder of an Option or a Right.

Arguably, even though one choice has been labeled an 'option' and the other a 'right' the section 365(d)(3) definition of their respective costs lacks even a difference in semantics. The difficulty in separating the two concepts is illustrated, and clarified by examining their focal points. Under the "option holder" paradigm the focus is on the assumption or rejection decision; it asks how much the DIP[213] would be willing to pay for the right but not the obligation to make the decision to assume or reject the lease. Arguably, that cost would be in direct proportion to the value of the lease to the DIP. If it is one that the DIP might assume and assign, it holds significant value and accordingly the debtor would be willing to pay more. The focus of the 'option' is not on the present use, it is on the anticipated value of an assumption decision. Its cost is driven by the value of the lease itself as a future asset.

In contrast, the DIP as holder of a right to temporary use and possession is not focused on the independent decision to be made during that period. The focus is on present occupancy of the property and consequently its cost relates to the period of time the DIP is in possession. Its cost function is driven by current usage and not by the potential market value of the lease post-assumption or rejection.

By simply defining the respective focal points it is apparent that the concept of the DIP as holder of a right to temporary use and possession is closely aligned with the purpose of section 365(d)(3). To reiterate, as Senator Hatch stated:

> [D]uring 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 due under the lease. These payments include rent due the landlord and common area charges which are paid by all the tenants according to the amount of space they lease. In this situation, the landlord is *forced to provide current services–the use of its property, utilities, security, and other services–without current payment. No other creditor is put in this position*.[214]

Congressional focus was on the landlord, on providing a remedy to his involuntary creditor status and particularly to the need to compensate him for costs incurred on behalf of the DIP in the post order for relief period. Section 365(d)(3) is designed to compensate the lessor for the lessee's use of the property, not to

---

[213] Under a true option scenario, it is more correct to state that the price of the option would be determined by the seller (the landlord in our scenario) and not by the buyer (DIP). However, under section 365(d)(3) the pricing mechanism has been removed from both buyer and seller – it has been set by Congress. The landlord might be thought of as an 'involuntary' option seller; with Congress using the landlord's pre-bankruptcy contract to derive the cost of an option.

[214] 130 CONG. REC. S8994-95 (daily ed. June 29, 1984) (statement of Sen. Hatch) (as quoted in *In Re* By-Rite Dist., Inc., 47 B.R. 660, 664–65 (Bankr. D. Utah 1985)).

provide the lessor with an allocation of benefit from the lessee's assumption. There is nothing in the legislative history that supports a section 365(d)(3) interpretation that focuses on the potential value to the debtor of the assumption decision. Further, in *Bildisco*,[215] the Supreme Court stated "the authority to reject an executory contract is vital to the basic purpose of . . . reorganization, because rejection can release the debtor's estate from burdensome obligations that can impede a successful reorganization."[216] Debtors pay nothing for the option to assume or reject; it is a cost-free tool available to all debtors. Likewise, under section 365(d)(3) the debtor has the option, free of charge, to reject the lease; there should be no difference between the DIP's general ability to freely reject executory contracts and its ability to reject an unexpired nonresidential property lease. Thus, the charge should be for the use of the property not for the option to assume or reject.

### *E. Economic Substance and the DIP as the Holder of a Right*

As previously discussed, acceptance of a "new entity" paradigm is logically associated with a proration or accrual approach. Likewise the "same entity" paradigm is logically associated with a performance date or billing approach. Those logical associations in turn clearly direct a particular interpretation of section 365(d)(3). The threshold question becomes whether the acceptance of the DIP as holder of a right to temporary use and possession supports proration or billing.

In search of an answer we will start with a statement of fact on which to anchor the subsequent analysis. The anchoring statement is that sections 365(d)(3) and 365(d)(4)[217] only apply to "true" or "bona fide" leases.[218] A frequently litigated issue under these particular Code sections is whether the lease is a "true lease" or a "disguised security arrangement."[219] Courts answer this question by examining the

---

[215] 465 U.S. 513 (1984).

[216] *Id*. at 528.

[217] 11 U.S.C. § 365(d)(4) (2000). Section 365(d)(4) provides as follows:

> Notwithstanding paragraphs (1) and (2), in a case under any chapter of this title, if the trustee does not assume or reject an unexpired lease of nonresidential real property under which the debtor is the lessee within 60 days after the date of the order for relief, or within such additional time as the court, for cause, within such 60-day period, fixes, then such lease is deemed rejected, and the trustee shall immediately surrender such nonresidential real property to the lessor.

*Id*.

[218] *See In re* Barney's, Inc., 206 B.R. 328, 331–32 (Bankr. S.D.N.Y. 1997) ("Sections 365(d)(3) and (d)(4) of the Bankruptcy Code apply only to 'true' or 'bona fide' leases."); Int'l Trade Admin. v. Rensselaer Polytechnic Inst., 936 F.2d 744, 748 (2d Cir. 1991) ("[T]he proper inquiry for a court in determining whether [section] 365(d)(4) governs an agreement fixing property rights is whether 'the parties intended to impose obligations and confer rights significantly different from those arising from the ordinary landlord - tenant relationship.").

[219] *In re* Fleming Cos., Inc., 308 B.R. 693, 695 (Bankr. D. Del. 2004) (evaluating section 365 "in determining whether debtor's leases is true 'lease' or disguised 'security agreement,' bankruptcy court should not regard as determinative the form or title chosen by parties.").

economic reality of the underlying transaction.[220] Stated another way, "[i]n determining whether a transaction created a true debtor-creditor relationship, the court is not bound by the label attached by parties, but must look to the underlying economic substance of the transaction."[221] Substance rules over form.

In examining the underlying economic substance of the lease, courts have held that "[w]hile the labels that the parties give to their deals may offer some direction,"[222] "[t]he mere form in which a particular transaction is cast is not controlling and thus, [the] [c]ourt is not bound either by the parties' characterization of the transaction as a lease or by the terminology (e.g., "rent", "lessee", "lessor") contained therein."[223] In *In re Samoset Assocs*.,[224] the court clearly conveyed its independence from intent of the contracting parties when it stated "although the instrument itself contains the express acknowledgement of the parties that the agreement constitutes a true lease, *conclusory incantations at variance with manifest operative effect* cannot foreclose further judicial inquiry."[225] "Moreover, it would be inherently inequitable to allow the parties' choice of label to affect the rights of third party creditors."[226] Therefore, economic substance plays a key role in sections 365(d)(3) and 365(d)(4).

Turning to the issue of whether a proration or billing approach is more logically consistent with the right to temporary use and possession paradigm, an economic substance analysis supports the application of the proration or accrual approach. It is the more accurate means of measuring value. As discussed, the "binding lease" or billing approach produces DIP costs that are subject to wide fluctuation. Fortuity, in the form and timing of the lease obligations directly, and at times drastically, impact the cost to the DIP under section 365(d)(3).[227] In contrast, the "nonbinding lease" or proration approach matches DIP payment with the underlying economic benefit. Proration, as applied to the "right to temporary use and possession" paradigm, is in line with previous practice under the Act, with practice under section 503(b)(1) and with those courts adopting the proration or accrual method under section 365(d)(3).

---

[220] "[C]ourts should look to the economic reality of the transaction, rather than to its form, in determining whether there has been a sale or true lease." *In re* Edison Bros. Stores, Inc., 207 B.R. 801, 809 (Bankr. D. Del. 1997) (citing Pactel Fin. v. D.C. Marine Serv. Corp., 136 Misc. 2d 194, 195 (1987).

[221] *In re* King, 272 B.R. 281, 297 (Bankr. N.D. Okla. 2002) (citing Katz v. Comm'r, 60 T.C.M. (CCH) 260, 262 (1990)).

[222] *In re* Trace Int'l Holdings, Inc., 287 B.R. 98, 108 (Bankr. S.D.N.Y. 2002) (stating nature of transaction is determined by economic substance).

[223] *In re* Chateaugay Corp., 102 B.R. 335, 343 (Bankr. S.D.N.Y. 1989) (stating court is not bound by parties' characterization of transaction as "lease."); *see also* PCH Assocs. V. Liona Corp. (*In re* PCH Assocs.), 804 F.2d 193, 198 (2d Cir. 1986) ("While the parties to a contract may intend that, between themselves, their relationship is to be governed by the label they affix, that label neither governs the rights of third parties' nor affects the legal consequences of the parties' agreement.")

[224] 24 U.C.C. Rept. Serv. 510 (Bankr. D. Me. 1978).

[225] *Id*. at 512–13 (emphasis added).

[226] *In re PCH Assocs.*, 804 F.2d at 198.

[227] *In re DeCicco of Montvale, Inc*., 239 B.R. 475, 479 (Bankr. D.N.J. 1999) (examining legislative history).

From a technical or theoretical standpoint, certain models or formulae possess an inherent validity; they produce consistent, predictable results. Pythagoras' Theorem[228] (for computing the hypotenuse of a right-angled triangle) is one such example; it does not matter whether one measures in centimeters, inches or even in hands – the substance of the relationships is unchanged by the form the measurement takes. In the same vein, a well-drafted law reduces uncertainty and increases predictable outcomes. We can see this very desire for certainty in *In re Cannonsburg Environmental Associates*,[229] wherein the court stated the purpose of section 365(d)(3) is to "prevent parties in contractual or lease relationships with the debtor from being left *in doubt* concerning their status vis-à-vis the estate."[230]

In evaluating the cost of a right to temporary use and possession under both the proration and billing methods, we have to ask which costing method possesses greater inherent validity. Stated differently, which method produces more consistent predictable results? Again, the proration or accrual costing method possesses greater inherent validity. Proration costing is not subject to fluctuations based on the form and timing of obligations under the lease. In effect, this method produces consistent results that reflect the economic substance of the lease. In contrast, the cost of a right to temporary use and possession computed under the billing method suffers from 'noise' caused by the disconnect between the economic benefit received by the debtor and the timing of payments under the lease during the "gap period,"[231] "twilight zone"[232] or "option phase."[233] As a result, application of the billing method to determine the cost of a right to temporary use and possession can result in vastly disparate treatment across debtors holding economically identical leases. In turn, disparate treatment of the debtor leads to disparate treatment of creditors and even lessors. Similar to the "nonbinding lease" approach, the conceptual status of the DIP as the holder of a right to temporary use and possession for a sixty day period supports application of proration.

