

A Roadmap for Managing §503(b)(9) Claims and Objections: The Debtor's Perspective

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Much has been written in the past two years about the enactment of §503(b)(9) of the Bankruptcy Code, which grants unpaid sellers of goods administrative priority for the value of goods received by the debtor within twenty days of the bankruptcy filing. Specifically, §503(b)(9) provides that:

(b) After notice and a hearing, there shall be allowed, administrative expenses...including...

(9) the value of any goods received by the debtor within 20 days before the date of commencement of a case under this title in which the goods have been sold to the debtor in the ordinary course of such debtor's business.¹



J. Kate Stickles

Despite the presence of §503(b)(9) claims in most chapter 11 business bankruptcy cases, there are few reported decisions that clarify the ambiguous and undefined terms used in §503(b)(9) or address the various factual and legal issues presented by this section. Indeed, the lack of legislative guidance and judicial precedence has proven problematic for some debtors confronted with claims under §503(b)(9).

This article examines certain practical and legal issues that counsel for a debtor should consider when developing and implementing a procedure to address §503(b)(9) claims and identifies specific issues to consider when analyzing and objecting to §503(b)(9) claims.²

¹ 11 U.S.C. §503(b)(9) (emphasis added).

² This article does not address the establishment of reclamation claims procedures under §546(c) or critical vendor issues. Counsel should be mindful of the interplay between §§503(b)(9), 546(c) and procedures for payment of critical vendors.

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Establishing Procedures for Asserting §503(b)(9) Claims



G. David Dean

Prior to the commencement of, or very early in, a case, the debtor should assess the extent of the debtor's potential §503(b)(9) liabilities and consider the most appropriate process for addressing

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such claims. Armed with such information, the debtor should implement a court-approved procedure for filing and reconciling §503(b)(9) claims.³ A debtor generally establishes either (1) a specific bar date for asserting §503(b)(9) claims, which is separate from the bar date set for filing pre-petition claims under Bankruptcy Rules 2002 and 3003 (the "general bar date") or (2) a general bar date for filing pre-petition claims that encompasses §503(b)(9) claims.⁴ Which process a debtor determines to implement will depend on a number of variables, including, but not limited to, the anticipated volume of §503(b)(9) claims, the size and anticipated duration of the case, the liquidity of the debtor and the jurisdiction in which the case is pending.⁵

³ In certain jurisdictions, uniform procedures for asserting §503(b)(9) claims may be contrary to local rule. For example, the Local Bankruptcy Rules for the U.S. Bankruptcy Court for the District of Massachusetts provide a deadline for asserting administrative claims pursuant to 11 U.S.C. §503(b)(9). See MLBR 3002-1.

⁴ In a small case with few vendors, it may not be beneficial for a debtor to establish §503(b)(9) claim procedures. In such a case, it would not be burdensome for the debtor to address requests for payment of §503(b)(9) claims on an individual basis.

A Separate §503(b)(9) Bar Date

The first option is to establish a separate §503(b)(9) bar date early in the case that precedes the general bar date.⁶ This process allows a debtor to assess more quickly the scope and extent of §503(b)(9) claims against the estate. An early assessment of the amount of potential §503(b)(9) claims is of critical importance in a case in which the debtor teeters on administrative insolvency in light of the need to satisfy the feasibility requirement of §1129(a)(11).⁷ Even if feasibility is not an issue, a debtor will want to know the amount of the potential administrative claims to be paid as a condition of confirmation of a chapter 11 plan.⁸ A separate and early §503(b)(9) bar date also allows the debtor greater time to object to claims. Given the limitation on the number of omnibus claim objections that can be filed per month in certain jurisdictions⁹ and the limitation on the number of claims that can be contained in an omnibus objection under

the Bankruptcy Rules,¹⁰ it is prudent to commence the analysis and reconciliation of §503(b)(9) claims early, particularly if a debtor seeks a quick exit from bankruptcy.

