NOTE

SHOULD CONGRESS REPEAL BANKRUPTCY CODE SECTION 503(B)(9)?

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INTRODUCTION

Perhaps no other amendment under the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA")[1] has gained as much notoriety in the last few years as section 503(b)(9).[2] Since October 17, 2005,[3] this section has provided vendors with an administrative expense claim for "the value of any goods received by the debtor within 20 days" pre-petition where the goods were sold to the debtor in its "ordinary course of business."[4] These "twenty-day" claims are unique because they cannot be paid in part or *pro rata* like general unsecured claims, nor can they be paid over time through a reorganization plan like secured claims.[5] Rather, all twenty-day claims must be paid *in full in cash on the effective date* of the plan.[6]

Section 503(b)(9) represents a "dramatic departure from bankruptcy precedent" because it primarily converts vendors who, pre-BAPCPA, were general unsecured creditors entitled to mere pennies on the dollar—if anything—under a

[1] Pub. L. No. 109-8, 119 Stat. 23 (codified as amended in scattered sections of 11 U.S.C.).

[2] 11 U.S.C. § 503(b)(9) (2006).

[3] *See* Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 1501, 119 Stat. 23, 216–17 (implementing Bankruptcy Code amendments 180 days after Act approval on April 20, 2005).

[4] 11 U.S.C. § 503(b)(9).

[5] *See id.* § 1129(a) (requiring all administrative expense claims be paid on plan implementation date); *see also In re* DFI Proceeds, Inc., No. 08-119552009, 2009 Bankr. LEXIS 4296, at *1–2 (Bankr. N.D. Ind. Dec. 21, 2009) (explaining Congress "created something of a chimera" with section 503(b)(9) by providing administrative expense based on pre-petition debt without connection to post-petition events); Ryan T. Routh, *Twenty-Day Claims: The Anticipated and Unanticipated Consequences of Code §503(b)(9)*, AM. BANKR. INST. J., Nov. 2006, at 24 (2006) (describing twenty-day claims as "hybrid" of pre-petition claim and administrative expense claim).

[6] *See infra* note 44 and accompanying text.

reorganization plan into a class that must be fully compensated before a reorganization plan may be implemented.[7] Consequently, twenty-day claimants can exact considerable leverage over a bankruptcy and their sheer numbers may ultimately dictate the success of a reorganization by chilling the debtor in possession ("DIP") financing market.[8] The section most directly impacts restaurants and retailers, which often have high inventory turnover rates and, therefore, significant twenty-day claims liability.[9] For many large retail debtors like Circuit City, Linens N' Things, Tweeter, and Sharper Image, the millions of dollars required to pay twenty-day claims have been an insurmountable hurdle to a successful non-liquidation reorganization.[10] According to one report, only three

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[7] *See* Lauren C. Cohen, *The Application of Section 502(d) to Section 503(b)(9) Claims–"You Can Put Lipstick on a Pig,"* 18 NORTON J. BANKR. L. & PRAC. 259, 261 (2009) (exploring disparate treatment of similarly situated creditors when section 503(b)(9) is applied); *see also* Brett Berlin et al., *Symposium: Business Bankruptcy Panel: Hot Topics In Retail Bankruptcy*, 25 EMORY BANKR. DEV. J. 343, 364–65 (2009) (stating section 503(b)(9) converts millions in unsecured debt, formerly handled in plans, into administrative expense claims); Valerie P. Morrison & Rebecca L. Saitta, *Impact of the Bankruptcy Abuse Prevention and Consumer Protection Act on Franchisee Reorganizations Under Chapter 11*, 27 FRANCHISE L.J. 125, 128 (2007) ("Under prior law, such claims were relegated to nonpriority general unsecured status."). Although, unique situations may arise where section 503(b)(9) will have no effect on a reorganization. *See In re* Henry S. Miller Commercial, LLC, No. 09-34422-SGJ-11, 2010 WL 4818096, at *3 (Bankr. N.D. Tex. Nov. 9, 2010) (holding no twenty-day claims where debtor discontinued operations pre-petition).

