

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM 2003

In the Matter of Ian's MegaCorporation Inc., Debtor

Ian's MegaCorporation Inc., Petitioner

v.

Chris Stange Properties Inc., Respondent

December 10, 2003

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTEENTH CIRCUIT IS GRANTED, LIMITED TO CONSIDERATION OF THE FOLLOWING QUESTIONS:

1. Whether a debtor may sell a lease outside the ordinary course of business under section 363 of the Bankruptcy Code or whether the debtor's only remedy is assumption and assignment under section 365.
2. Whether a pro-rata portion of a rent payment that became due and payable pre-petition, but covered a substantial period of time post-petition, should be treated as an administrative expense that must be paid promptly under § 363(d)(3) of the Bankruptcy Code, or whether the entire payment must be treated as a pre-petition claim.

**UNITED STATES COURT OF APPEALS
SIXTEENTH CIRCUIT**

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)
In the Matter of Ian’s MegaCorporation Inc.,)
Debtor)
)
Chris Stange Properties Inc., Appellant)
)
v.)
) **No. 03-0956**
Ian’s MegaCorporation Inc., Appellee)
) **Decision and Order**
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Decided: July 4, 2003

Before DOYLE, STROM, and LOMBARDI

DOYLE, Circuit Judge, for the Court.

The Court today considers two issues: (1) whether a debtor may sell a lease outside the ordinary course of business under section 363 of the Bankruptcy Code or whether the debtor’s only option is assumption and assignment under section 365, and (2) whether the Debtor should be compelled to pay promptly, as an administrative expense, a pro-rata portion of the rent payment that became due and payable pre-petition, but covered a substantial period of time post-petition under section 365(d)(3) of the Bankruptcy Code, or whether the entire payment must be treated as the pre-petition claim.

Facts and Background

Chris Stange Properties (“Stange”) is the owner of the Pinegrove Shopping Center, a strip mall located in the suburban City of Adamsville, State of Kothari. Pinegrove is comprised of an anchor tenant plus eight smaller tenants and has a master

plan of being a high quality family-oriented shopping center in a suburban setting. The anchor tenant is a national gourmet grocery store chain, and the smaller tenants comprise: the debtor, a camera store, a vitamin store, a health spa, a jewelry store, a fashion shoe store, a ladies dress shop and an ice cream and candy shop. Stange is appealing the District Court's order affirming the sale of a leasehold by Ian's MegaCorporation ("Ian's") under section 363 of the Bankruptcy Code. Additionally, Stange appeals the District Court's upholding of the Bankruptcy Court's denial of the landlord's motion to compel immediate payment of that portion of rent that covered a period following the filing of the tenant's petition, notwithstanding that the entire rent became due and payable pre-petition.

Ian's is incorporated in the State of Kothari, with its main office in California. Ian's, among other things, runs a chain of video rental stores in three states, California, Arizona, and Kothari under the name of Ian's VideoBusters ("VideoBusters"). VideoBusters mainly rents family-oriented movies. Additionally, Ian's produces top quality movies that are rented and sold exclusively through its own stores and stars the famous actor C.B. Fowler.

In 1997, VideoBusters entered into a ten-year lease ("Lease") with Stange covering 6000 square feet retail space in Pinegrove Shopping Center. The Lease requires the payment of rent in advance at the beginning of each quarter in the amount of \$100,000, with payment due dates of January 1, April 1, July 1, and October 1. Additionally, the Lease restricts assignment by providing that the tenant may not assign the lease "without landlord's prior written consent, which consent may not be

unreasonably withheld if the assignee's proposed use is substantially similar to assignor's use."

In 2001, Ian's was faced with increasing financial pressures because of the economic downturn and increased competition. The principal competitive pressure came from Internet video rentals where customers are able to rent an unlimited number of videos every month for a flat rate with no late fees. Additionally, the local cable service provider introduced video on demand that provided cable subscribers with convenient movie rental without leaving home.