More recently, the courts have been faced with leases incorporating, as additional or further rent, provisions for repayment of debt.[234] In light of sections 365(d)(3) and 365(d)(4)'s applicability to "true leases" and the corresponding importance of the economic substance of a transaction, the court's decision in *In re*

---

[228] Pythagoras' Theorem : $a^2 + b^2 = c^2$ where "c" is the hypotenuse, or the longest side of a right triangle.

[229] Tully Constr. Comp., Inc. v. Cannonsburg Envtl. Assocs., Ltd. (*In re* Cannonsburg Envtl. Assocs., Ltd.), 72 F.3d 1260, 1266 (6th Cir. 1996).

[230] *Id*. at 1266 (emphasis added).

[231] *In re* Peaberry's Ltd., 205 B.R. 6, 8 (B.A.P. 1st Cir. 1997) (describing *In re Almac's Inc*. situation as "gap" period); *In re* Almac's Inc., 167 B.R. 4, 7–8 (Bankr. D.R.I. 1994) (considering landlord's claim for debtor's rent for sixty day period after bankruptcy filing).

[232] Schmitt, *supra* note 25, at 234 (writing period between commencement of case and debtor's decision to assume or reject lease is "twilight zone" for landlord).

[233] *In re* UAL Corp., 291 B.R. 121, 124 (Bankr. N.D. Ill. 2003) (stating period from date order for relief is entered to date unexpired lease of nonresidential real property is assumed or rejected can be referred to as "option phase").

[234] Cukierman v. Uecker (*In re* Cukierman), 265 F.3d 846, 850 (9th Cir. 2001) (determining obligation to pay promissory notes is obligation covered by section 365(d)(3)).

*Cukierman*[235] begs the question just how much "financing" activity is acceptable before the court recognizes that the "manifest operative effect"[236] of such a provision is not in the nature of a "true lease." *Cukierman* gives further proof that the billing date approach is inconsistent with the "use and possession" model. It forces the debtor to pay under 365(d)(3) for something unrelated to the value or cost of the temporary use–it requires the debtor to pay part of the price for the option. *Cukierman* provides another example of how the billing date approach is subject to strategic manipulation.

## IV. LEASES AND THE COST OF A RIGHT TO TEMPORARY USE AND POSSESSION

### *A. Assumptions*

This section puts the ideas previously discussed into practice. Using three different lease scenarios,[237] we explore the cost of a right to temporary use and possession under both the proration or accrual approach and then under the performance date or billing approach. Prior to plunging into the hypotheticals, a few definitions and assumptions are in order.

First, rent, as used in this segment, is "the consideration paid for the use or occupation of property;"[238] it can be further characterized as either a sunk cost, stemming from pre-petition utility, or as an administrative cost, representing the charge for current consumption of a resource.[239] Leases are structured either as gross or net leases. "A gross lease obliges the tenant only to pay rent, with the landlord responsible for paying taxes, insurance, and maintenance. In a net lease, the tenant pays, in addition to rent, expenses such as taxes, insurance, and maintenance, making the rent payment net to the landlord."[240]

---

[235] *Id*.

[236] *In re* Samoset Assocs., 24 U.C.C. Rep. Serv. 510, 512–13 (Bankr. D. Me. 1978) (utilizing phrase "manifest operative effect" when finding express acknowledgement by parties that agreement constitutes "true lease," cannot foreclose further judicial inquiry if at odds with manifest operative effect).

[237] In homage to the original voices crying for change, the hypotheticals have been set in the context of 'the shopping center.' However, section 365(d)(3) in its application is not so limited; it applies to any unexpired nonresidential real property lease.

[238] GEORGE A. PINDAR, AM. REAL ESTATE LAW § 11-58 462 (1976) (defining "rent"); *see also In re* Malden Mills Indus., Inc., 303 B.R. 688, 704–05 (B.A.P. 1st Cir. 2004) (finding personal property left in leased premises by debtor constitutes use and occupancy in accordance with state law, but use and occupancy charge must be reasonable storage charge); *In re* UAL Corp., 291 B.R. 121, 126–27 (Bankr. N.D. Ill. 2003) (recognizing advance payment of rent on first of month for use and occupancy during month, holding where order for relief entered after first day of month but prior to end of month, payment not required for prorated rent for period between order for relief and last day of month).

[239] *See In re* Comdisco, Inc., 272 B.R. 671, 674–75 (Bankr. N.D. Ill. 2002) (characterizing rent as sunk cost relating to time before bankruptcy case or as charge for consumption of resource during administration of case).

[240] *In re* Smith, 249 B.R. 328, 337 (Bankr. S.D. Ga. 2000) (explaining net lease as lease where tenant pays, in addition to rent, expenses such as taxes, insurance and maintenance); *see also In re* Omne Partners II, 67 B.R. 793, 795 (Bankr. D.N.H. 1986) (recognizing "triple net lease" transaction where lessee is obligated to pay certain taxes, charges, costs, expenses attributable to property which otherwise would be born directly by owner-lessor).

Conceptually, the difference between a gross lease and a net lease is more one of form and ease of administration than of substance. The lessor is going to include the costs of taxes, maintenance and insurance "within the rental charge or agree to a lower rent if the lessee takes responsibility for them."[241] Further, in a typical triple-net lease the assumption of responsibility for these charges is the means employed by lessors to "superficial shifting of costs of ownership to the lessee to assure their profits."[242] In a short-term lease costs of ownership can be more accurately predicted, thereby permitting use of the gross lease. For commercial leases, which tend to run for a longer duration, the landlord can more easily maintain its profit margin over the long run under the net lease structure. Alternatively, it could elect a more administratively cumbersome approach and write several short-term leases to cover the same time period. The inability to lock in long-term is a significant downside to this solution.

Section 365(d)(3) directs the DIP to the terms of the lease to determine their post-petition, pre-rejection obligations. Similarly, section 502(b)(6), which contains a provision limiting a lessor's claim for damages,[243] directs a party to the terms of the lease. Namely, section 502(b)(6) similarly provides that the lessor's damages are a function of the "rent reserved by such lease."[244] Under section 502(b)(6) courts have had to interpret the statute's "rent reserved" language in light of common commercial real estate practice such as the triple-net lease.[245] In response, the court in *In re McSheridan*,[246] developed a three-part classification test to determine whether a charge is properly considered as "rent reserved" under section 502(b)(6)(A):

> 1. The charge must: (a) be designated as "rent" or "additional rent" in the lease; or (b) be provided as the tenant's or lessee's obligation in the lease;
> 2. The charge must be related to the value of the property or the lease thereon; and
> 3. The charge must be properly classifiable as rent because it is a

---

[241] *In re* Edison Bros. Stores, Inc., 207 B.R. 801, 819 (Bankr. D. Del. 1997) (affirming lessor would include costs for taxes, insurance, maintenance, etc., in rental charge or will agree to lower rent if lessee takes responsibility for them).

[242] Int'l Trade Admin. v. Rensselaer Polytechnic Inst., 936 F.2d 744, 751 (2d Cir. 1991) (finding triple net lease arrangement distinguishable from situations with indicia of ownership, since triple net lease is superficial shifting of costs).

[243] 11 U.S.C. § 502(b)(6) (2000) (providing limitation on amount of section 501 claims, "if such claim is the claim of a lessor for damages resulting from the termination of a lease of real property, such claim exceeds (A) the *rent reserved by such lease*. . ..(B) any unpaid rent due under such lease. . ..) (emphasis added).

[244] *Id.*

[245] *In re* McSheridan, 184 B.R. 91, 97 (9th Cir. 1995) ("Certain of these other obligations under a triple-net lease have been held to relate to the value of the real property or lease thereon, and, thus, have been regarded as 'rent reserved' under section 502(b)(6)(A).").

[246] 184 B.R. 91 (9th Cir. 1995).

fixed, regular or periodic charge.[247]

This test aims to identify charges in the lease that, in substance, are in the nature of rent. Generally, charges for real estate taxes, common area maintenance and insurance are all held to be "rent reserved" under section 502(b)(6).[248]

Additional items such as interest, late charges, attorneys fees and unamortized building allowances are less likely to be included as rent, but under section 502(b)(6) their ultimate status is left to the court's determination after applying the *McSheridan* factors. This approach may have utility[249] in the section 365(d)(3) context where additional or further rent provisions within the lease provide for debt repayment.[250] Arguably, such provisions satisfy the first and third prongs of *McSheridan*; the final determination would depend on whether the charge is sufficiently "related to the value of the property or the lease thereon."[251] However, in this analysis it is important to keep the proper contextual reference in mind and not apply the *McSheridan* factors in isolation to any charge that have been manipulated to fit. The issue is rent, which has been defined as "the consideration paid for the use or occupation of property."[252] Aligned with this definition and the legislative history of 365(d)(3) the DIP has been defined as the holder of a right to temporary use and possession. The focus during the sixty day post-petition period is on the current payment for current services. To the extent that additional items may be structured to fit under a 502(b)(6) analysis with a focus on capping damage claims, such charges may not represent a present cost of occupancy but may be more appropriately categorized as payment of antecedent debt.[253]

### *B. Three Leases*

In this section we explore the cost of a sixty day right to temporary use and

---

[247] *Id*. at 99–100 (outlining three-part test for charge to constitute "rent reserved" under section 502 (b)(6)(A)).