[8] *See In re* Brown & Cole Stores, LLC, 375 B.R. 873, 878 n.8 (B.A.P. 9th Cir. 2007) ("Congress gave tremendous leverage to a twenty-day sales claimant . . . permitting it to demand full payment as of confirmation . . . perhaps dramatically affecting the outcome the case."); *Circuit City Unplugged: Why Did Chapter 11 Fail to Save 34,000 Jobs?: Hearing Before the Subcomm. on Commercial and Admin. Law of the H. Comm. on the Judiciary*, 111th Cong. 35 (2009) [hereinafter *Circuit City Unplugged*] (prepared statement of Richard M. Pachulski, Counsel, Circuit City Creditors' Committee) (opining Circuit City reorganization impossible without sufficient funds to settle all section 503(b)(9) administrative expenses); *see also* Morrison & Saitta, *supra* note 7, at 129 (stating increased likelihood of administrative claims qualification under section 503(b)(9) will give franchisor creditors greater bargaining power in franchisee reorganizations, but could create "delays due to protracted vendor negotiations, below-market sales transactions, or, worse, liquidations of businesses that otherwise could be rehabilitated").

[9] *See, e.g., Lehman Brothers, Sharper Image, Bennigan's and Beyond: Is Chapter 11 Bankruptcy Working?: Hearing Before the Subcomm. on Commercial and Admin. Law of the H. Comm. on the Judiciary*, 110th Cong. 32 (2008) [hereinafter *Is Chapter 11 Bankruptcy Working?*] (prepared statement of Lawrence C. Gottlieb, Esq., Cooley Godward Kronish LLP) (stating section 503(b)(9) presents severe liquidity concerns for high volume retailers who must fully pay administrative expense claims before reorganization plan implementation); Michael G. Wilson & Henry P. "Toby" Long III, *Section 503(b)(9)'s Impact: A Proposal To Make Chapter 11 Viable Again For Retail Debtors*, AM. BANKR. INST. J., Feb. 2011, at 20 (suggesting insufficient funds for section 503(b)(9) claims have sometimes precluded retailers from reorganizing); *see also In re* Bashas' Inc., 437 B.R. 874, 895, 929 (Bankr. D. Ariz. 2010) (approving debtor-grocery store chain plan allocating $29,653,056 for twenty-day claims).

[10] *See In re* Plastech Engineered Prods., Inc. ("*Plastech III*"), 394 B.R. 147, 151 (Bankr. E.D. Mich. 2008) (commenting on debtor's inability to fully pay twenty-day claims and "significant differences in the treatment of pre-petition debts of creditors who otherwise appear to be similarly situated"); *see also Circuit City Unplugged*, *supra* note 8, at 26 (testimony of Richard M. Pachulski, Attorney, Pachulski Stang Ziehl & Jones, LLP) ("[I]f the economy and the bank group's DIP financing did not destroy any chance of Circuit City having sufficient time to achieve internal reorganization by downsizing or selling Circuit City's businesses, bankruptcy code Section 503(b)(9) was the final death knell."); Biana Borukhovich, *BAPCPA:*

retailers have successfully reorganized since BAPCPA, due in part to the effects of section 503(b)(9).[11]

In fundamentally altering a debtor's prospect for reorganization, section 503(b)(9) was destined to be challenged, but Congress is still primarily responsible for much of the needless litigation arising under the section. Congress failed to provide any legislative history on why section 503(b)(9) was necessary or what the provision attempted to accomplish.[12] Only theories abound: Is section 503(b)(9) Congress's attempt to codify the longstanding practice of paying certain pre-petition claims of vendors through so-called "critical vendor orders"? Was Congress trying to punish debtors for stockpiling goods shortly before filing bankruptcy? Or did Congress believe section 503(b)(9) would strengthen a vendor's pre-existing right to reclaim goods? None of these theories hold water when measured against the statutory language of section 503(b)(9).

