

BANKRUPTCY

Expert Analysis

Rising to the challenge of managing 503(b)(9) claims

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Corporate restructuring lawyers have found much to complain about since the enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. Limiting the number of extensions on the time to assume or reject leases, as well as the number of extensions on the exclusive period for a debtor to file a plan of reorganization, has arguably impeded the ability of certain debtors to reorganize successfully. These consequences were certainly foreseeable — and the changes were fought for that reason.

However, the addition of 11 U.S.C. § 503(b)(9) was less controversial and seemed less likely to significantly affect reorganizations.¹ That section created a new type of administrative priority claim for 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.”

As set forth below, in certain cases this new category of claim had significant effects on debtors trying to reorganize, as it creates both substantive and procedural hurdles. In cases where a debtor receives goods from numerous vendors, the volume and extent of 503(b)(9) claims can drastically change the debtor’s reorganization strategy.

Such claims must be paid in full in order for a debtor to obtain confirmation of its reorganization plan. This requires a much larger amount of cash on hand at confirmation. For many debtors, that means it is imperative to determine the universe of these claims quickly. Unfortunately, the Bankruptcy Code offers debtors no guidelines as to how and when such claims must be asserted, which has resulted in an additional layer of administrative complexity.

Creative debtors are creating their own procedures for processing claims, and the courts have been flexible and open to various approaches proposed. Fortunately, advance planning can minimize, or at least manage, the impact of 503(b)(9) claims.

UNIQUE CLAIM PRESENTS NEW CHALLENGES AND CONTRADICTIONS

Since Section 503(b)(9) conceived a completely new kind of claim, the case law interpreting its provisions is still taking shape. As with any new statute, each word

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and clause could be subject to competing interpretations until precedent resolves any ambiguities.

The courts recently have analyzed most of 503(b)(9)'s provisions in depth, including the meaning of "received"² and "value," and the important distinction between "goods" and "services." The goods-versus-services debate comes up often with respect to the delivery of energy products, and the results are still contradictory.

In *In re Plastech Engineered Products*³ the court found that natural gas constituted "goods" that can form the basis for a Section 503(b)(9) claim. The court in *In re Pilgrim's Pride* also issued an extensive and thoughtful opinion concluding that natural gas is a good, but electricity is a service.⁴ In *In re Samaritan Alliance LLC*⁵ the court also found that electricity was a "service," as it could not be reclaimed, but a contrary opinion was reached in *In re Erving Industries*.⁶

The contradictory nature of this new claim further complicates how best to manage them. Almost all other administrative priority claims are post-petition claims that are granted priority because the creditor adds value by providing a good or service for the benefit of the post-petition estate.⁷

Conversely, Section 503(b)(9) claims are administrative in priority, but arise pre-petition. This has caused some contradictory results, such as the opinion in *In re Plastech Engineered Products*,⁸ where the court found that Section 502(d), which provides for disallowance of a claim if the creditor received an avoidable transfer, was inapplicable to Section 503(b)(9) claims because Section 502(d) does not apply to administrative claims.

The court in *In re Circuit City* reached the opposite conclusion, holding that 502(d) could be used to disallow 503(b)(9) claims.⁹

Meanwhile, in *In re Associated Grocers*, the bankruptcy judge found that the setoff provisions of Section 553(a) do not apply to claims asserted under Section 503(b)(9). However, this was reversed by the Bankruptcy Appellate Panel for the 9th Circuit, which held that Section 503(b)(9) claims are pre-petition claims properly susceptible to setoff, despite the fact that Section 553 is not ordinarily applied to administrative claims.¹⁰

Preparing objections to Section 503(b)(9) claims also presents new challenges. Debtors can generally assess the vast majority of filed claims by simply referring to their own accounting records and determining whether goods or services were obtained from the creditor and whether payment was made.

However, the additional requirements of Section 503(b)(9) regarding the nature and timing of the claim raise evidentiary concerns, as some of that information may be solely in the hands of the creditor. Simply stated, Section 503(b)(9) claims cannot be treated like other pre-petition or administrative claims.

TAKING CHARGE OF THE CLAIM FILING PROCESS

As noted above, the Bankruptcy Code does not provide any guidance as to when or how to assert a claim under Section 503(b)(9). Although at first blush this appears to be another bothersome congressional oversight destined to cause more confusion, the debtor can actually turn it into a useful opportunity. By seizing control of the process, a debtor can dictate its own procedures to its advantage.