The potential problem with this option, however, is that because the §503(b)(9) bar date predates the general bar date, there is a greater likelihood that an earlier scheduled bar date for §503(b)(9) claims will invite creditors to file claims regardless of the nature of the

⁵ A motion to establish bar dates for §503(b)(9) claims may not be without objection. In *Goody's Family Clothing Inc., et al.*, Case No. 08-11133 (CSS), Docket No. 385 (Bankr. D. Del. July 21, 2008), the U.S. Trustee objected to a motion to establish a bar date for filing a request for payment of administrative expense under §503(b)(9), in part on the grounds that administrative claims are properly sought by "request" pursuant to §503(a). Depending on the jurisdiction, a debtor may consider preserving a creditor's right to file a "request" under §503(b)(9) while simultaneously establishing a bar date.

⁶ See, e.g., *In re Aegis Mortgage Corp.*, Case No. 07-11119 (BLS), Docket No. 602 (Bankr. D. Del. Nov. 26, 2007) (order establishing §503(b)(9) bar date); *Fedders North America, Inc.*, Case No. 07-11176 (BLS), Docket No. 67 (Bankr. D. Del. Aug. 28, 2007) (order establishing §503(b)(9) bar date and approving form of §503(b)(9) claim request).

⁷ 11 U.S.C. §1129(a)(11).

⁸ 11 U.S.C. §1129(a)(9)(A) (requiring full payment of allowed administrative expenses on effective date of plan as a condition to confirmation, unless holder has agreed to different treatment).

⁹ See, e.g., Del. Bankr. L. R. 3007-1(f)(ii).

¹⁰ Fed. R. Bankr. P. 3007(e)(6).

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claim, simply because it will be the first bar date in the case. Consequently, the pool of claims could include many more invalid §503(b)(9) claims. The use of separate bar dates may also result in the filing of duplicate claims under the general bar date, as well as motions for the payment of administrative expense claims pursuant to §503(b)(9). As a result, the debtor will need to object not only to invalid §503(b)(9) claims, but also may have to compare each §503(b)(9) claim with the creditor's later filed general proof of claim—and possibly, administrative expense motion—to ensure that the creditor has not asserted multiple claims for the sale of the same goods. This exercise is complicated and time-consuming for the debtor and its professionals who must review and analyze each claim.

A Single Bar Date for All Pre-Petition Claims, Including §503(b)(9) Claims

The second option is to incorporate the deadline for filing §503(b)(9) claims into the general bar date.¹¹ If this option is selected, debtor's counsel—working with the claims agent—should consider modifying the standard proof of claim form to allow a creditor to assert its §503(b)(9) claim and other pre-petition claims in a single proof of claim. In some cases, debtors have included the §503(b)(9) bar date in the general bar date, but have not specifically advised creditors (either in the notice or in a modified proof of claim form) that they should assert their §503(b)(9) claim on the general bar date using the official or modified proof of claim form. Absent clear instruction to creditors, this process can be confusing, particularly since the official proof of claim form does not contain a box which references §503(b)(9) claims.¹²

While establishing a single bar date and claim form for the filing of all pre-petition claims may slightly delay the debtor's analysis of the scope of §503(b)(9) claims in a case, it will inevitably reduce the number of invalid

§503(b)(9) claims and duplicate claims that are filed as a result of the separate early §503(b)(9) bar date. The debtor, therefore, is spared the dubious exercise of sorting through a larger volume of claims and comparing a creditor's §503(b)(9) and general proof of claim to ensure that no “double dipping” has occurred.

Issues to Consider When Reviewing §503(b)(9) Claims for Potential Objections

Once the debtor has established a bar date for the filing of §503(b)(9) claims and such claims have been filed, the debtor can begin to review the validity of the claims and prepare objections.¹³ While the facts of each case will dictate the specific issues a debtor's professionals should consider when determining whether a §503(b)(9) claim is objectionable, below is a summary of issues to consider in analyzing §503(b)(9) claims.

Can a Debtor Object to the §503(b)(9) Claim of Secured Creditor?

In *In re Brown & Cole Stores LLC*, the Ninth Circuit Bankruptcy Appellate Panel (BAP) held that §503(b)(9) administrative priority is not limited to unsecured claims, and that secured creditors also have §503(b)(9) rights.¹⁴ Debtor's counsel should be aware of this authority when considering whether to object to a §503(b)(9) claim on the ground that the claim is secured.

Did the Debtor Receive “Goods” from the Creditor?