The lack of legislative history means that courts cannot turn to any guideposts when they must resolve any number of section 503(b)(9)'s textual ambiguities. Since section 503(b)(9)'s enactment, commentators and practitioners alike readily recognized that this relatively terse provision leaves key terms undefined and creates significant case administration issues.[13] Moreover, in crafting a provision with such far-reaching implications, Congress—save for one exception—did not amend any other Bankruptcy Code ("Code") section to explicitly account for section 503(b)(9).[14] This creates significant problems where, at every turn, creditors are arguing that the section should be read expansively and debtors are trying to cabin the effects of the section.

Nail In the Coffin For Retailers, 6 PRATT'S J. BANKR. L. 455, 463–64 (2010) (explaining section 503(b)(9) creates particularly enormous obstacle to successful reorganization in mid-size and large retail cases).

[11] *See* Borukhovich, *supra* note 10, at 458.

[12] *See infra* note 66.

[13] *See, e.g.*, David G. Epstein, *BAPCPA and Commercial Credit: Who (Sic) Do You Trust?*, 10 N.C. BANKING INST. 57, 67 (2006) (highlighting "muddiness" of section 503(b)(9)); Richard Levin & Alesia Ranney-Marinelli, *The Creeping Repeal of Chapter 11: The Significant Business Provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, 79 AM. BANKR. L.J. 603, 607 (2005) ("[Section] 503(b)(9) is so poorly drafted that it is not even expressly dependent on nonpayment prepetition."); Alan N. Resnick, *The Future of the Doctrine of Necessity and Critical-Vendor Payments in Chapter 11 Cases*, 47 B.C. L. REV. 183, 204–05 (2005) (emphasizing Code does not specify time of payment under statute and language leaves open definition of "value"); Routh, *supra* note 5, at 80 (recognizing various future twenty-day claims litigation issues spurned by lack of statutory explanation and legislative guidance).

[14] *See* Frederick J. Glasgow III, Comment, *Reclaiming the Defenses to Reclamation*, 26 EMORY BANK. DEV. J. 301, 315 (2010) (concluding section 546(c)(2) as sole statutory reference to section 503(b)(9) after studying entire Code); *see also In re* Commissary Operations, Inc., 421 B.R. 873, 879 (Bankr. M.D. Tenn. 2010) ("Congress did not amend section 547(c)(4) to include a new subsection reducing new value by the amount of any section 503(b)(9) claim."); Paul R. Hage & Patrick R. Mohan, *Is it Still New Value? Application of Section 503(b)(9) to the Subsequent New Value Preference Defense*, 19 NORTON J. BANKR. L. & PRAC. 469, 471 (claiming addition of section 503(b)(9) poses problems in connection with unchanged new value exception under 547(c)(4)).

Without defined terms and any indication as to how section 503(b)(9) is to operate with other Code provisions, courts apply their own definitions and form conclusions, often based on whichever policy consideration they assume Congress intended or deem most persuasive. Unsurprisingly, the case law reveals a remarkable divergence over nearly every legal issue involving section 503(b)(9), highlighting the growing potential for forum shopping. Given all the problems associated with section 503(b)(9), increasingly commentators argue that the section should be reformed[15] or, as one congressman proposes, repealed.[16]

This Note argues that, unless Congress provides some sort of legislative gloss on why section 503(b)(9) was passed and then revises the section to advance that objective, section 503(b)(9) should be repealed. In reaching this conclusion, this Note analyzes section 503(b)(9), the current case law, and several reform proposals. Specifically, Part I discusses the bankruptcy landscape prior to section 503(b)(9)'s enactment, including the state of critical vendor orders and the growing rift between courts highlighted by the Seventh Circuit's *K-Mart* decision. Part II provides an overview of section 503(b)(9), including its statutory operation, its effect on critical vendor orders, and the Congressional theories behind the section. Part III highlights where the current section 503(b)(9) case law now stands. Finally, Part IV offers several proposals that would address some of the problems section 503(b)(9) raises.