In 2002, Ian's financial situation grew worse when it faced the loss of its major star, C. B. Fowler. After growing bored with the big screen, Fowler decided not to renew his contract. Instead, he successfully ran for governor in the state's gubernatorial recall election. With no star for its films and a continuing loss of market share in the movie rental business, Ian's filed for Chapter 11 bankruptcy on July 3, 2002. Ian's also failed to pay the quarterly rent that was due on July 1, 2002, and covered the July, August and September rental.

On August 15, 2002, Ian's moved to sell all 30 of its leases in the State of Kothari, including the one with Stange, to Videorama pursuant to section 363 of the Bankruptcy Code. The sale agreement provided that closing of the sale was conditioned on the debtor obtaining a final non-appealable order approving the sale.

Videorama rents and sells movies with 50% of its revenue derived from movies of an adult nature and 50% of its revenue derived from general audience movies. The majority of traffic for Videorama will be after the hours of many other stores in the shopping center. The Bankruptcy Court found, and it is not contested, that Videorama's

financial condition and operating performance is not as strong as Ian's was at the time Ian's entered into the lease with Stange. Videorama, however, is not in financial distress and is in a substantially better financial condition than Ian's is currently.

Videorama's purchase of the leases was part of a national campaign to expand into new markets such as the State of Kothari. The 30 Ian leases would give Videorama an immediate market presence in Kothari. Testimony by Videorama's President at the sale hearing established that Videorama was interested in the leases only as a package and was not willing to remove the Stange lease from the package of leases subject to the sale.

Testimony presented by the debtor established that successful reorganization would be impossible without the sale of the leases and that in the event of liquidation, the sale of the leases as a package would provide significant additional funds for distribution to unsecured creditors. In addition, the sale of the leases as a package to Videorama would yield a substantially higher value to the estate than the sale or assignment of leases on a piecemeal basis to other potential purchasers or assignees.

Stange did not present any evidence to rebut the testimony presented by the debtor, but objected to the sale in the Bankruptcy Court on the basis that section 363 does not apply to unexpired leases, and that the debtor's only option for the treatment of unexpired shopping center leases was section 365. In addition to its objections to the Motion to Sell Lease Agreements, Stange moved to compel immediate payment of the post-petition portion of the quarterly rent that became due on July 1, 2002, under section 365(d)(3) of the Bankruptcy Code. Section 365(d)(3) requires the timely performance of

all obligations under the lease that arise after the order for relief, which would include the payment of rent.

Holding that the sale of leases under section 363 was proper, the Bankruptcy Court entered an order on October 15, 2003, approving the sale of all 30 of Ian's Kothari leases to Videorama. The Court found no conflict between section 363 and section 365 of the Bankruptcy Code, reasoning that 363 and 365 are separate and independent provisions of the Bankruptcy Code that make no reference to each other, and should not be read in a manner as to introduce conflict. With respect to Stange's motion to compel payment of the rent under section 365(d)(3), the Bankruptcy Court held that the issue would be largely moot if its decision that the lease could be sold under section 363 (which would require the purchaser to pay the rent) is upheld on appeal. The Bankruptcy Court held, however, that section 365(d)(3) was, in any case, inapplicable to the rent due July 1 since the obligation arose on the billing date, became due pre-petition, and was a general unsecured claim not subject to timely payment under section 365(d)(3). Consequently, Stange would not have been entitled to have any part of the rent treated as a post-petition administrative expense. Stange appealed.

In an oral ruling from the bench, the District Court affirmed the Bankruptcy Court. The District Court determined that section 363 was properly applied to the sale of the leases, and concurred with the Bankruptcy Court's treatment of the claim for immediate payment of rent. Stange appeals to this court.¹

I. Jurisdiction and Standard of Review

¹ The sale proposal approved by the Bankruptcy Court provided that Videorama would cure any payment defaults under the sold leases at closing. Since the closing has not occurred, and in light of our reversal of the sale order, we must address the section 365(d)(3) issue raised by Stange.

Because this case is appealed from a final decision of a District Court exercising appellate review, this Court’s jurisdiction arises under 28 U.S.C. §158(d). We review findings of fact under clearly erroneous standard, and findings of law are reviewed *de novo*.