Absent any express direction from the court, presumably the general bar date for unsecured pre-petition claims would apply to 503(b)(9) claims. Such claims, although administrative, fit within the general definition of a claim under Section 101(5) because they arose pre-petition.¹¹ Certainly, any bar date set specifically for administrative claims would apply to 503(b)(9).

However, in many cases, these bar dates will not be soon enough for the debtor, particularly if it needs to immediately determine financing needs for the plan. Therefore, the first step in managing Section 503(b)(9) claims is for the debtor to specifically ask for and obtain a bar date.

Section 503(b)(9) does not specify a procedure for filing claims. It appears that creditors should assert such claims by motion like other administrative claims.

Practically speaking, creditors who are less familiar with bankruptcy procedures are likely to attempt to assert such claims using the general claim form. As the official claim form states that the form should not be used for administrative claims, it seems that the assertion of a 503(b)(9) claim simply by writing it into a claim form would be ineffective to create an administrative priority claim.

If numerous separate motions are filed seeking 503(b)(9) priority claims, it can lead to significant costs for the debtor as it is forced to respond to each creditor individually. Having motions as the only evidence of claims can lead to inefficiencies in processing the claims and make it more difficult for debtors to determine quickly the amount and validity of the claims.

Therefore, a highly effective second step for the debtor is to create procedures that streamline and standardize the process of asserting claims, such as creating a specialized claim form that captures Section 503(b)(9) claims. For debtors using a professional claims agent, a specialized form creates further savings by allowing electronic processing and management of Section 503(b)(9) claims, as well as general unsecured claims.

Finally, 503(b)(9) claims can overlap or duplicate other types of claims, such as reclamation claims, "critical vendor" claims or general unsecured claims. It is important to recognize the duplicative nature of these claims and ensure that creditors receive only a single recovery for any amounts owed. Therefore, any process that seeks to standardize the assertion of Section 503(b)(9) claims will be most effective if the debtor concurrently addresses the procedures for these other types of claims.

Many debtors are managing these challenges by filing "first-day" motions asking the court to set early bar dates, require customized claim forms to be used and allow them to seek qualified data so that claims can be analyzed immediately. By instituting efficient procedures, debtors can gain benefits including greater access to creditor information, better management of administrative-claim exposure, and a decrease in duplicative or overlapping claims.

An increasingly common and very effective mechanism for managing claims is creating a specific claim form either solely for the 503(b)(9) claims or to combine general unsecured claims and 503(b)(9) claims on a modified version of the B-10 form.

Properly drafted, such forms can not only provide easy access to all the information needed by the debtor, but also create time efficiencies for the professionals involved.

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In addition, by streamlining the process for creditors, debtors can reduce or even eliminate the legal fees creditors incur by attempting to assert such claims.

RECENT CASES YIELD EFFECTIVE SOLUTIONS

Specialized claim forms created solely for 503(b)(9) claims represent one of the best innovations since this new category of claims was created. In cases where a debtor may want to assess the universe of Section 503(b)(9) claims before dealing with general unsecured claims, a separate form sent only to creditors the debtor identifies as likely to have Section 503(b)(9) claims allows the debtor to obtain all the relevant information prior to tackling other claims.

These forms have been approved in diverse jurisdictions such as the Northern District of Alabama,¹² Delaware¹³ and the Eastern District of Virginia.¹⁴

Common elements of these forms include requests for specific shipping information regarding shipments allegedly made within the 20-day window, requiring creditors to break out the value of “goods” versus “services” for any invoices claimed to have priority. They also generally include a certification that shipments were made in the ordinary course of business.

Debtors have also set bar dates for 503(b)(9) claims and often specified that filing a special claim form is the only way to assert such a claim, thereby eliminating the use of motions. In some instances, the forms require creditors to disclose if they have submitted a reclamation claim or if they are also seeking payment of this amount through a “critical vendor” process.

Reclamation allows suppliers to recover the goods it shipped just before the bankruptcy to the debtor. The “critical vendor” doctrine allows a debtor to pay certain vendors deemed essential to the continued viability of the business and the debtor’s ability to reorganize.