[248] *See In re* Smith, 249 B.R. 328, 338 n.7 (Bankr. S.D. Ga. 2000) (stating common area maintenance charge, taxes, insurance generally held to be rent in net lease claims governed by section 502(b)(6)); *In re* Fifth Ave. Jewelers, Inc., 203 B.R. 372, 381 (Bankr. W.D. Pa. 1996) (finding real estate taxes, insurance, common area maintenance fees "clearly included in the cap because they are designated as 'additional rent' in . . . lease agreement.").

[249] In raising this, it is recognized that application of the *McSheridan* factors may support inclusion of debt obligations incorporated as "additional rent." It has been raised for illustrative purposes, and to raise awareness of potential divergence in treatment under the Code. It should be noted that section 502(b)(6) has a different purpose and caution should be used in reading in any broader intent.

[250] *See In re* Cukierman, 265 F.3d 846, 849–51 (9th Cir. 2001) (interpreting section 365(d)(3) bright-line rule encompassing all obligations of trustee including "further rent" payment).

[251] *In re* McSheridan, 184 B.R. 91, 99 (9th Cir. 1995) (specifying third prong to determine if charge is to constitute "rent reserved" under section 502(b)(6)(A)).

[252] PINDAR, *supra* note 238, at 462 (1976) (defining "rent."); *see also In re UAL Corp*., 291 B.R. 121, 124 (Bankr. N.D. Ill. 2003) (noting rent payment for occupation of property is dispositive under section 365(d)(3)); *In re* Malden Mills Indus., Inc., 303 B.R. 688, 708–09 (B.A.P. 1st 2004) (noting upon vacating property tenant is no longer liable for use and occupancy payment).

[253] *See In re* Cukierman, 242 B.R. 486 (9th Cir. 1999) (noting obligation under section 365(d)(3) includes more than just rent).

possession under three different leases. The "cost" is computed by applying section 365(d)(3) first using an accrual approach and second applying the billing method. For comparability purposes the following factual basis is assumed:

1. The Debtor–Common Facts:

The debtor, Pampered Pets Daycare and Spa, Inc. ("Pampered") has three locations within the State of Petopia. Petopia levies property taxes in arrears. Taxes for each calendar year are billed on the last day of the year and are due in equal installments on March 31 and September 31 of the following year.

To assure an adequate customer base, Pampered's business plan called for its facilities to be located in close proximity to pet-centered superstores. In 2000, it had the opportunity to acquire 5,000 square foot leases in three identical shopping centers–each home to Animal Kingdom Mega Centers ("Mega Center") as anchor stores. The Mega Centers occupied 50,000 square feet, or half of the total retail space in each shopping center. On April 1, 2000 Pampered signed seven-year leases with each landlord, and after investing approximately $100,000 in leasehold improvements in each facility, the grand openings were held on June 1, 2000. Pampered was able to obtain financing for the leasehold improvements at 8.5 percent interest. While the landlords and lease provisions were varied, Pampered determined that for budget purposes their cash requirements would be approximately equal at each location.

Pampered operated successfully throughout 2002. In early October, 2003, Pampered was surprised by the sudden bankruptcy and closing of all Animal Kingdom Mega Centers. Decreased revenues and increased costs in the wake of the departure of Animal Kingdom forced Pampered to file for bankruptcy on March 3, 2004.

2. Lease 1:

Pampered signed its first lease with Gross Lease Management, Inc. ("GLM"). The lease was a gross lease; the terms of the lease provided for a monthly rent of $25,000 payable on the first of each month ($300,000 annually). GLM would pay for real estate taxes and common area maintenance charges on the property. At the time Pampered filed for bankruptcy they were three months delinquent.

3. Lease 2:

Pampered signed its second lease with Net Lease Management, Inc. ("NLM"). The lease was a net lease; the terms of the lease called for a monthly base rent of $21,500 ($258,000 in annually). In addition the lease contained certain provisions designated as "additional rent." These provisions included an obligation for (i) the tenant's prorata portion of real estate taxes, and (ii) the tenant's prorata

portion of common area maintenance charges ("CAM"). Both charges would be due and payable within thirty days of invoicing by the Landlord. While real estate taxes were to be prorated based on total retail square footage–and would remain fixed at five percent–proration of CAM charges would be determined based on total square footage under lease, and would fluctuate depending on occupancy.

Based on historical figures provided by NLM, Pampered determined that its annual cost for taxes and common area maintenance charges should run in the $38,000 to $42,000 range. Its calculations were based on a five percent allocation of both real estate taxes and common area maintenance costs. From 2001 through 2003 Pampered paid all invoices for common area maintenance and taxes that were submitted by the Landlord. During that time, annual billings were within the projected range.

As of the petition date, Pampered was three months delinquent on its base rent under the net lease. On March 15, 2004 NLM sent Pampered a bill for $12,500 representing its share of the first half of the 2003 real estate taxes. On March 31, 2004 NLM billed another $15,000 for common area maintenance charges from October, 2003 through March, 2004. The backup documentation showed that Pampered was now billed at twice[254] the rate it had previously paid. Due to the departure of Animal Kingdom, which had occupied half of the retail space, Pampered's prorata share of CAM charges doubled; it was now credited with a ten percent share of the maintenance charges. Pampered has not paid either of these invoices.

4. Lease 3:

Pampered signed its third lease with Lenders Lease Management, Inc. ("LLM"). LLM is a sister company of NLM and uses the same base lease as NLM. The third lease was also a net lease; it called for a base rent of $21,500 monthly and provided for separate payments for real estate taxes and common area maintenance charges under additional rent provisions in the lease. The specific clauses relating to real estate taxes and common area maintenance were identical to those provided for under the NLM lease.

LLM's lease differed from the NLM lease in two significant respects: (i) LLM accelerated its payment of the second half of the 2003 real estate taxes and invoiced Pampered for an additional $12,500 on April 5, 2004, and (ii) under the additional rent clauses there was a separate provision for repayment of a promissory note. In this case, Pampered was able to obtain financing from LLM for the $100,000 needed for leasehold improvements. The rate charged by LLM was the same as that charged by Acme Finance for the loans LLM took out for its other locations. The relevant repayment terms of the note, dated April 1, 2000, include

[254] *See* 130 CONG. REC. S8994-95 (daily ed. June 29, 1984) (arguing resulting problem for shopping centers under Code is "tenants often must increase their common area charge payments to compensate for the trustee's failure to make the required payments for the debtor.").

interest at 8.50 percent per annum, and 83 monthly payments of $1,598[255] representing principal and interest starting May 1, 2000. Furthermore, all payments under the note would be deemed "additional rent" and shall be paid with the monthly base rent.

Paralleling its NLM lease, as of the petition date Pampered was three months delinquent with its base rent; and further, had been billed $12,500 for taxes on March 15th and $15,000 for common area maintenance charges on March 31, 2004. In addition, Pampered was $4,792.89 in arrears on its promissory note, representing three monthly "additional rent" payments as called for in the lease. Pampered has not paid any of these invoices.

*C. The Cost of a Sixty day Right to Temporary Use and Possession:*

1. Lease 1-GLM

*a. Accrual*

Under the accrual method, the gross lease Landlord would be entitled to the prorated portion of the rent for the sixty day period starting on March 3, 2004. In this case, the annualized rent is $300,000. If we assumed a 360 day year, the daily rental that would be accrued is $833.33, or approximately $50,000 for the sixty day period. Thus, under the accrual method the cost of the right to temporary use and possession is $50,000[256].

*b. Billing*

Since Pampered filed for bankruptcy on March 3, 2004 the Landlord will not be entitled to rent under the terms of the lease for the balance of the month. However, assuming that the debtor does not reject the lease until the end of the sixty day period, the Landlord would be entitled to timely payment of the April 1st and May 1st rents. Theoretically, the cost of the right to temporary use and possession for this gross lease under the billing method is also $50,000.[257]

As indicated, the cost of the right to temporary use and possession was determined by the two rent payments that fell due (or two obligations that arose) during the sixty day period. Since the rent for the month of March was due on March 1st the full $25,000 would be classified as a pre-petition claim.

However, it should be noted that under the billing method the Landlord is not entitled to prompt payment of rent under section 365(d)(3) for the period March 3rd through March 31, 2004–the stub period. Technically, section 365(d)(3) does

---

[255] Real Estate calculator, *available at* http://www.bankrate.com/brm/real-estate-home.asp?link=2. Monthly principle and interest payments of $1,597.63 (last visited April 21, 2004). Figure obtained using loan amortizing software with the following criteria - $100,000 loan at 8.5% over eighty-three months.

[256] Proration or Accrual cost under section 365(d)(3) would be $833.33 x 60 days = $50,000.

[257] Performance or Billing date cost under section 365(d)(3) would be $25,000 due on April 1 + $25,000 due on May 1=$50,000.

not redress the "unintended consequences" visited upon landlords under section 503(b) during the this time. For the duration of the stub period, which is determined by the structure of the lease and the timing of the petition, and which may encompass the entire sixty day post-petition period, the landlord's pre section 365(d)(3) problems remain–and arguably, may be compounded.[258]

Yet, nothing in the Code specifically prevents the Landlord from submitting an administrative expense claim under section 503(b)(1)[259] for the "the actual, necessary costs and expenses of preserving the estate"[260] for the period March 3rd through March 31st.[261] Thus, under the billing method, the Landlord could recover well in excess of $50,000.[262] The exact amount would depend on the fair market value of the debtor's actual use of the property during that period. It is conceivable that under the billing method the Landlord may claim or recover more for this sixty day period from a bankrupt tenant than it would outside of bankruptcy.[263]

---

[258] See Appendix 1 for examples of quarterly and annual leases where no "obligations arise" during the sixtyday period under section 365(d)(3). Further, as illustrated and discussed in the Appendix, there may be a question as to whether, with the adoption of section 365(d)(3), a section 503(b) claim remains available.