II. *Sale of the Lease Under Section 363*

When a statute is involved, the starting point for any analysis is the statutory language. The Supreme Court has repeatedly stated that a court “should always turn first to one, cardinal canon before all others... [namely that the] courts must presume that a legislature says in a statute what it means and means in a statute what it says. . . .” *Connecticut National Bank v. Germain*, 503 U.S. 249, 253-54 (1992). Further, “a more specific statute will be given precedence over a more general one, regardless of their temporal sequence.” *Busic v. United States*, 446 U.S. 398, 406 (1980).

Section 363 of the Bankruptcy Code allows for the use, sale, or lease of property belonging to the bankruptcy estate. Specifically for our purposes, subsection (b) addresses the sale, by the trustee, of estate property outside the ordinary course of business.¹ 11 U.S.C. § 363(b) (2003).

In contrast, section 365 of the Bankruptcy Code allows a DIP to “assume or reject any executory contract or unexpired lease of the debtor.” 11 U.S.C. § 365(a) (2003). Furthermore, the debtor is free to assign the lease notwithstanding a provision in the lease that restricts or prohibits assignment. 11 U.S.C. § 365(f)(1) (2003). The assumption and

¹ The Bankruptcy Code treats the debtor-in-possession (DIP) as the trustee in a Chapter 11 case. Furthermore, the DIP has the same authority as a trustee when it comes to exercising the powers of section 363 or section 365. 11 U.S.C. §§ 1107(a), 1108 (2003). For this reason we will use the terms trustee and DIP interchangeably throughout this opinion.

assignment of the lease is conditioned on future performance of the contract by the debtor; specifically the Code requires that if the lease is in default, as it is here, the DIP must, *inter alia*, cure the default and provide “adequate assurance of future performance under such contract or lease.” 11 U.S.C. § 365(b)(1)(C) (2003). Further, shopping center landlords are offered “extraordinary protection” when compared to other non-debtor parties to executory contracts and unexpired leases. *In re Rickel*, 209 F.3d 291, 298 (3d Cir. 2000).

Section 365 provides that the assumption and assignment of a shopping center lease must include assurances:

“(A) of the source of rent and other consideration due under such lease, and *in the case of an assignment, that the financial condition and operating performance of the proposed assignee and its guarantors, if any, shall be similar to the financial condition and operating performance of the debtor and its guarantors, if any, as of the time the debtor became the lessee under the lease;*
(B) that any percentage rent due under such lease will not decline substantially;
(C) that assumption or assignment of such lease is subject to all the provisions thereof, including (but not limited to) provisions such as radius, location, use, or exclusivity provision, and will not breach any such provision contained in any other lease, financing agreement, or master agreement relating to such shopping center; and
(D) *that assumption or assignment of such lease will not disrupt any tenant mix or balance in such shopping center.*”

11 U.S.C. § 365(b)(3) (2003) (emphasis added).

Therefore, the debtor may assign an unexpired lease if “(A) it assumes the ... lease in accordance with section 365 and (B) there is adequate assurance of future performance by the assignee.” *In re Rickel*, 209 F3d 291, 299 (3d Cir. 2000). These requirements do not apply to a sale under section 363, which permits the sale on approval of the court, and requires the court, on request of a party with an interest in the property sold, to provide adequate protection for such interest.

On appeal, Stange argues that section 365 is the only remedy available to a lessee-debtor for the treatment of unexpired leases. It reasons that section 365 is more specific than section 363, and a specific section should control a general provision of the Code. Additionally, the intent of section 365 was to provide additional protection for the landlord of a shopping center. Stange contends that the assignment to Videorama would be precluded under section 365 by virtue of section 365(b)(3)(B) and (D) of the Bankruptcy Code, which provide specific protection not found in section 363. Therefore, Stange argues, to interpret the Code in a manner where a sale of a lease is possible under section 363 would make those additional protections meaningless.