I. LANDSCAPE BEFORE SECTION 503(B)(9)

Shortly before Congress enacted section 503(b)(9), a growing rift had developed between jurisdictions and their treatment of certain pre-petition claims. This time period is integral to understanding section 503(b)(9)'s impact on bankruptcy practice.

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[15] *See* Borukhovich, *supra* note 10, at 477 (arguing section 503(b)(9) should be amended); *see also* Wilson & Long, *supra* note 9, at 21, 57 (proposing overhaul of section 503(b)(9)); *Is Chapter 11 Bankruptcy Working?*, *supra* note 9, at 71 (response to post-hearing questions from Lawrence C. Gottlieb, Esq., Cooley Godward Kronish LLP, New York, NY) (proposing section 503(b)(9) be amended so vendors receive mere priority claim for goods sold to debtor 10 to 15 days pre-petition).

[16] See Representative Jerrold Nadler (D-NY) and his proposed bill, Business Reorganization and Job Protection Act of 2009, H.R, 1942, 111th Cong. (1st Sess. 2009), which would eliminate section 503(b)(9) from the Bankruptcy Code. *But see* Connor Bifferato, Kevin Collins & Thomas Driscoll, *Reclamation Post-BAPCPA; An Uphill Battle For Suppliers*, 6 No. 9 ANDREWS BANKR. LITIG. REP. 1 (2009), *available at* 6 no. 9 ANBKRLR 1 ("[Section 503(b)(9)] only goes halfway and still favors secured lenders and debtors, leaving suppliers to bear the majority of risk."); Bruce S. Nathan et. al, *BAPCPA Rollback As A Cure For Unsuccessful Reorganizations? Not So Fast!*, BUS. REORGANIZATION COMM. NEWSL. (Am. Bankr. Inst., Alexandria, Va.), Mar. 2010, http://www.abiworld.org/committees/newsletters/busreorg/vol9num4/not_so_fast.pdf (likening repeal of section 503(b)(9) as "akin to prescribing that a patient's limb be amputated to cure a sprain—the proposed cure is unrelated to the illness").

A. Prevalence of "Critical Vendor" Orders

In the early 2000s, many courts became frustrated with the increasingly liberal grounds with which bankruptcy courts were entering "critical vendor orders." Critical vendors supply "goods or services that are deemed so essential to the debtor's business that if the vendor were to stop doing business with the company, the viability of the company would be put at risk."[17] Typically, these vendors are "either sole-source suppliers of branded products or original equipment manufacturers, whose goods or services cannot be readily obtained elsewhere."[18] Given their unique characteristics, these vendors leverage their status by "refus[ing] to provide goods or services unless their prepetition balances are paid in part or full" ahead of senior creditors.[19]

Critical vendor orders, which persist today, are problematic for several reasons. First, as evidenced by the K-Mart decision discussed *infra*,[20] these orders are often made without a finding that a creditor is critical or would stop doing business with the debtor.[21] Second, these orders are typically included in larger "first day orders" made on the date of the bankruptcy filing with little or no notice to senior creditors.[22] Third, because most vendors deemed "critical" are unsecured creditors, these orders circumvent the repayment priority hierarchy known as the "absolute priority rule," which generally holds that secured creditors must be paid ahead of unsecured creditors.[23]

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[17] Shirley S. Cho, *The Intersection of Critical Vendor Orders and Bankruptcy Code § 503(b)(9)*, 29 CAL. BANKR. J. 7, 8 (2007) [hereinafter Cho, *Intersection*].

[18] *Id.*

[19] *Id.*

[20] *See infra* notes 27–40 and accompanying text.