Section 503(b)(9) is limited to the sale of goods.¹⁵ Claims for the sale of personal property other than goods are not entitled to administrative priority under §503(b)(9).¹⁶

The term “goods” is not defined in the Bankruptcy Code. At least one court has relied on the definition of goods used in Article 2 of the Uniform Commercial Code (UCC) in the context of §503(b)(9).

The essential element of “goods” under Articles 2 and 9 of the UCC (which contain slightly different definitions of the term “goods”) is that they are “movable.” In *In re Samaritan Alliance LLC*, the U.S. Bankruptcy Court for the Eastern District of Kentucky, relying on the definition of “goods” in Article 2 of the UCC, held that electricity was not a “good,” and therefore §503(b)(9) did not apply.¹⁷ The court rejected the claimant's argument that electricity is a good because it is “movable,” and held that electricity was more properly characterized as a “service.” This is just one example of the type of characterization issue that may arise under §503(b)(9).

What Is the “Value” of the Goods?

The term “value” is also undefined in the statute, and the authors are unaware of any cases interpreting the meaning of value in the context of a §503(b)(9) claim objection. One possible dispute that could arise, however, is whether “value” equates to the value of the goods to the debtor, or whether “value” implicates some type of market valuation analysis. Counsel should also be aware of any supply or similar agreement governing the sale price of goods, as market conditions may dictate a lower value for the goods than the price the debtor is obligated to pay under the contract for the goods. In this case, the debtor may argue that the value of the goods is less than the sale price. Finally, the debtor may argue that the value of the goods is less for the debtor (who may sell them at liquidation value) than the actual sale price.

Were the Goods Sold “in the Ordinary Course of the Debtor's Business”?

The statute requires that the debtor be in the business of buying the goods in the ordinary course of its business. As an example, in *In re Magwood*, the U.S. Bankruptcy Court for the Middle District of Alabama, addressing reclamation, noted that a car dealer that sold a car to a debtor, who was not in the business of buying or selling cars and purchased the car for her own personal use, did not meet the requirements for an administrative claim under §503(b)(9) because the debtor was not in the business of buying

¹¹ See, e.g., *In re Steve & Barry's Manhattan LLC, et al.*, Case No. 08-12579 (ALG), Docket No. 324 (Bankr. S.D.N.Y. 2008) (order requiring filing of §503(b)(9) claims by bar date set for pre-petition claims).

¹² As such, if a debtor intends to establish a single bar date, it is recommended that the debtor file a motion early in the case setting forth the procedures for asserting §503(b)(9) claims so that creditors are aware of the process. Absent notice regarding the procedure for asserting §503(b)(9) claims, it is likely the debtor will receive more inquiries from creditors regarding the filing of claims, and creditors will be more inclined to file motions seeking payment of their §503(b)(9) claims.

¹³ In addition to establishing a procedure for asserting §503(b)(9) claims, a debtor may also request that the court establish a uniform procedure for objecting to and reconciling §503(b)(9) claims. A uniform procedure will provide clarity to creditors and afford a debtor the necessary procedural vehicle to efficiently and economically object to and reconcile §503(b)(9) claims.

¹⁴ See *In re Brown & Cole Stores LLC*, 375 B.R. 873, 879 (9th Cir. B.A.P. 2007).

¹⁵ L. King, 4 *Colliers on Bankruptcy*, ¶503.16[1] (15th ed. rev. 2008).

¹⁶ *In re Deer*, Case No. 06-02460-NPO (Bankr. S.D. Miss., June 14, 2007) (citing L. King, 4 *Colliers on Bankruptcy*, ¶503.16[1] (15th ed. rev. 2005)) (advertising purchased under contract does not constitute sale of goods under 11 U.S.C. §503(b)(9)).

¹⁷ *In re Samaritan Alliance LLC*, 2008 WL 2520107, *2, Case No. 07-50735 (Bankr. E.D. Ky. June 20, 2008).

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vehicles.¹⁸ In analyzing objections to §503(b)(9) claims, counsel should be cognizant of the type of goods that were sold to the debtor as related to the debtor's business.

Were the Goods "Received" within 20 Days of the Bankruptcy Filing?