In response, Ian's asserts that its interest in the lease is an interest in property that, under a plain reading of the statute, can be sold under section 363. Ian continues by asserting that section 363 and 365 are not in conflict. They are simply two alternative methods by which a debtor can deal with an unexpired lease; it can sell its interest in the lease under section 363 or it can assign it under section 365.

The Bankruptcy Court below would allow the DIP to sell a lease in a shopping center under section 363 of the Bankruptcy Code without complying with the requirements of section 365. In considering whether section 363 could ever apply to the sale of a lease, it is well established that a sale of a lease is in the nature of an assignment. *See Cinicola v. Scharffenberger*, 248 F.3d 110, 124 (3d Cir. 2001)(explaining that a sale and assignment of an executory contract are the same). Section 363 governs the sale of property outside the ordinary course of business. Therefore, section 363 can apply to the assignment of a lease because a sale and an assignment of a lease are the same. Thus, at

first glance, the Bankruptcy Court's actions appear permissible under section 363 of the Bankruptcy Code.

However, section 363 does not exist in a vacuum; it must be read in light of section 365. In the present case there is a conflict between two sections of the Code, one that allows for the sale of a lease with certain restrictions and the other permitting an assignment subject to other more specific restrictions. Faced with a conflict between two sections of the Code, there is a need to determine which one is controlling.

In reconciling the two sections, we turn to another principle of statutory interpretation -- that the specific provision controls even if enacted prior to the general provision. *In re Churchill Properties III, Ltd. Partnership*, 197 B.R. 283, 286 (Bankr. N.D.Ill. 1996) (finding that section 365 prevails over the more general section 363). Section 363 is a general provision that applies to the sale of property regardless of the type of property sold. *See generally* 11 U.S.C. § 363 (2003) (containing no provisions controlling specific types of property sales). In sharp contrast, section 365 contains specific provisions regarding the treatment of unexpired leases. 11 U.S.C. § 365(a)(2003). Even more specifically, section 365 contains provisions regarding shopping center leases. 11 U.S.C. § 365(b)(3)(2003). Those provisions prevent a non-consensual assignment of a shopping center lease unless the assignee is in the same financial condition and operating condition as the assignor was when the assignor entered into the original lease. Furthermore it is provided that assurance must be given that the assignment will not disrupt the tenant mix in the shopping center. 11 U.S.C. § 365(b)(3)(A), (D) (2003). Section 365 contains the more specific provision; and

therefore, we hold that section 365 is controlling and section 363 does not apply to the sale of leases in a shopping center.

Under section 365, the sale of the leases here would not be permitted. The Bankruptcy Court made a determination that Videorama's financial condition and operating performance is not similar to Ian's financial condition as of the time when Ian's entered into the lease with Stange and thus this assignment would violate 11 U.S.C. § 365(b)(3)(A). Further, as a more adult-oriented video store, Videorama would disrupt the tenant mix of this family-oriented high quality shopping center in violation of 11 U.S.C. § 365(b)(3)(D). Therefore, the assignment of the Stange lease to Videorama is not permissible.

Lastly the dissent's reliance on the recent decision in the Seventh Circuit, *Precision Industries, Inc. v. Qualitech SBQ*, 327 F.3d 537 (7th Cir. 2003), is misplaced. *Qualitech* involved the sale of real property free and clear of a lease under section 363(f) of the Bankruptcy Code. On the other hand, section 365(h) deals with rejection of leases by the landlord in bankruptcy. The Court held that sections 363(f) and 365(h) were not in conflict. When the property is sold free and clear of a lease, section 363 governs and where the landlord retains the fee but rejects the lease section 365 governs. That is not the case here. A "sale" of a lease and an "assignment" of a lease are the exact same thing. The dissent would have us believe that Congress wrote two alternative provisions of the Bankruptcy Code for assignment/sale of leases -- one, section 365, containing enormous detail as to when and under what circumstances the assignment/sale would be permitted and the other, section 363, containing no detail or requirements as to when the assignment/sale could take place or what the consequences would be to the landlord.