[21] *See In re* K-Mart Corp., 359 F.3d 866, 869 (7th Cir. 2004) (finding lower court granted critical vendor order without any evidence indicating vendors would discontinue business with debtor); *see also In re* Payless Cashways, Inc., 268 B.R. 543, 544 (Bankr. W.D. Mo. 2001) (allowing critical vendor motion where no objection from creditors); Travis N. Turner, *Kmart and Beyond: A "Critical" Look at Critical Vendor Orders and the Doctrine of Necessity*, 63 WASH. & LEE L. REV. 431, 441 (2006) (noting critical vendor motions are usually made and approved on first day of case before affected creditors have notice or opportunity to object); Michael St. James, Book Note, *Why Bad Things Happen in Large Chapter 11 Cases: Some Thoughts About Courting Failure*, 7 TRANSACTIONS TENN. J. BUS. L. 169, 173 (2005) (reviewing LYNN M. LOPUCKI, COURTING FAILURE: HOW COMPETITION FOR BIG CASES IS CORRUPTING THE BANKRUPTCY COURTS) (noting debtors often forum shop for courts willing to enter critical vendor orders).

[22] *See* Official Comm. of Unsecured Creditors of Cybergenics Corp. v. Chinery, 330 F.3d 548, 574 n.8 (3d Cir. 2003) ("Large corporate debtors routinely seek so-called 'first-day' orders, in which they ask the bankruptcy court to approve . . . the payment of pre-petition claims of critical vendors . . . ."); *In re* Corner Home Care, Inc., 438 B.R. 122, 126 (Bankr. W.D. Ky. 2010) (cautioning against "critical vendor motions [that] have become standard operating procedure as part of first day orders"); Frederick Tung, *The New Death of Contract: Creeping Corporate Fiduciary Duties for Creditors*, 57 EMORY L.J. 809, 833 n.100 (2008) ("[T]he package of first-day orders the judge signs more and more commonly includes an order approving payments to critical vendors.").

[23] *See* 11 U.S.C. § 1129(b) (2006) (codifying absolute priority rule); Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 202 (1988) ("[T]he absolute priority rule 'provides that a dissenting class of unsecured creditors must be provided for in full before any junior class can receive or retain any property [under a reorganization] plan.'" (quoting Ahlers v. Norwest Bank Worthington (*In re* Ahlers), 794 F.2d 388, 401 (8th

Although these orders are not expressly mentioned in the Code and may violate the absolute priority rule, courts justify critical vendor orders on "a variety of common law and statutory interpretations," including the "doctrine of necessity" said to derive from section 105.[24] This section allows a court to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the Code]."[25] Therefore, as long as a court finds a critical vendor motion "necessary" to enforce *any* provision of the Code, the motion can be granted. For example, courts often use section 364, which authorizes a debtor to obtain post-petition credit, as a basis for necessitating a critical vendor order when a vendor refuses to make a loan unless some or all of its pre-petition debt is paid.[26]

B. Backlash Against Critical Vendor Orders: The K-Mart Decision

The hostility towards critical vendor orders is best illustrated with the Seventh Circuit's *In re K-Mart* ("*K-Mart*")[27] decision in 2004. In *K-Mart*, on the same day the debtor filed for bankruptcy, the bankruptcy court granted the debtor's critical vendor motion, citing the doctrine of necessity.[28] The court's order gave the debtor "openended permission to pay any debt to any vendor it deemed 'critical' in the exercise of unilateral discretion, provided that the vendor agreed to furnish goods on 'customary trade terms' for the next two years."[29] In effect, the debtor could use some $320 million to pay any vendors it deemed critical.[30] Capital Factors, a major creditor owed $20 million dollars, apparently not considered critical by K-Mart, objected to the court's order.[31] The bankruptcy court overruled Capital Factors'

Cir. 1986))); *In re* Arts Dairy, LLC, 414 B.R. 219, 222 (Bankr. N.D. Ohio 2009) (explaining absolute priority rule requires paying secured creditors before unsecured creditors, and unsecured creditors before equity interests).