[259] *In re* ZB Co., 302 B.R. 316, 319 (Bankr. D. Del. 2003) ("Section 503(b)(1)(A) fills the stub period gap created by section 365(d)(3).").

[260] 11 U.S.C. § 503(b)(1)(A) (2000) (announcing allowed administrative expenses); *In re* Dant & Russell, Inc., 853 F.2d 700, 707 (9th Cir. 1988) (noting bankruptcy courts discretion to determine administrative expenses is limited by section 503(b)(1)(A)).

[261] *See In* re Rhodes, Inc., 321 B.R. 80, 92 (Bankr. N.D. Ga. 2005) (upholding separate section 503(b) claim for administrative expenses). The court stated:

> It would be a strange result indeed, bordering on the absurd, to hold that in enacting section 365(d)(3) to protect landlords, Congress intended to strip landlords of any right to payment of an administrative expense for use of the premises for the stub rent period and to leave them with only pre-petition, unsecured claims.

*Id*.

In this case, the court fashioned a sight variation on the billing method; and held that obligations arise under section 365(d)(3) when the liability for the expense becomes "fixed in an amount unalterable by subsequent events." Thus, in keeping with this billing-like method, that court was concerned with the stub period, and the potential void in recovery for the landlord for that time. While this is a legitimate concern, more particularly when the billing method is applied, the court did not consider the potential windfall that might be created by requiring the debtor to pay obligations that become "fixed in an amount unalterable by subsequent events," and that include some rent for the post 365(d)(3) or post rejection period.

[262] It becomes more interesting if we assume instead that rent is payable on a quarterly basis in advance and that a payment due date falls within the sixty day period. If the debtor is not in default as of the petition date it has already paid for the stub period. Under the billing date method it would be required to pay for another ninety days–a period well beyond the sixty day use period under section 365(d)(3). Assuming, under the same quarterly rent scenario, that the debtor was in default pre-petition the landlord would be entitled to assert a general unsecured claim, a claim under section 365(d)(3) for any payment that comes due within the day period, and depending on the court, see Appendix 1, the landlord may assert a section 503(b) claim for the stub period (the period between the date of filing and the date the first payment comes due within the sixty day period under section 365(d)(3).

[263] One might question whether this result alone would qualify as a sufficiently "absurd" interpretation of section 365(d)(3) so as to rule out the billing method.

2. Lease 2 - NLM

*a. Accrual*

Under the accrual method, courts are not limited by section 503 concepts such as fair market value and actual usage. Even if the debtor locked the doors as of the date of filing, courts will look to the terms of the lease to determine the post order for relief, pre-rejection rent under section 365(d)(3). Courts rely on the nature of the obligation to determine whether it is one that arises from or after the order for relief and thereby qualifies for priority treatment under section 365(d)(3); in doing so, courts adopting the proration or accrual method are not bound by the artifice of a particular billing or invoice date.

Under the accrual approach March rent–due on the 1st, will be prorated or bifurcated into a pre-petition unsecured claim for two days and a post-petition priority claim subject to 365(d)(3) for the balance of the month. This bifurcation process will be repeated in May to include the last two days of the sixty day period. The cost of the right to temporary use and possession under the NLM lease would be computed as follows:

| | | |
|---|---|---|
| Base Rent | (60/360 x $258,000) | $ 44,000 |
| Common Area Maintenance, 3/3 - 3/31 | | $ 2,417[264,265] |
| Real Estate Taxes | | $ 4,167[266] |
| Total Option Cost | | $ 50,584 |

In this scenario real estate taxes are billed in arrears; the installment billed to the debtor on March 15th represented taxes for the period of January through June 2003. There is nothing to prorate. If taxes were billed in advance for 2004, then a portion of those taxes would be allocated to the cost of the right to temporary use and possession.

---

[264] If the dates of the charges were specifically identified we would recognize those charges arising on or after March 3, 2004. Without such detail, I have simplified the proration by assuming the $15,000 was incurred uniformly over 180 days, and that twenty-nine days of expense qualify under section 365(d)(3).

[265] Under section 503(b), the debtor might have been able to challenge the amount invoiced. Since the lease called for an allocation based on a proration of square footage under lease the departure of the Animal Kingdom Mega Centers, Inc. effectively doubled their allocation of costs. It is questionable whether an allocation depending on third party action would qualify as a benefit to the estate.

[266] None of the $12,500 invoiced on March 15, 2004 would qualify as taxes under § 365(d)(3) since the entire amount was attributable to the pre-petition period. Note: however, prorated taxes for the post-petition period are included. To simply the hypothetical we have assumed that current real estate taxes remain unchanged from 2003 levels.

### *b. Billing*

Under the terms of the NLM lease the following obligations would arise[267] in the sixty day post-petition period:

| | | |
|---|---|---|
| March 15th | Real Estate Taxes – 1st half 2003 | $ 12,500 |
| March 31st | Common Area Maintenance, 10/03 - 3/04 | $ 15,000 |
| April 1st | Base Rent | $ 21,500 |
| May 1st | Base Rent | $ 21,500 |
| | Total Option Cost | $ 70,500 |

Again, as with the GLM lease, the cost of the right of temporary use and possession under the billing method does not include a provision for rent for the balance of March, 2004–the stub period. The Landlord may elect to submit a claim under section 503(b)(1) for "the actual, necessary costs and expenses of preserving the estate"[268] which would be limited to the fair market value of the debtor's actual use during that period.[269]

In contrast to the gross lease, the effects of the interplay of the structure of a lease with the performance or billing date method become apparent. While all of the leases were structured to be identical from the debtor-tenant's cash flow perspective the uncoupling of economic substance from the form of the lease yields

---

[267] Under the performance or billing date method, "obligations arise" under section 365(d)(3) when a payment becomes due within the sixty day post-petition period.

[268] 11 U.S.C. § 503(b)(1)(A) (2000); *In re* Dant & Russell, Inc., 853 F.2d 700, 707 (9th Cir.1988).

[269] An interesting and unanswered question is how would the courts treat additional section 503(b)(1) claims for (i) "current" real estate taxes – *i.e.* can the Landlord submit a claim for real estate taxes covering the sixty day period starting on the petition date, and (ii) common area maintenance charges for the balance of the sixty day period beginning on April 1, 2004?

(i) A Landlord wishing to squeeze every last drop from the Tenant would have strong section 503(b)(1) support for claiming current taxes covering the March 3rd through March 31, 2004 period. After all, this approach comports with pre section 365(d)(3) practice and with practice under the Bankruptcy Act; it is simply a proration of taxes. The area of uncertainty that remains is how would the courts treat a claim for taxes once section 365(d)(3) obligations arise? In this case, on April 1, 2004 the Tenant is obligated to make a payment for base rent; would this trigger the courts to preclude the Landlord from submitting a claim for current taxes for the balance of the sixty days or can he submit a section 503(b)(1) claim for the whole sixty day period?

(ii) In this hypothetical, the Landlord invoiced six months of common area maintenance charges on March 31st. If the lease provides for semi-annual invoicing of these charges does the Landlord have a section 503(b)(1) claim for the actual and necessary common area maintenance charges for the balance of the sixty day period beginning April 1, 2004? Would a court look to preclude this claim if the lease specified invoicing dates or if the lease was silent but the Tenant could show business practice?

widely disparate results based on the adoption of the either the billing date or accrual method. Under the accrual approach the cost of the right to temporary use and possession under a net lease is not significantly different than its cost under a gross lease. In contrast, this same right now costs an extra $20,500–a more than forty percent increase in cost for a zero increase in benefit. Furthermore, the total cost to the estate, as discussed in detail under the gross lease–billing method analysis, may be increased even more by an additional claim under 503(b) for actual and necessary costs for the March 3 through March 31 stub period.

Thus, while the cost of the right to temporary use and possession under the billing method is a simple computation, the total claims made by the Landlord for this period could be considerably larger depending on the existence of section 503(b)(1) claims.

3. Lease 3 - LLM

*a. Accrual*

Again, as with the NLM lease under the accrual method, many courts will look to the terms of the lease and will prorate the invoices for base and additional rent over the pre- and post-petition periods. The cost of a right to temporary use and possession for the LLM lease under accrual method would be computed as follows:

| | | |
|---|---|---|
| Base Rent | (60/360 x $258,000) | $ 44,000 |
| Common Area Maintenance, 3/3 - 3/31 | | $ 2,417[270] |
| Real Estate Taxes – 1st and 2nd half 2003 | | $ 0[271] |
| Real Estate Taxes | | $ 4,167[272] |
| Note Payments | | $ 0[273] |

[270] If the dates of the charges were specifically identified we would recognize those charges arising on or after March 3, 2004. Without such detail, I have simplified the proration by assuming the $15,000 was incurred uniformly over 180 days, and that twenty-nine days of expense qualify under section 365(d)(3).

[271] None of the $12,500 invoiced on March 15, 2004 would qualify as taxes under section 365(d)(3) since the entire amount was attributable to the pre-petition period.

[272] None of the $12,500 invoiced on March 15, 2004 would qualify as taxes under section 365(d)(3) since the entire amount was attributable to the pre-petition period. Note: however, prorated taxes for the post-petition period are included. To simply the hypothetical we have assumed that current real estate taxes remain unchanged from 2003 levels.