Indeed, it is not even clear under section 363(e) that the landlord would be entitled to the adequate protection that section affords for the harm caused by the assignment, since adequate protection is available only to one who has an interest in the property sold and the landlord has a reversion after the term of years but no direct interest in the lease itself. Clearly, in the situation involved in the case before us, the specific requirements of section 365 must govern the purported “sale” of the lease.

III. *Rent Payments*

The second issue before the Court involves the rent that became due and payable pre-petition but was attributable in part to a substantial period of time post-petition. The question is whether the Debtor should be compelled to make payment of a pro-rata portion of the rent as an administrative expense that must be timely paid under section 365(d)(3) of the Bankruptcy Code, or whether the entire payment must be treated as a general unsecured pre-petition claim. The rent under the lease here is paid quarterly on the first day of each calendar quarter. The payment in question became due on July 1, 2002, and covered the period of time from July 1, 2002, through September 30, 2002. The petition was filed on July 3, 2002. The rent that became due and payable on July 1 covered the post-petition period from July 3, 2002, to September 30, 2002. The debtor did not pay any portion of the July 1st payment. Our research has revealed no prior decision in this jurisdiction addressing this important issue of law.

Section 365(d)(3) of the Bankruptcy Code states in relevant part that: “The trustee shall timely perform all the obligations of the debtor ... arising from and after the order for relief under any unexpired lease of nonresidential real property, until such lease is

assumed or rejected, notwithstanding section 503(b)(1) of this title.” 11 U.S.C. § 365(d)(3) (2003).

The apparently clear language of section 365(d)(3) has produced a hopeless division of authority. Two schools of thought have emerged among the courts. The first school, the apparent majority view among the lower courts, holds that the obligation of the debtor under a lease arises not when the payment becomes due but rather accrues day-to-day. Under this interpretation the debtor must only perform that portion of the obligation that is attributable to or accrues within the period from the filing of the petition to the date of rejection of the lease. This is commonly called the “accrual method.” *See In the Matter of Handy Andy Home Improvement Centers, Inc.*, 144 F.3d 1125 (7th Cir. 1998). The Court in *Handy Andy* dealt with a situation where a property tax bill was received by the tenant post-petition but covered a period of pre-petition time. In holding that the tenant was obligated to reimburse the landlord only for that portion of the tax bill that accrued post-petition, the Court took the position that the obligation to pay taxes did not arise when it become due and payable under the lease but rather accrued day to day, as tax obligations were incurred. *Handy Andy*, 144 F.3d at 1127.

The contrary view, or “billing date approach,” is represented by *Koenig Sporting Goods, Inc. v. Morse Road Company (In re Koenig Sporting Goods, Inc.)*, 203 F.3d 986 (6th Cir. 2000). Courts adopting this view reason that the terms of the lease establish what the lease obligations are and when they arise. These courts hold that section 365(d)(3) requires the tenant to pay all obligations that become due and payable after the filing of the petition and before the rejection or assumption of the lease, regardless of whether the bill covers a pre-petition or a post-rejection period of time.

Ian's urges us to adopt the billing date approach, and, consistently with this approach, to hold that the entire rental payment for the quarter of July 1, 2002, through September 30, 2002, represents a general pre-petition unsecured claim. Stange, however, contends that such a result would be inequitable because this approach would force it to provide almost three-months worth of post-petition services to its tenant without current compensation.

The language of section 365(d)(3) is not as clear and unambiguous as the dissent contends. Indeed, the very existence of the hopeless split of judicial decisions that this language has produced suggests the opposite. The only thing this statute is clear on is the timing of the required performance of the obligations by the trustee. Lease obligations that arise post-petition must be performed on a timely basis. There is no disagreement on this point.

The problem is in determining the meaning of the word "arising." Either the obligation arises, as favored by the dissent, when it becomes due and payable (i.e. on the billing date), or as we hold, the obligation is a continuing one and arises piecemeal, day after day, from the beginning to the end of the period a certain bill covers. *Handy Andy*, 144 F.3d at 1127. The statute provides no definition of the word "arising." However, if Congress had intended the use of the Draconian billing date as the dissent claims it did, could it not have articulated that by using the words "obligations that become due and payable" or more specifically "obligations that are billed pursuant to agreement" from and after the order for relief? Instead, Congress used the term "arising" and we believe deliberately so. Rent is paid for the right to use and occupy property. Rent therefore *arises* as that right is being exercised – over the term for which payment is made,

regardless of whether the parties determine that the *payment* will be made in advance or in arrears.