Using this type of special form greatly streamlines the analysis of the claims, making it possible for debtors to determine quickly and efficiently the extent of their claim exposure.

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Both 503(b)(9) and reclamation demands concern “goods” sold in the “ordinary course” of business, but reclamation demands do have a deadline for assertion: within 45 days of the shipment of goods, but no later than 20 days after the bankruptcy filing. This will likely fall before any bar date has been established for 503(b)(9) claims.

In addition, the remedies differ; a successful reclamation demand entitles the creditor to the actual return of goods, whereas 503(b)(9) provides for a priority claim for the value of the goods. For debtors that prefer to keep recently shipped goods, offering a priority claim in lieu of the merchandise has been a common practice. The incorporation of 503(b)(9) claims gives debtors the authority to formally do what was usually permitted before — although now the choice becomes the creditor’s, not the debtor’s.

We can see an example of this hybrid approach in a comprehensive solution used in *In re Dura Automotive Systems*.¹⁵ In that case, the debtors requested a general bar date for pre-petition claims, including priority claims under 503(b)(9).

The debtors also modified the official claim form to include a block for the assertion of a 503(b)(9) claim.

The debtors then addressed the “critical vendor” issue by sending customized letters to trade vendors asking them to enter into an agreement to extend post-petition credit in exchange for payment for pre-petition shipments.

Although the amount of the vendor’s pre-petition claim often mirrors the amount of the priority claim allowed under 503(b)(9), thus far the courts that have addressed the issue of the timing of payment of 503(b)(9) claims have uniformly ruled that there is no expedited right to payment created by the statute. Instead, the courts have ruled only that payment must be made to confirm a plan, absent a showing of hardship to the claimant that outweighs prejudice to the debtor and potential detriment to other creditors.

By providing a timing benefit, the debtors gave vendors an incentive to extend credit at a low additional cost to the estate, as such claims were likely “priority” in any event. Having a single form for priority and general unsecured claims greatly reduces processing time, regardless of whether counsel is processing claims or using a claims administrator.

In *In re Circuit City*, the debtor filed two separate motions, one to set a bar date exclusively for 503(b)(9) claims and a second for administrative priority and procedures for reclamation claims. The debtor provided a separate proof of claim form for the 503(b)(9) claims and required the creditors to submit documentation and a statement regarding reclamation claims.¹⁶

Creditors filing reclamation claims were required to include supporting documents and statements to the court as to whether they would also assert a 503(b)(9) claim. The court confirmed administrative priority for goods received post-petition, authorized the return of goods and set procedures for reclamation claims.

Similarly, in *In re Tweeter*, the debtor filed a first-day motion seeking a quick bar date for Section 503(b)(9) claims. A special one-page claim form was created and sent with the bar date notice, in addition to an explanation of the requirements for a valid Section 503(b)(9) claim.¹⁷

Debtors must also decide if they want to encourage the assertion of Section 503(b)(9) claims. By creating special procedures, a debtor necessarily alerts creditors to a possible claim that some of them may have otherwise overlooked. Adding claim forms will make it easier for creditors to assert such claims, thereby increasing the estate’s liabilities.

Some debtors have preferred to ignore the issue and dealt with only the creditors who came forward without any prodding. This strategy is not without risks, as a late surge of claims could complicate a reorganization strategy.

In *In re Pilgrim’s Pride* the debtor chose to set an early bar date for Section 503(b)(9) claims, thereby eliminating the risk of unknown claims, but did not provide a special form. Instead, creditors were required to submit a request for a claim by methods ranging from letters to memoranda to motions.¹⁸

At the other end of the spectrum, some debtors have put an even greater burden on themselves to identify 503(b)(9) claims, thereby reducing the burden on creditors.

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In *In re SemCrude LP* the debtor filed a motion to establish procedures for 503(b)(9) claims, reclamation claims and statutory liens. The debtor set a deadline to file its amended Schedule E, which set forth all 503(b)(9) claims, as well as statutory lien claims. Any interested party had 30 days to object to Schedule E, which then triggered the claim process.¹⁹

Both a lender and the debtor filed objections, which were litigated in the Bankruptcy Court. Although this process may have required more upfront work for the debtor, the court noted that the procedure greatly streamlined the process by removing the need for every vendor to submit a claim for processing.²⁰

CONCLUSION

All good things can come to an end, and misguided legislation is one of them. Although debtors and bankruptcy professionals are in the midst of determining best practices for 503(b)(9) claims management, and making significant progress, there is the possibility that this Code section may be eliminated. The Business Reorganization and Job Protection Act of 2009, H.R. 1942, was introduced in April 2009 to address some of the more unfortunate effects of BAPCPA. It proposes to repeal Section 503(b)(9) and eliminate creditors' administrative claims.