[24] Cho, *Intersection*, *supra* note 17, at 8–9 (discussing doctrine of necessity and section 105(a) being among several pre-BAPCPA court justifications for critical vendor payments); *see also In re Corner Home Care*, 438 B.R. at 125 (mentioning doctrine of necessity origins and eventual application to critical vendor motions); Scott L. Hazan & John C. Wright, *Vendor and Debtor Issues and Possible Solutions in the "Modern" Retail Chapter 11: Are These Really New or is this "Déjà Vu All Over Again?,"* Am. Bankr. Inst. N.Y.C. Bankr. Conference (May 4, 2009), *available at* 050409 ABI-CLE 405 ("The statutory authority for critical vendor relief is dissimilar to Section 503(b)(9) in that it is not expressly set forth in the Bankruptcy Code.").

[25] 11 U.S.C. § 105(a).

[26] *See id.* § 364(b) ("The court, after notice and a hearing, may authorize the trustee to obtain unsecured credit or to incur unsecured debt other than under subsection (a) of this section, allowable under section 503(b)(1) of this title as an administrative expense."); *In re Payless Cashways, Inc.*, 268 B.R. at 544 (allowing debtor's motion to pay pre-petition debts to critical vendors pursuant to section 364(b)); Cho, *Intersection*, *supra* note 17, at 10 (discussing authorization of critical vendor payments under section 364(b) under theory payments analogous to extension of credit).

[27] *In re* K-Mart Corp., 359 F.3d 866 (7th Cir. 2004).

[28] *Id.* at 868.

[29] *Id.* at 868–69.

[30] *See* Resnick, *supra* note 13, at 197.

[31] *Id*.

objection and, despite refusing to stay its decision, Capital Factors appealed.[32] Meanwhile, K-Mart proceeded to pay $300 million to 2330 other vendors it deemed "critical."[33]

On appeal, the district court reversed, holding that the bankruptcy court had used section 105 to "add on to the Code" and had rearranged the Code's repayment hierarchy without articulating any applicable authority for doing so.[34] But in affirming the district court, the Seventh Circuit, through Judge Easterbrook, used the critical-vendor order as an opportunity to reign in a practice the court viewed as an affront to the Code. The court held that "a 'doctrine of necessity' is just a fancy name for a power to depart from the Code" and rejected sections 105 and 364 as authorizing critical-vendor payments.[35] The court was further dumbfounded by the fact that K-Mart made its "largest critical vendor payment" to a vendor *already obligated to make deliveries* to it under a long-term, non-terminable contract.[36]

Ultimately, the Seventh Circuit did not prohibit critical vendor orders, but instead raised the bar for granting them.[37] The court left open the possibility that section 363(b)(1), which governs the sale of the debtor's property, could provide a basis for authorization.[38] However, to invoke this section, the debtor would have to meet an exacting standard:

> [T]he debtor must *prove*, and not just allege, two things: that, but for immediate full payment, vendors *would* cease dealing; and that the business will gain enough from continued transactions with the favored vendors to provide some residual benefit to the remaining, disfavored creditors, or at least leave them no worse off.[39]

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[32] *Id.*

[33] *In re K-Mart Corp.*, 359 F.3d at 869. K-Mart's remaining 2000 creditor-vendors were eventually paid approximately 10% of their claims under a chapter 11 reorganization plan. *Id.*

[34] Capital Factors, Inc. v. K-Mart Corp., 291 B.R. 818, 822–23 (N.D. Ill. 2003) (stating equitable powers in section 105 only allow bankruptcy courts to enforce provisions of Code, not to add on to Code as they see fit); Resnick, *supra* note 13, at 198 ("[T]he district court concluded that the bankruptcy court had impermissibly altered the priority scheme set forth in the Bankruptcy Code without articulating any applicable authority to support doing so and, therefore, its critical-vendor order could not be allowed to stand.").

[35] *In re K-Mart Corp.*, 359 F.3d at 871–72.

[36] *Id.* at 873.

[37] *See id.* at 871.