However, even if the word “arising” were not clear, it is, at best for the billing date advocates, ambiguous. If it is ambiguous, we must look to its purpose in the context of the Bankruptcy Code to determine its meaning. Judge Posner explained the history and purpose of the 1984 amendment in *Handy Andy*. Prior to the amendment of section 365 in 1984, landlords found themselves in an untenable position when their tenants filed in bankruptcy. They could not evict the tenants because of the automatic stay and were forced to provide current services from the date of the bankruptcy filing to the date of assumption or rejection of the lease by the tenant. If the tenant failed to pay the rent or other charges for that period of time, the landlord was entitled to claim them as an administrative expense priority claim under section 503(b)(1). The twin problems for landlords were that under section 503(b)(1) the determination of administrative expense status required proof that such rents and charges were actual and necessary expenses of the estate and the landlords bore a credit risk since there was no requirement that the debtor pay the charges on a current basis. To relieve landlords from such an awkward position the amendment to section 365(d)(3) provided that the trustee shall timely perform all post-petition obligations under the lease notwithstanding the requirements of section 503(b)(1).¹ The amendment eliminated the necessity to prove that the rents and other charges due under the lease were actually necessary to the estate. *Handy Andy*, 144 F.3d at 1128.

¹ Senator Orin Hatch described the purpose of the amendment as correcting a situation under which the landlord was “forced to provide current services – the use of its property, utilities, security, and other services – without current payment.” 130 Cong. Rec. 8895 (1994).

This, however, does not mean that Congress intended to do any more than that or to afford administrative priority status to any expenses and charges that benefited the debtor pre-petition or post-rejection. Such a position unravels the carefully crafted priority scheme in the Bankruptcy Code without clear statutory mandate. *El Paso Properties Corp. v. Gonzales (In re Furr's Supermarkets, Inc.)*, 283 B.R. 60, 69 (BAP 10th Cir. 2002). Statutory priority must be narrowly construed. *In re Southern Star Foods, Inc.*, 144 F.3d 712, 714 (10th Cir. 1998).

The billing date approach favored by the dissent would do precisely that and thus would violate the priority scheme of the Bankruptcy Code. For example, in *Montgomery Ward*, where the tax bill was due in arrears, the Court granted administrative expense status to more than a year's worth of back taxes even though a large part of them were pre-petition and thus did not benefit the estate. *See Centerpoint Properties v. Montgomery Ward Holding Corp. (In re Montgomery Ward Holding Corp.)*, 268 F.3d 205 (3rd Cir. 2001). In *Koenig Sporting Goods*, where the rent was payable in advance on the first day of each month, the Court granted administrative priority to rent covering the post-rejection period even though the debtor's estate did not benefit from it because it had already surrendered the premises. *Koenig Sporting Goods, Inc. v. Morse Road Company (In re Koenig Sporting Goods, Inc.)*, 203 F.3d 986 (6th Cir. 2000).

In the instant case the table is turned against the landlord. Even though the rent that was due two days prior to the petition date covered almost three months of the post-petition period, the billing date approach would give the landlord nothing. In each of these examples the mechanical application of the billing date approach created a windfall either for the landlord or for the tenant, depending on the facts of each case. There is

nothing in section 365(d)(3) that compels this kind of inflexible reading or absurd result. The accrual method, on the other hand, affords each party only that which it deserves in light of the priority scheme of the Bankruptcy Code. Thus, we conclude that the accrual method is the proper interpretation of section 365(d)(3). Under this approach, the rent must be apportioned so that the rent attributable to the post-petition period from July 3 through September 30, 2002, has administrative expense status and must be paid immediately, while the portion of the rent covering July 1 and July 2, 2002, must be deemed a general unsecured claim.