Section 503(b)(9) does not define the term "received." Depending on the manner in which the goods were transported and the terms of the contract between the parties, disputes are likely to arise as to the date the goods were received. The UCC defines receipt of goods as "taking physical possession of them."¹⁹ In *In re Pridgen*, the U.S. Bankruptcy Court for the Eastern District of North Carolina relied on the definition of "received" in Article 2 of the UCC and denied the §503(b)(9) claim of a creditor oil company that sold gasoline to chapter 13 debtors that operated a grocery store.²⁰ In that case, the gasoline was physically delivered to the store prior to the applicable 20-day §503(b)(9) period, but title did not pass to the debtors until the gasoline was pumped by the customers. The creditor, in an effort to bring the claim within the 20-day period, argued that the debtors "received" the gasoline when titled passed under the agreement.²¹ Relying on Article 2 of the UCC, the court held that the creditor was not entitled to an administrative expense claim. The court reasoned that the relevant factor in determining when the goods were received was when the debtors received physical delivery of the gasoline at the store.²²

Application of Receipt of Payments During 20-day Period

As a debtor slides into bankruptcy, creditors often alter the payment terms and demand that the debtor pay for goods in advance or provide cash on delivery. Because of the favorable treatment §503(b)(9) provides to creditors, subsequent to the bankruptcy filing a creditor may attempt to apply funds that were paid in advance for goods received during the 20-day period to older unpaid invoices for goods received by the debtor prior to the 20-day period. In *In re Wetco*

Restaurant Group LLC, the U.S. Bankruptcy Court for the Western District of Louisiana denied a §503(b)(9) claim because the evidence showed an intent on the part of the creditor to obtain payment in advance for goods covered by the 20-day period.²³ The court did not allow the creditor to apply such payments to older unpaid invoices in order to preserve its §503(b)(9) claims. Debtor's counsel should review the payment history during the 20-day period, and if any payments were made during that period, counsel should closely examine whether such payments were advances or COD payments. If the answer to that question is yes, the debtor may have a solid objection to the §503(b)(9) claim.

Is Debtor Entitled to Exercise the Right of Setoff against a §503(b)(9) Claim?

In *In re Brown & Cole Stores LLC*, the Ninth Circuit BAP held that the provisions of §553(a), which provide for setoff of mutual debts that arise prior to bankruptcy, apply to §503(b)(9) claims.²⁴ Setoff allows entities that owe money to each other to cancel out or apply their mutual debts against each other. In determining whether the right to setoff should be preserved in bankruptcy under §553, the party asserting setoff must demonstrate the following: (1) the debtor owes the creditor on a prepetition debt, (2) the creditor owes the debtor on a prepetition debt and (3) the debts are mutual.²⁵ The court held that unlike other administrative claims that arise post-petition, §503(b)(9) claims are prepetition claims and are subject to setoff against claims the debtor has against the creditor arising prior to the petition date.

Even if a creditor's §503(b)(9) claim is valid, a debtor should examine all potential pre-petition claims against that creditor, such as warranty or other claims that remain unresolved with respect to the goods delivered prior to the 20-day period. In the event the debtor has pre-petition claims against the creditor, the assertion of such claims could defeat an otherwise valid §503(b)(9) claim.

Conclusion

Absent a rule dictating a uniform

¹⁸ See, e.g., *In re Magwood*, 2008 WL 509635, *1, No. 07-11288-DHW (Bankr. M.D. Ala. Feb. 22, 2008).

¹⁹ UCC §2-103(1)(c).

²⁰ *In re Pridgen*, 2008 WL 1836950, *4, Case No. 07-04531-RDD (Bankr. E.D.N.C. April 22, 2008).

²¹ *Id.*

²² *Id.*

²³ *In re Wetco Restaurant Group LLC*, 2008 WL 1848779, *3, Case No. 07-51169 (Bankr. W.D. La. April 23, 2008).

²⁴ See *In re Brown & Cole Stores LLC*, 375 B.R. 873, 879 (9th Cir. B.A.P. 2007).

²⁵ *Id.*

process for asserting and reconciling §503(b)(9) claims, debtor's counsel should establish procedures to address such claims, giving consideration to the facts and overall strategy of a case. After §503(b)(9) procedures have been implemented and claims filed, counsel should consider the issues raised in this article, and other issues as case law develops, in determining whether §503(b)(9) claims are objectionable. n