[38] Resnick, *supra* note 13, at 200; *see In re K-Mart Corp.*, 359 F.3d at 872 (noting section 363(b)(1) is more promising source of authority for critical vendor orders than section 364(b) even though order failed regardless); Mark. A. McDermott, *Critical Vendor and Related Orders: Kmart and the Bankruptcy Abuse Prevention and Consumer Protection Act of* 2005, 14 AM. BANKR. INST. L. REV. 409, 418 (2006) (cautioning against Seventh Circuit's suggested use of section 363(b)(1) as legal authority for critical vendor payments because of Code's established payment priorities).

[39] *In re K-Mart Corp.*, 359 F.3d at 868; *see* Resnick, *supra* note 13, at 201 (reading *K-Mart* to require debtor to prove "vendor would, in fact, refuse to make future deliveries, even if not obligated to do so under a prepetition contract").

Clearly, the court's new standard would preclude bankruptcy courts from rubber-stamping critical vendor orders.

While *K-Mart* only extends to the Seventh Circuit, the decision "exemplifie[d] the trend in the appellate courts of limiting bankruptcy courts' previously broad discretion to authorize a debtor to pay prepetition claims outside of a plan of reorganization."[40] The growing division between courts and their criteria for granting critical vendor motions may have prompted vendors to lobby Congress—at the time drafting BAPCPA—for statutory protection. However, whether section 503(b)(9) meant to explicitly tackle critical vendor orders is far from clear.

II. OVERVIEW OF SECTION 503(B)(9)

In considering whether section 503(b)(9)'s enactment, a mere one year after *K-Mart*, was a Congressional reaction to the state of critical vendor jurisprudence, it is first necessary to analyze what the provision does. This Part will then discuss section 503(b)(9)'s effect on critical vendor orders and the Congressional theories for the section.

A. Section 503(b)(9) and the Nature of an Administrative Expense

As mentioned earlier, section 503(b)(9) creates a new type of administrative expense. The section provides:

> (b) After notice and a hearing, there shall be allowed administrative expenses, other than claims allowed under section 502(f) of this title [governing involuntary bankruptcies], including—
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> (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.[41]

Administrative expenses are a subcategory of unsecured claim, which differ from general unsecured claims by virtue of sections 507(a)(2) and 1129(a)(9)(A).[42] Under section 507(a)(2), administrative claims are paid second in priority to domestic support obligations and costs incurred by a trustee ,while most general unsecured

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[40] Resnick, *supra* note 13, at 203.

[41] 11 U.S.C. § 503(b)(9) (2006). BAPCPA also created two other administrative expense categories in sections 503(b)(7) and (8). *Id.* § 503(b)(7) (dealing with certain nonresidential real property leases); *id.* § 503(b)(8) (providing expense for costs associated with closing health care business).

[42] *See id.* §§ 507(a)(2), 1129(a)(9)(A); *accord* Aaron G. York, *Protecting Trade Creditors' Right in Bankruptcy*, AM. BANKR. INST. J., Sept. 2010, at 52 (noting 503(b)(9) claims are given priority payment under section 507(a)(2), and section 1129(a)(9)(A) states plans cannot be confirmed unless they provide for payment of claims under section 507(a)(2)).

claims are paid third in priority under section 507(a)(3).[43] Moreover, unlike other priority claims that can be paid through a reorganization plan, administrative expenses must be fully paid in cash on the effective date of the plan under section 1129(a)(9)(A), unless the claimant agrees to alternative treatment.[44]

Notably, almost all of the nine listed administrative expenses under section 503(b) consist of unsecured post-petition costs incurred in the administration of the estate.[45] Apart from sections 503(b)(3) and 503(b)(4) which involve filing fees in an involuntary bankruptcy, section 503(b)(9) is the only other administrative expense arising pre-petition.[46] Section 503(b) is a non-exhaustive list of administrative expenses, but unlisted claims can only qualify under section 503(b)(1)(A) if they are related to "the actual, necessary costs and expenses of preserving the estate."[47] Courts also narrowly construe section 503(b)(1)(A) because granting an

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[43] 11 U.S.C. § 507 (ranking payment priorities).