Our conclusion is further supported by the economic rationale articulated by the Seventh Circuit in *Handy Andy* and the recent case of *HA-LO Industries, Inc. v. Centerpoint Properties Trust*, 342 F.3d 794, 799 (7th Cir. 2003). As Judge Posner stated in *Handy Andy*, the purpose of providing the lessor with priority is “to enable the debtor to keep going for as long as its current revenues cover its current costs, so that it does not collapse prematurely because of the weight of its existing debt ... In economic terms, the prioritizing of post-petition debt enables the debtor (or trustee) to ignore sunk costs – treat bygones as bygones – and continue operating as long as the debtor’s business is yielding a net economic benefit.” *Id.*

The recent decision in *HA-LO Industries* involving pre-paid rental does not require a contrary result. Although the Seventh Circuit there deviated from the accrual method in favor of the billing date approach, the Court reasoned that where payments are billed in advance the rationale of *Handy Andy* does not apply because such payments do not represent “sunk costs” that relate to the time before the bankruptcy case was commenced. *HA-LO Industries, Inc. v. Centerpoint Properties Trust*, 342 F.3d 794, 799

(7th Cir. 2003). Here, unlike *HA-LO Industries*, the rental payment covers a substantial post-petition period where the debtor is in possession of the premises and thus does not represent sunk costs, but rather represents the current costs of continued post-petition operations. While we prefer to rely upon the statutory language and adopt a fixed “accrual” interpretation of the term “arising” for all cases, the result we reach today is equally supported by the economic analysis approach used by the Seventh Circuit.

Conclusion

For the reasons set forth above we hold here today that: (1) section 365 is the only remedy available when the assignment involves a lease in a shopping center, and (2) the accrual approach is the proper method for determining whether an obligation “arises” post-petition under section 363(d)(3). Thus, Stange is entitled to prompt payment as an administrative expense under section 363(d)(3) of rent that became due pre-petition but which covered the post-petition period. Therefore, we remand this case to the Bankruptcy Court for the determination consistent with the judgment herein.

So ordered.

STROM, Circuit Judge dissenting

I respectfully dissent because the Court introduces conflict in the Bankruptcy Code where none exists. The Supreme Court has stated time and again that “...it is the duty of the courts, absent a clearly expressed Congressional intention to the contrary, to regard each [statute] as effective.” *Morton v. Mancari*, 417 U.S. 535, 551 (1974).

Additionally, the “legislature says in a statute what it means and means in a statute what it says there.” *United States v. Ron Pair Enterprise*, 489 U.S. 235, 241-42 (1989).

With respect to the sale of the leases, there are two relevant sections of the Bankruptcy Code, 363 and 365. Section 363 governs the sale of property outside of the ordinary course of business. 11 U.S.C. § 363(b) (2003). Section 365 controls the assumption and assignment of unexpired leases. 11 U.S.C. § 365 (2003). The Court today impermissibly refuses to read the statute in manner to avoid conflict between the two sections. *See Watt v. Alaska*, 451 U.S. 259, 267(1981) (directing courts to read conflicting statutes “to give effect to each if we can do so while preserving their sense and purpose.”).

I am persuaded by the analysis in the recent Seventh Circuit case of *Precision Industries, Inc. v. Qualitech SBQ, LLC*. *Precision Industries, Inc. v. Qualitech SBQ, LLC*, 327 F.3d 537 (7th Cir. 2003), the only circuit level case that has considered whether section 363 is in conflict with section 365. There, the Court allowed the sale of real property free and clear of a long-term ground lease under section 363(f) without complying with the leasehold protection language of section 365(h). The Court reasoned that sections 363 and 365 were separate provisions of the Code and were capable of being read in a manner where one did not control the other. *Id.* at 548. There is no indication that section 363 is to be secondary to section 365. *Id.* at 547. Neither section cross-references the other; a technique that is typically used when Congress intends for one section of the Code to limit another. *Id.* A cross-reference could have easily been included if Congress had so intended.