[273] It is yet to be determined how a court applying the accrual method would deal with this situation. Would it look to the economic substance of the provision and decide that the clause should be severed as a disguised financing transaction and not an element of a true lease? Would it bifurcate the monthly payments between principal (arising pre-petition) and interest expense (arising, in part, post-petition) and prorate that

| | |
|---|---|
| Total Option Cost | $ 50,584 |

The amount is the same as it was under the NLM lease. The open issue, and one which might change the cost of the option under the accrual method, is how would a court applying the accrual method deal with the debt repayments incorporated into the lease? There is no case law on this issue. In this scenario I have made the assumption that such a provision would be severed from the 365(d)(3) analysis in courts applying the proration or accrual method. The rationale for this assumption is based on the true lease versus disguised financing line of cases.[274]

Sections 365(d)(3) and (d)(4) only apply to true leases and not to disguised financing arrangements. In the true lease–disguised financing analysis courts examine the economic substance of the lease and are not bound by the labels ascribed by the parties.[275] This focus on economic substance over form parallels the focus of the proration or accrual method. As evidenced by the hypotheticals, the cost of a right to temporary use and possession under an accrual method comports with underlying economic substance of the lease; the cost does not fluctuate based on the readily manipulated features of a lease such as the timing of an invoice or payment. Therefore, applying the true lease–disguised financing paradigm, I have assumed that such a clearly recognized financing provision, regardless of label, would be severed from the cost computation.[276]

---

portion of interest expense attributable to the post-petition period? These questions have yet to be addressed by the courts.

Sections 365(d)(3) and (d)(4) are only applicable to true leases. Thus, for purposes of this analysis I have assumed that any provisions pertaining to repayment of a promissory note, regardless of how they are denominated, are in fact disguised financing elements within an otherwise valid lease. Further, I have assumed that these provisions would be severed from any analysis under section 365(d)(3).

[274] *See In re* Barney's, Inc. et al., 206 B.R. 328, 331–21 (Bankr. S.D.N.Y. 1997) citing Int'l Trade Admin. v. Rensselaer Polytechnic Inst., 936 F.2d 744, 748 (2d Cir. 1991) ("Sections 365(d)(3) and (d)(4) of the Bankruptcy Code apply only to "true" or "bona fide" leases."); *In re* Edison Bros. Stores, Inc., 207 B.R. 801, 809 (Bankr. D. Del. 1997) ("Courts should look to the economic reality of the transaction, rather than to its form, in determining whether there has been a sale or true lease.").

[275] *In re* PCH Assocs., 804 F.2d 193, 197 (2d Cir. 1986) ("Merely by labeling a transaction a "lease," when its contents spoke of some other transaction, did not remove all ambiguity. Thus, the district court concluded that extrinsic evidence was properly admitted to clarify what exactly the parties intended to create. The district court was correct in looking beyond the form of the Sale-Leaseback Agreement and Ground Lease for clarification of the true nature of the transaction."); *In re* Barney's, Inc. et al., 206 B.R. 328, 332 (Bankr. S.D.N.Y. 1997) citing *In re* Best Prods. Co., 157 B.R. 222, 230 (Bankr. S.D.N.Y. 1993) ("We apply an "economic realities" test: while the parties to a transaction may intend that, as between themselves, their relationship be governed by the label they affix, that label neither governs the right of third parties nor affects the legal consequences of the parties' agreement."); *In re* Samoset Assocs., 24 U.C.C. Rept. Serv. 510, 512–13 (Bankr. D. Me. 1978), (stating "although the instrument itself contains an express acknowledgement of the parties that the agreement constitutes a true lease, conclusory incantations at variance with manifest operative effect cannot foreclose further judicial inquiry.").

[276] Notwithstanding this assumption, if an accrual method court were to include the "additional rent" in the cost of the option, only the prorated portion relating to the sixty day post-petition period would be included in the cost–in keeping with the approach applied to the balance of the lease provisions.

*b. Billing*

Under the terms of the LLM lease the following obligations would arise in the sixty day post-petition period:

| | | |
|---|---|---|
| March 15th | Real Estate Taxes – 1st half 2003 | $ 12,500 |
| March 31st | Common Area Maintenance, 10/03–3/04 | $ 15,000 |
| April 1st | Base Rent | $ 21,500 |
| April 1st | Note Payment | $ 1,598 |
| April 5th | Real Estate Taxes – 2nd half 2003 | $ 12,500 |
| May 1st | Base Rent | $ 21,500 |
| May 1st | Note Payment | $ 1,598 |
| | Total Option Cost | $ 86,196 |

In this case, a strict application of the billing method yields an even higher cost for the right to temporary use and possession. Since the lease simply provided that the Tenant's portion of real estate taxes was due within thirty days of receipt of an invoice providing proof of payment by the Landlord, the acceleration of its payment and subsequent billing of the debtor to take full advantage of section 365(d)(3) qualifies as an obligation arising from or after the petition date in accordance with the statute.

Further, in *In re Cukierman*, the court held that where obligations are denominated as "further rent" they are entitled to priority treatment under section 365(d)(3)–even where those obligations actually represent repayments of promissory notes.[277] Thus, much to the chagrin of Acme Financial and the Debtor, the monthly principal and interest payments under the LLM loan for April and May are deemed valid obligations under section 365(d)(3) and are included in determining the cost of the right to temporary use and possession.

As we have seen in the two previous examples, there is still the question of section 503(b)(1) claims that the Landlord might make. For the most part, the questions under the LLM lease mirror those under the NLM lease with one difference. How would the courts treat a section 503(b)(1) claim for that portion of additional rent that is attributable to repayment of the promissory note? To ask the question is to answer it. The existence of a promissory note is evidence of pre-

[277] *In re* Cukierman, 265 F.3d 846, 851 (9th Cir. 2001) (discussing further rent).

existing debt; there is no current benefit to the debtor's estate and thus no valid section 503(b)(1) claim even though it is denominated as additional rent.

*D. Comparison of the Cost of a Right to Temporary Use and Possession*

The chart below summarizes the cost of a right to temporary use and possession of three hypothetical leases under the accrual or proration method and under the performance date or billing method.

| **Lease** | **Accrual** | **Billing**[278] |
|---|---|---|
| #1-GLM | $50,000 | $50,000 |
| #2-NLM | $50,584 | $70,156 |
| #3-LLM | $50,584 | $86,196 |

To aid comparability, the hypothetical leases were designed to yield approximately equal annual out-of-pocket disbursements for Pampered. Under the common fact pattern, in all three leases the Debtor borrowed an additional $100,000 for its leasehold improvements. The financing terms were identical, save for a provision in lease three (the LLM lease) calling for payments on the note to be made as additional rent. The additional rent attributable to the note is included in the cost of the right (to temporary use and possession) under the billing method and is in accord with the courts holding in *In re Cukierman*.[279] As stated in the previous section, the note payments are not included in the cost of the right to temporary use and possession under the proration or accrual method based on the assumption that this provision would be severed from the lease as a disguised financing transaction.

What conclusions can we reach from this comparison? There are several. First, if a nonresidential real property lease is structured as a gross lease providing for monthly rent payments, then cost of a sixty day right to temporary use and

[278] Note these figures represent the cost of an option under section 365(d)(3). In many cases, as in these hypotheticals, the billing method leaves the Landlord with the choice to submit an additional claim under section 503(b)(1) for the "the actual, necessary costs and expenses of preserving the estate." 11 U.S.C. § 503(b)(1) (2000). This alternative or supplemental action is particularly important where the lease does not provide for monthly payments. In these cases, disallowance of a section 503(b)(1) claim may leave the Landlord in a worse position under BAFJA than he was under the 1978 Code. If no obligations arise (*i.e.*, no payments are due) during the sixty day period covered by section 365(d)(3), then failing a section 503(b)(1) claim would cause the Landlord to receive nothing. In all three leases presented here, the Landlord can submit a section 503(b)(1) claim for the period March 3rd through March 31st, 2004. *See In* re Rhodes, Inc., 321 B.R. 80, 92 (Bankr. N.D. Ga. 2005) (discussing pre-rejection and post-rejection obligations).

[279] *See* 265 F.3d 846, 850–51 (9th Cir. 2001) (finding lease obligation enjoyed administrative status conferred by section 365(d)(3), regardless of whether such lease obligation related to or exceeded use of premises).

possession is uniform regardless of which interpretation of section 365(d)(3) has been adopted by the circuit.[280] Second, for leases of approximately equal economic substance (as measured by annual cash disbursements), there is less variance in the cost of a right (to temporary use and possession) under the accrual method. Third, the billing method yields the greatest variance in pricing and is subject to greater manipulation by either the debtor or the Landlord. Finally, under the performance date or billing method there is the potential for a section 503(b)(1) claim[281] in addition to the section 365(d)(3) priority claim; not only could this yield an even greater disparity between the landlord claims during the sixty day post-petition period of jurisdictions adopting the performance or billing date method versus the proration or accrual method, but it effectively preserves the problems, albeit only for the stub period, that section 365(d)(3) was intended to remedy.

## V. COSTING METHODOLOGY, SECTION 365(d)(3) AND ABSURDITY

To determine whether the costing method, accrual method, or billing method better comports with section 365(d)(3), we begin with the text itself. The statute is deceptively simple: section 365(d)(3) provides in relevant part:

> 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.[282]

The questions that have split the courts for the last 20 years are equally simple in form: Is it ambiguous? What is an "obligation"? When does it "arise"? Simply put, how do we implement section 365(d)(3)?