Currently, the legislation is being reviewed by the House Subcommittee on Commercial and Administrative Law, but appears to be languishing. In the meantime, 503(b)(9) claims are affecting cases and constituents in Chapter 11 cases across the country.

For as long as this new section and claim exist, the charge to debtors and their counsel is to take control of managing these claims, as well as other related specialized claims such as reclamation claims.

There are a multitude of approaches to addressing 503(b)(9) claims, as seen in recent cases demonstrating a variety of successful procedures. Setting a specific bar date and creating a process for asserting claims can greatly minimize costs and surprises. In addition, specialized claim forms make the process easier for all parties and have been embraced by the courts.

Debtors, creditors and their corporate restructuring professionals must be thorough in evaluating and choosing the most effective claims management strategy in order to successfully navigate the complex administrative challenges presented by 503(b)(9) claims.

NOTES

¹ This provision basically codifies the previous common practice of allowing creditors who would otherwise have a reclamation claim to instead obtain an administrative priority claim. In fact, Section 503(b)(9) was added to the Code in a section called "Reclamation." However, by allowing the creditor to control the claim, as opposed to allowing the debtor to dole out such claims solely at their own discretion, the number of claims becomes unmanageable in some cases.

² *In re Circuit City Stores Inc.*, No. 08-35653, 2010 WL 1451338 (Bankr. E.D. Va. Apr. 8, 2010).

³ *In re Plastech Engineered Prods.*, 397 B.R. 828 (Bankr. E.D. Mich. 2008).

⁴ *In re Pilgrim's Pride*, 421 B.R. 231 (Bankr. N.D. Tex. 2009).

⁵ *In re Samaritan Alliance LLC*, No. 07-50735, 2008 WL 2520107 (Bankr. E.D. Ky. 2008).

⁶ *In re Erving Indus.*, No. 09-30623, 2010 WL 1416148 (Bankr. D. Mass. Apr. 7, 2010).

⁷ The exception is claims made by petitioning creditors in an involuntary bankruptcy filing for the costs and expenses associated with the petition, which is an extremely limited circumstance.

⁸ *In re Plastech Engineered Prods.*, 394 B.R. 147, 150 (Bankr. E.D. Mich. 2008).

⁹ *In re Circuit City Stores*, 426 B.R. 560 (Bankr. E.D. Va. 2010).

¹⁰ *In re Associated Grocers*, 375 B.R. 873 (B.A.P. 9th Cir. 2007).

- ¹¹ Counsel that is not otherwise creating special procedures for Section 503(b)(9) claims should consider adding language to the standard bar date notice to specifically include Section 503(b)(9) claims to eliminate ambiguity.
- ¹² *In re BFW Liquidation LLC*, No. 09-00634, order entered (Bankr. N.D. Ala. Apr. 23, 2009).
- ¹³ *In re Hub Holding Corp. et al.*, No. 09-11770, order entered (Bankr. D. Del. June 17, 2009); *In re Tweeter Home Entmt.*, No. 07-10787, order entered (Bankr. D. Del. June 14, 2007).
- ¹⁴ See *In re Circuit City*, 426 B.R. 560.
- ¹⁵ *In re Dura Auto. Sys.*, 403 B.R. 300 (D. Del. 2009).
- ¹⁶ See *In re Circuit City*, 426 B.R. 560.
- ¹⁷ *In re Tweeter Home Entmt.*, supra note 13.
- ¹⁸ *In re Pilgrim's Pride Corp.*, No. 08-45664, motion granted with modification (Bankr. N.D. Tex. Dec. 30, 2008).
- ¹⁹ *In re SemCrude LP*, No. 08-11525, order entered (Bankr. D. Del. Sept. 16, 2008).
- ²⁰ *In re SemCrude LP*, 416 B.R. 399 (Bankr. D. Del. 2009).



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