Additionally, sections 363 and 365 apply in different circumstances. Section 365 governs when a debtor wishes to assume or reject a contract and section 363 governs a sale of an asset. *Id.* at 547. If Ian's wished to retain its lease then it would be required to comply with the provisions of section 365; however, the debtor is seeking to maximize the estate by selling the lease to a willing buyer, Videorama. Therefore, I conclude that sections 363 and 365 are independent of each other. Because section 363 applies, the sale of the lease should be allowed without regard to whether Ian's has satisfied the conditions imposed by section 365(b)(3) that apply only to a lease the debtor has assumed and assigned under section 365. The District Court should be affirmed, and the sale of the lease should be allowed.

I also disagree with the majority's interpretation of section 365(d)(3). The majority ignores the plain language of the statute and improperly relies on policy justifications to reach a non-statutory result that it deems more equitable.

According to the plain language of this statute, the trustee must timely perform those lease obligations that arise "from and after" the order for relief. What the obligations are and when they arise is determined by the terms of the lease. *Centerpoint Properties v. Montgomery Ward Holding Corp. (In re Montgomery Ward Holding Corp.)*, 268 F.3d 205, 209-210 (3rd Cir. 2001). "The clear and express intent of section 365(d)(3) is to require the trustee to perform the lease in accordance with its terms." *Id.* at 209. An obligation arises under a lease when the legally enforceable duty to perform arises under it. *Id.* at 211. The obligation we are concerned with, the payment of quarterly rent, became due and payable in accordance with the terms of the lease on July 1, 2002, a date prior to the order for relief, not "from and after" such order. Since the

egally enforceable obligation of the tenant to make the payment arose pre-petition it is clear that the landlord holds an ordinary unsecured pre-petition claim for the entire rent payment in question. The majority argues that if Congress intended the billing date approach it could have articulated that with more specific language. I can only conclude that if Congress intended the accrual method, it could have simply substituted the word “accruing” for the word “arising.”

In addition to the Third Circuit, the Sixth Circuit also follows the billing date approach. *Koenig Sporting Goods, Inc. v. Morse Road Company (In re Koenig Sporting Goods, Inc.)*, 203 F.3d 986 (6th Cir. 2000). Courts adopting this view hold that the clear and unambiguous language of section 365(d)(3) requires the tenant to pay all the obligations that become due and payable after the filing of the petition and before the rejection or assumption, regardless of whether the bill covers a pre-petition or a post-rejection period of time.

The Sixth Circuit in *Koenig Sporting Goods* dealt with a situation like the instant case where rent was due in advance. The rent payment in that case was billed one month in advance and became due several days prior to the tenant’s rejection of the lease. Thus, the rental payment covered a period of time when the tenant was no longer entitled to any services from the landlord because the lease had been rejected. Nevertheless, the Court held that not only the statute but also equity mandated the adoption of the billing date approach. The Court explained that the tenant was in the sole control of the rejection date and could have easily prevented the outcome by rejecting the lease prior to the payment coming due. *Koenig Sporting Goods*, 203 F.3d at 989. Even the Seventh Circuit, when confronted with an advance payment situation, has adopted the billing date

approach. *See, HA-LO Industries, Inc. v. Centerpoint Properties Trust*, 342 F.3d 794, 799 (7th Cir. 2003).

I am mindful of the concern voiced by Stange that the billing date approach will require it to provide services post-petition without payment. However, the language of section 365(d)(3) is sufficiently clear, and it is not the function of courts to second guess Congress or make better laws than those written by Congress. *Montgomery Ward*, 268 F.3d at 211. I believe that this approach represents the logical application of the statute as intended by Congress. Congress intended the 1984 amendment to section 365(d)(3) to require that landlords be paid all post-petition bills as they become due until the date of rejection. In this case the bill became due and payable prior to the petition date. I do not think that Congress intended to grant landlords any special priority status for their pre-petition claims. *See also Handy Andy*, 144 F.3d at 1128.

Therefore, I would affirm the District Court and hold that under the clear mandate of section 365(d)(3) Ian's is not obligated to promptly pay the quarterly rent payment that became due pre-petition. Such payment should be treated as the pre-petition general unsecured claim.