The closest and most appropriate analogy to the section 365(d)(3) sixty day period is a right to temporary use and possession. Using the conceptual status of the DIP as the holder of a right to temporary use and possession of the property, the potential answers and interpretations can be narrowed by starting with these questions: What would be fair in Congress' contemplation for a debtor to pay for the right to this sixty day use and possession period? Should it be any more than the costs attributable to that period? Is it fair that if the lease provides for a performance or billing date that falls outside the period covered by section 365(d)(3), the debtor pays nothing to the landlord? Is it fair, under the billing

---

[280] This conclusion is not valid if the terms of the lease provide for quarterly or annual rent payments in advance or in arrears. *See e.g.,* Appendix 1.

[281] *See e.g.*, *In* re Rhodes, Inc., 321 B.R. 80, 92 (Bankr. N.D. Ga. 2005) (permitting section 503(b)(1)(A) claim for administrative expenses for the stub period); *In re* ZB Co., 302 B.R. 316, 319 (Bankr. D. Del. 2003) (recognizing proration of rent not permitted under section 365(d)(3) still leaves Landlord remedy under section 503(b)(1)(A), and "[s]ection 503(b)(1)(A) fills the stub period gap created by section 365(d)(3).").

[282] 11 U.S.C. § 365(d)(3) (2000).

method, that if a quarterly or annual rental payment falls due towards the end of the sixty day period that the debtor has to pay both a stub period claim under section 503(b)(1) plus an additional three or twelve months of rent to use and possess the property for sixty days? Did Congress intend to eliminate the unintended consequences of 503(b) in *toto* when it adopted 365(d)(3)–the effect under a proration or accrual method; or did Congress intend, under a performance or billing date interpretation, to retain section 503(b) and its unintended consequences for the stub period, and provide a remedy which, depending on the degree of disconnect between the structure of the lease payments and the economic substance of the lease may yield no relief, some relief or a windfall to the Landlord? Examples of these scenarios have been included in Appendix 1.

From the language of section 365(d)(3), it is clear that Congress' fair contemplation does not include limiting the lessee's payment during this period to the "reasonable value"[283] of the "actual and necessary"[284] costs of preserving the estate. Based on the conceptual status of the DIP as the holder of a right to temporary use and possession, the hypotheticals discussed, and the billing lease scenarios provided in the appendix, it is evident that the performance date or billing approach, with the potential to limit the landlord to a section 503(b)(1) claim, is an absurd result.[285] As such, courts "must look beyond the language of the statute. . . when. . . although the statute is facially clear, a literal interpretation would lead to internal inconsistencies, an absurd result, or an interpretation inconsistent with the intent of Congress."[286]

Furthermore, the court in *In re Furr's Supermarkets, Inc*.[287] characterized claims under section 365(d)(3) as providing:

> lessors a priority claim *similar to* an administrative expense claim under section 503(b)(1).[288] The difference is that lessors, as opposed to typical administrative expense claimants under [section] 503(b)(1), are not required to establish value or prove a benefit to the estate to establish the amount of their claim, but rather are entitled to current payment of the amounts required under their leases.[289]

---

[283] *Id.*

[284] *Id*.

[285] *See e.g*., Appendix 1, ex. 5; *see also In re* Koenig Sporting Goods, Inc., 203 F.3d 986, 988 (6th Cir. 2000) (resorting to judicially created rules of statutory construction and stating departure from language of legislature is appropriate only in rare instances where "'literal application of a statute will produce a result demonstrably at odds with the intentions of its drafters . . . or when the statutory language is ambiguous.'").

[286] Vergos v. Gregg's Enters., Inc., 159 F.3d 989, 990 (6th Cir. 1998) (explaining situations where court must look beyond text of statute).

[287] 283 B.R. 60 (B.A.P. 10th 2002).

[288] *Id*. at 65 (discussing section 365(d)(3)).

[289] *Id*. at 65–70 (interpreting and discussing segment of section 365(d)(3), "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

The view advanced by this court and others[290] gives a landlord two claims–a section 503(b) claim for stub rent[291] and a section 365(d)(3) claim for payments coming due within the sixty day period. In light of Congress' stated intent in enacting section 365(d)(3) to provide landlords with "current payment" for "current services,"[292] the potential windfalls and continued pitfalls of this two-claim approach seems clearly an absurd result and therefore is not a reasonable interpretation of section 365(d)(3). A common sense reading of the statute indicates that the legislation was related to issues of creditor equality, of timeliness of payment and of a desire to prevent administrative cost shifting from the debtor to innocent parties. There is nothing in the statutory language that could be inferred as providing a clear indication that Congress intended to depart from prior practice,[293] especially a departure that has the potential to render section 365(d)(3) a nullity[294] based simply on the form of the lease.

In answering the question: "[w]hat would be Congress's fair contemplation for a debtor to pay for use and possession during this sixty day period?" the three lease hypotheticals clearly illustrate that application of a proration or accrual method more closely corresponds to the economic substance of the debtor's use by more accurately measuring the cost of the "current services" provided by the landlord during that period. As noted earlier, the performance date or billing method has the potential to produce costs that significantly understate or overstate the landlords "current service" in contravention of legislative intent.

Defining the conceptual status of the DIP as the holder of a right to temporary use and possession clarifies the nature of the "gap"[295] period or "twilight

---

relief under any unexpired lease of nonresidential real property, until such lease is assumed or rejected, notwithstanding section 503(b)(1) of this title.") (emphasis added).

[290] *See In* re Rhodes, Inc., 321 B.R. 80, 92–93 (Bankr. N.D. Ga. 2005) (allowing section 503(b)(1)(A) claim for stub period and noting reference to cases under Bankruptcy Act for claim is entirely appropriate); *In re* ZB Co., 302 B.R. 316, 319 (Bankr. D. Del. 2003) (acknowledging remedy of proration of rent under both section 503(b)(1)(A) and section 365(d)(3)).

[291] Note this interpretation does not eliminate the "unintended consequences" of section 503(b). Assuming the jurisdiction accepts the continued necessity of a 503(b) claim under the performance or billing method (*See* Appendix 1), then at best, adoption of section 365(d)(3) merely limits the "unintended consequences" 503(b) effects to the stub period. As discussed, the stub period may correspond to the full sixty day post petition period theoretically governed by section 365(d)(3). The effect results in an application of section 365(d)(3) being rendered a nullity.

[292] *See In re* By-Rite Distrib., Inc., 47 B.R. 660, 664–65, (Bankr. D. Utah 1985) (inferring congressional intent) (statement of Sen. Hatch, 130 CONG. REC. S8994-95 (daily ed. June 29, 1984)).

[293] *See e.g.*, Lamie v. U.S. Trust., 540 U.S. 526, 539–42 (2004) (analyzing opposing interpretations of legislative history and intent and concluding clearest understanding comes from statutory text); Cohen v. De la Cruz, 523 U.S. 213, 221–22 (1998) (rejecting specific version of statutory interpretation because Congress did not make its intent "unmistakably clear.").

[294] Applying the performance or billing date method to a lease calling for quarterly or annual payments provides increased opportunity for strategic filing, such that no "obligations arise" under the lease during the sixty day post-petition period. This effectively renders section 365(d)(3) a nullity and leaves the landlord with, at best, a section 503(b) claim; the landlord gets none of the protection Congress intended to give.

[295] *See, e.g.*, Krikor Dulgarian Trust v. Unified Mgmt. Corp. of R.I. (*In re* Peaberry's Ltd.), 205 B.R. 6, 8 (B.A.P. 1st Cir. 1997) (reviewing divergent lines of authority regarding treatment of priority of landlords'

zone"[296] and brings into focus or sharpens the "absurd" results under the performance date or billing approach. Further, there is nothing in the statutory text or legislative history that is inconsistent with this argument.

## CONCLUSION

Classifying the conceptual basis of the DIP as the holder to a right to temporary use and possession of the property under the lease is the most appropriate model for applying section 365(d)(3). It is both consistent with the legislative history of section 365(d)(3) that stressed the need to provide the landlord with "current payment" for "current services," and is reinforced by the economic substance of the post order for relief, pre-assumption or rejection period. Application of this conceptual approach acts to highlight the absurdity of applying the performance date or billing approach to section 365(d)(3).

The performance date or billing method, which purports to be a plain language interpretation of section 365(d)(3) to some courts, and made attractive as a bright-line test, leaves the door open to absurd results if applied unquestioningly. Further, the performance date or billing method raises economic substance issues when the lease contains debt repayment provisions, at least when those provisions are labeled "further rent." An awareness of the role of economic substance in the true lease–disguised financing arrangement analysis under 365(3) and (d)(4) should be considered lest we end up with two disparate treatments of economic substance under a single provision of the Code. While the potential for strategic manipulation by both parties can be reduced or eliminated by careful drafting, business realities do not favor this as a complete solution. Finally, bankruptcy policy such as equality of treatment both within classes of creditors and between classes is rendered a fiction by a billing method approach.

The proper interpretation of section 365(d)(3), which flows from the conceptual status analysis of the DIP as the holder of a right to temporary use and possession to the property, requires application of the proration or accrual approach. This yields consistent results that meet the legislative objective of Congress;–to remove the involuntary creditor status and provide landlords with current payment for current services. Further, the cost of this right is also within the fair contemplation of what Congress might infer as to what a debtor should pay for use of the property during the sixty day period covered by section 365(d)(3) and as a bonus, it avoids the potential for the absurd results that befall the performance date or billing approach.

## APPENDIX 1

---

claims for post-petition rent); *In re* Almac's Inc., 167 B.R. 4, 7 (Bankr. D.R.I. 1994) (finding landlord's claim for rent accruing through gap period not entitled to super priority treatment).

[296] Schmitt, *supra* note 25, at 233–34 (using term twilight zone to refer to period of time between commencement of case and assumption or rejection of lease).

LEASE CLAIMS: "BILLING DATE" APPROACH

This appendix is a compilation of lease scenarios and claims available under the performance date or billing method. It is provided for illustrative purposes. The scenarios presented are designed to highlight the variance in claims available, and potential for absurd results based on adoption of the billing approach.

The *Montgomery Ward* court adopted the billing approach stating section 365(d)(3) supports "a straightforward interpretation that produces a *rational result* and no other reasonable interpretation [is] consistent with the text."[297] The court continued, "we are constrained to hold that [section] 365(d)(3) is not ambiguous."[298] The question to ask is if the facts of the underlying lease were changed, would the court in *Montgomery Ward* have reached the same conclusion. If not, if the 'rational result' is limited to a subset of all nonresidential real property leases, then we are forced to conclude that either the statement is false or that Congress passed legislation with a discriminatory effect in its application.

The following scenarios are examined:

I. LEASE PROVIDING FOR MONTHLY RENT OF $10,000

II. LEASE PROVIDING FOR QUARTERLY RENT OF $30,000–NO LEASE PAYMENTS ARISE[299] DURING THE SECTION 365(d)(3) PERIOD.

III. LEASE PROVIDING FOR QUARTERLY RENT OF $30,000–QUARTERLY LEASE PAYMENT ARISES DURING THE SECTION 365(d)(3) PERIOD.

IV. LEASE PROVIDING FOR ANNUAL RENT OF $120,000 IN ADVANCE

V. LEASE PROVIDING FOR ANNUAL RENT OF $120,000 IN ARREARS

Each of the scenarios is presented in three segments beginning with a Timeline showing dates and lease obligations in relation to the entry of the Order for Relief and the end of the section 365(d)(3) period. If applicable, the stub period–the period from entry of the Order for Relief until the first obligation arises under the lease, is highlighted. The second segment is the claim summary, detailing the category of claim, the amount of each claim and brief comments. The final segment, to the extent relevant, expands on the nature of the claims and questions the 'rationality' of the result.

---

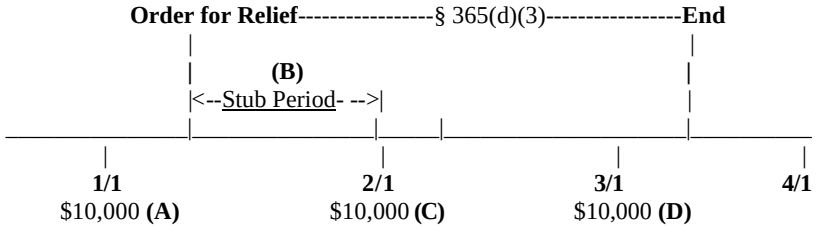
[297] Centerpoint Props. v. Montgomery Ward Holding Corp. (*In re* Montgomery Ward Holding Corp.), 268 F.3d 205, 209–10 (3d Cir. 2001) (emphasis added) (recognizing clear and express intent of section 365(d)(3) is to require trustee to perform lease and abide by terms).

[298] *Id*. at 210 (acknowledging since statute is unambiguous, there is no need to review legislative history, but proceeding nonetheless and noting legislative history consistent with decision).

[299] As used in this section, the term "arise" comports with the payment due date under the terms of the lease.

## I. SCENARIO 1: LEASE TERMS PROVIDE FOR MONTHLY PAYMENTS OF $10,000

### *A. Timeline*




### *B. Claim Summary*

| Claim Category | Amount of Claim | Comments |
|---|---|---|
| Pre-petition General Unsecured | (A) | $10,000 due under the terms of the lease on 1/1. |
| § 365(d)(3) | (C) + (D) | $20,000 representing the lease payments due on 2/1 and 3/1. Falling within the section 365(d)(3) period. |
| § 503(b)(1)(A) | (B) or ?? | See comments below: The critical question is whether, and to what extent a section 503(b)(1)(A) claim can exist in concert with a section 365(d)(3) claim. |

### *C. Further Comments*

1. The Stub Period (B)

*UAL*,[300] *CCI Wireless*,[301] *HG Global*[302] all support the contention that proration

[300] *In re* UAL Corp., 291 B.R. 121, 126–27 (Bankr. N.D. Ill. 2003) (concluding section 365(d)(3) does not require payment of stub period rent under payment date approach).

[301] *In re* CCI Wireless, L.L.C., 279 B.R. 590, 594 (Bankr. D. Colo. 2002) (adopting performance date approach). While the court recognized that certain leases contain a specific proration provision, in effect permitting proration during the stub period, this lease did not; the landlord in *CCI Wireless* possessed a pre-petition unsecured claim for this period. The court in *CCI Wireless* stated that it "is cognizant of possible imbalance or inequities between a lessor and lessee or debtor-in-possession where rents are paid longer-term (e.g., quarterly, etc.)," and suggested that in these cases, wherein the landlord is placed in a disadvantageous position the courts work on a case-by-case basis. *Id*. *CCI Wireless* seems to support the contention that post

is not required during this period. As a result, one might infer that there is no section 503(b)(1)(A) claim for this period. That conclusion possesses a certain logical appeal–the landlord provided services for sixty days and in return he has a claim for two months rent. The periods covered by the claim do not coincide with the sixty day section 365(d)(3) period in which he provided the services, but from the landlord's perspective there is an elemental equality achieved. In *Koenig*, the court hints at potential problems with this logic which, while hidden here, are brought into focus in leases calling for quarterly or annual payments.[303] These problems will be discussed in subsequent scenarios.

In contrast to the positions stated previously, *ZB Co*. and *In re Rhodes*[304] provide for a section 503(b)(1)(A) claim for the stub period. This claim would be limited to the "actual use" and "reasonable value" requirements of section 503(b) and would be subject to the traditional administrative claims process.

Certain questions remain unanswered, for example, if a section 503(b) claim is supported in addition to a claim under section 365(d)(3) then conceivably the landlord might recover more than sixty days worth of rent, did Congress intend this result? Likewise, the section 365(d)(3) claim labeled (D) technically includes rent for the post section 365(d)(3) period.[305] If Congress wished to provide "current payment" for "current services" within the sixty day post order for relief period, could they have intended this result?

---

enactment of section 365(d)(3), the landlord's recourse is limited to a pre-petition general unsecured claim, a post-petition 365(d)(3) claim for payments, if any, that come due under the lease, and if none, a request for a custom remedy if application of the billing date method leads to an inequitable result.

[302] *In re* HQ Global Holdings, Inc., 282 B.R. 169, 174 (Bankr. D. Del. 2002) (rejecting debtor's argument for proration during stub period).

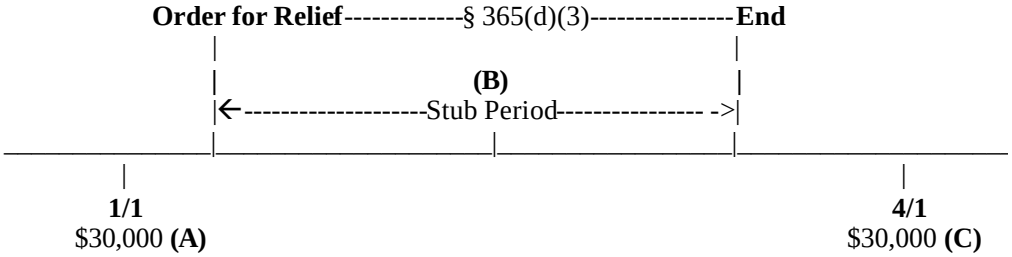
[303] *In re* Koenig Sporting Goods, Inc., 203 F.3d 986, 987 (6th Cir. 2000) (requiring debtor to pay rent for entire month even though debtor rejected nonresidential lease and vacated premises on second day of month).

[304] *In* re Rhodes, Inc., 321 B.R. 80, 92 (Bankr. N.D. Ga. 2005) (approving section 503(b)(1)(A) claim for administrative expenses for the stub period.); *In re* ZB Co., 302 B.R. 316, 320 (Bankr. D. Del. 2003) (approving cash collateral motion on account of debtor providing payment for stub period rent).

[305] As used in this scenario the term "post section 365(d)(3) period" equates to the post-rejection period.

## II. SCENARIO 2: LEASE TERMS PROVIDE FOR QUARTERLY PAYMENTS OF $30,000 –NO LEASE PAYMENTS ARISE DURING THE SECTION 365(d)(3) PERIOD.

### *A. Timeline*




### *B. Claim Summary*

| Claim Category | Amount of Claim | Comments |
|---|---|---|
| Pre-petition General Unsecured | (A) | $ 30,000 due under terms of the lease on 1/1. For the period 1/1 through 3/31. |
| § 365(d)(3) | N/A | There is no "due date" that falls within the 60 day period covered by section 365(d)(3)–its effect has been rendered nugatory by the combination of the lease payment structure and the timing of the bankruptcy filing. |
| § 503(b)(1)(A) | (B) or ?? | See comments below: The critical question is whether, and to what extent a section 503(b)(1)(A) claim can exist in concert with a section 365(d)(3) claim. |

### *C. Further Comments*

1. Section 365(d)(3) Claim

The bright-line rule of the performance date or billing method would, under this scenario, render section 365(d)(3) nugatory. Technically, no obligations 'arise' during this period under this approach. The landlord must continue to provide services for which he is not compensated under this provision of the Code.

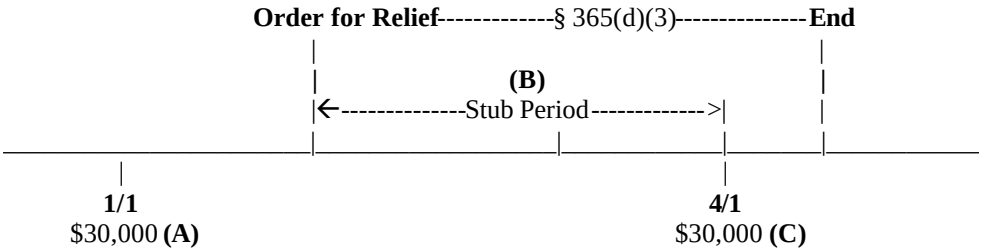
2. The Stub Period (B)

The courts holding in *ZB Co*. is more strongly supported in this fact pattern. Absent a section 503(b) claim for the stub period, which in this case covers the full sixty days under section 365(d)(3), the landlord would be entirely stripped of recourse for its continued services.[306] As stated above, the bright-line effect of section 365(d)(3) denies recovery to the landlord for post order for relief–pre-rejection services.

If Congress wished to protect landlords from involuntary creditor status, is it reasonable to assume it would have legislated a fix that has the potential to deny any opportunity to recover for their post-petition services to the debtor? In effect, to compound the problem they intended to remedy.

## III. SCENARIO 3: LEASE TERMS PROVIDE FOR QUARTERLY PAYMENTS OF $30,000 –QUARTERLY LEASE PAYMENT ARISES DURING THE SECTION 365(d)(3) PERIOD.

### *A. Timeline*




[306] *In* re Rhodes, Inc., 321 B.R. 80, 92 (Bankr. N.D. Ga. 2005) (approving section 503(b)(1)(A) claim for administrative expenses during stub period); *In re* ZB Co., 302 B.R. at 319 (holding proration prohibited under section 365(d)(3) but allowing landlord remedy of recovering administrative expenses under section 503(b)(1)(A) to fill stub period gap).

*B. Claim Summary*

| **Claim Category** | **Amount of Claim** | **Comments** |
|---|---|---|
| Pre-petition General Unsecured | (A) | $ 30,000 due under terms of the lease on 1/1. For the period 1/1 through 3/31. |
| § 365(d)(3) | (C) | By fortuity, the "due date" for the second quarter running April 1 through June 30 falls within the 60 day period covered by section 365(d)(3). Thus, the landlord has a claim for a 90 day period, most of which falls outside section 365(d)(3) and quite likely results in the debtor paying rent for premises that they no longer occupy, nor have any rights to use or possession. |
| § 503(b)(1)(A) | (B) or ?? | See comments below: The critical question is whether, and to what extent a section 503(b)(1)(A) claim can exist in concert with a section 365(d)(3) claim. |

*C. Further Comments*

1. Section 365(d)(3) Claim

While Congress eliminated, as requisite to payment, any use or benefit to the debtor during the sixty day period covered by section 365(d)(3), did they intend to extend the "notwithstanding [section] 503(b)(1)" boon to the post-rejection landlords? Under this scenario, the landlord receives a section 365(d)(3) claim for the period April 1 through June 30–the majority of this period falling in the post section 365(d)(3) period. The landlord is able to recover monies for services that conceivably were never provided, and thus were of no benefit to, the estate.

2. The Stub Period (B)

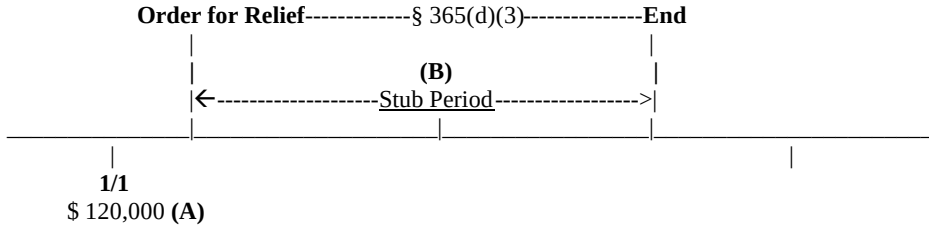
Absent a section 503(b) claim for the stub period, the landlord would be limited to a three month section 365(d)(3) claim. The availability of a section 503(b)(1) claim would provide the landlord with another two months of benefit—albeit subject to "actual use" and "reasonable value" limits.

Based on the previous scenario, the availability of a section 503(b)(1) claim

logically must exist as a separate and independent claim. As implied above, to conclude otherwise would convert Congress's remedy to section 503(b)'s involuntary creditor status into one of uncompensated servitude–facially an absurd result. Therefore, without any provision in the Code preventing a landlord from filing separate claims, the landlord will receive 150 days worth of post order for relief compensation (section 365(d)(3)—"current payment" + section 503(b)—administrative expense) for a sixty day period of time. Is this really what Congress intended?

## IV. SCENARIO 4: LEASE TERMS PROVIDE FOR AN ANNUAL PAYMENT OF $120,000 - IN ADVANCE

### *A. Timeline*




### *B. Claim Summary*

| Claim Category | Amount of Claim | Comments |
|---|---|---|
| Pre-petition General Unsecured | (A) | $ 120,000 due under terms of the lease on 1/1. For the period 1/1 through 12/31. |
| § 365(d)(3) | N/A | There is no "due date" falling within the 60 day period covered by section 365(d)(3)–its effect has been rendered nugatory by the combination of the lease payment structure and the timing of the bankruptcy filing. |
| § 503(b)(1)(A) | (B) or ?? | See comments below: The critical question is whether, and to what extent a section 503(b)(1)(A) claim can exist in concert with a section 365(d)(3) claim. |

*C. Further Comments*

1. Section 365(d)(3) Claim

This is essentially a scenario 2 refrain. Section 365(d)(3) is rendered superfluous by the combination of lease structure and timing of the petition date. With another slight variation *i.e.*, if the annual rent payment fell due within the sixty day period then, theoretically the DIP might find itself obligated to pay rent for more than ten months post-rejection. Is this what Congress intended? There is some indication that even courts adopting the billing method would have a problem with this.

In *Koenig*, the court, which held that the debtor was obligated to pay a full month of rent (the majority of which fell post-rejection), indicated in dicta that "if the *Koenig* case involved an entire year of rent instead of just a month, the court may have ruled differently to avoid distorting fundamental bankruptcy principles."[307] Again the court seems to be adopting a materiality exception to the plain language billing approach. Was it Congress's intention for the courts to adopt an interpretation of section 365(d)(3) that is only reasonable some of the time, especially when there exists an alternate interpretation that is both consistent with prior practice, closely reflects the economic reality of current services and does not suffer from "LMPD" - lease multiple personality disorder?

2. The Stub Period (B)

The interface of the billing approach and the absence of a section 503(b) claim for the stub period would transform section 365(d)(3) into a "no payment at any time" provision. Clearly, it is beyond the bounds of logic to assume this was Congressional intent.

---

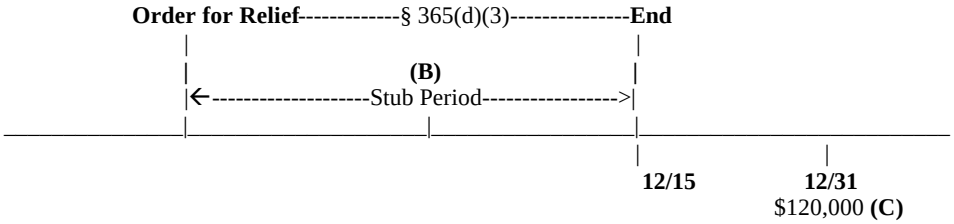
[307] *In re* Koenig Sporting Goods, Inc., 221 B.R. 737, 741 (Bankr. N.D. Ohio 1998), *aff'd In re* Koenig Sporting Goods, Inc., 229 B.R. 388 (B.A.P. 6th Cir. 1999), *aff'd In re* Koenig Sporting Goods, Inc., 203 F.3d 986 (6th Cir. 2000). Stating:

> Whether this same conclusion would follow if the Court were faced with the issue of awarding the landlord a year's rental for two days occupancy, in the unlikely event rent was payable yearly in advance, is an open question. Logic would demand the same result, but the lack of precision and clarity in the language of section 365 (d)(3) may indicate that Congress intended the courts to exercise some discretion where an inflexible approach to section 365(d)(3) would *severely distort fundamental bankruptcy principles*.

*Id*. (emphasis added).

## V. SCENARIO 5: LEASE TERMS PROVIDE FOR AN ANNUAL PAYMENT OF $120,000 –IN ARREARS

### *A. Timeline*




### *B. Claim Summary*

| Claim Category | Amount of Claim | Comments |
|---|---|---|
| Pre-petition General Unsecured | N/A | Taking the performance or billing date approach to its logical conclusion, the landlord in this case would not have a pre-petition general unsecured claim for rent. |
| § 365(d)(3) | N/A | Again, by fortuity, the "due date" for rent falls outside the period covered by section 365(d)(3). |
| § 503(b)(1)(A) | (B) or ?? | See comments below: The critical question is whether, and to what extent a section 503(b)(1)(A) claim can exist in concert with a section 365(d)(3) claim. |

### *C. Further Comments*

1. Section 365(d)(3) Claim

As before, we are presented with another scenario where section 365(d)(3) was rendered superfluous. Did Congress intent to pass a statutory provision with such a "hit or miss" effect?

2. The Stub Period (B)

Again, the absence of a section 503(b) claim for the stub period would leave the landlord with empty hands. More accurately, the landlord would be forced to subsidize the operations of the debtor during the sixty day section 365(d)(3) period. This not only drains additional funds from the landlord for items such as utilities and common area maintenance charges, it creates an unrealistic picture of the fiscal strength of the reorganized entity. By subsidizing the debtor during this period the court may make an erroneous determination of feasibility. Once the subsidy is removed, will the debtor be able to make plan payments?