[44] *See id.* § 1129(a)(9)(A); *In re* Arts Dairy, LLC, 414 B.R. 219, 221 (Bankr. N.D. Ohio 2009) (noting section 1129(a)(9) requires payment of all administrative expenses claims on earlier of plan implementation date or plan confirmation date); *In re* S. Star Oil Co., No. 08-61072-fra11, 2008 WL 4224498, at *2 (Bankr. D. Or. Sept. 15, 2008) ("Unless the holder of the claim agrees to different treatment, a claim allowed under § 507(a)(2) must be paid in full on the effective date of the plan."); Chad P. Pugatch, Craig A. Pugatch & Travis Vaughan, *The Lost Art of Chapter 11 Reorganization*, 19 U. FLA. J.L. & PUB. POL'Y 39, 70 (2008) (stating section 503(b)(9) means debtor must pay all administrative claims in cash by effective date of plan). A few cases do exist where twenty-day claimants have agreed to different treatment. *See, e.g.*, *In re* Jennifer Convertibles, Inc., No. 10-13779(ALG), 2011 WL 350507, at *1 (Bankr. S.D.N.Y. Feb. 4, 2011) (approving reorganization plan where creditor agreed "to allow its substantial § 503(b)(9) priority claims to be treated *pari passu* with allowed general unsecured claims"); *In re* Benchmark Homes, Inc., Nos. BK06-80243-TJM, BK06-80248-TJM, BK06-80249-TJM, BK06-80250-TJM, BK06-80251-TJM, 2008 WL 4844122, at *1 (Bankr. D. Neb. Oct. 30, 2008) (recalling claimants entered stipulated agreement to set off secured claims from payment of twenty-day claims); *see also In re* Dana Corp., 350 B.R. 144, 146 (Bankr. S.D.N.Y. 2006) (noting parties made settlement agreement to resolve any disputes concerning creditor's twenty-day claim by arbitration).

[45] *See* 11 U.S.C. § 503(b) (listing administrative expenses); Laura B. Bartell, *Straddle Obligations under Prepetition Contracts: Prepetition Claims, Postpetition Claims or Administrative Expenses?*, 25 EMORY BANKR. DEV. J. 39, 41 (2008) (noting two itemized expenses under section 503(b) arise post-petition).

[46] *See* 11 U.S.C. § 503 (b)(3), (4) (giving administrative expense priority for preparations relating to filing of involuntary bankruptcy petition under section 303); *In re* DFI Proceeds, Inc., No. 08-119552009, Bankr. LEXIS 4296, at *2 (Bankr. N.D. Ind. Dec. 21, 2009) (noting section 503(b)(9) is unique because it provides administrative expense based on pre-petition debt without connection to bankruptcy estate); *In re* TI Acquisition ("*TI Acquisition I*"), 410 B.R. 742, 745 (Bankr. N.D. Ga. 2009) ("§ 503(b)(9) joins §§ 503(b)(3)(A), 503(b)(3)(E) and 503(b)(4) in describing pre-petition expenses that are to be accorded administrative expense priority.").

[47] 11 U.S.C. § 503(b)(1)(A). Section 503(b)(1)(A) administrative expense claims are narrowly construed, and jurisdictions vary on what costs are "actual" and "necessary" for estate preservation. *See* Cohen, *supra* note 7, at 260 ("The term 'administrative expense' is not clearly defined in the Bankruptcy Code . . . [but] [c]ourts have typically found that a claim is an administrative expense if '(1) it arose from a transaction with the bankruptcy estate and (2) directly and substantially benefited the estate.'"); *see also In re* Williams, 246 B.R. 591, 594 (B.A.P. 8th Cir. 1999) (reaffirming well-settled law requiring transactions be with estate and to benefit estate for administrative expense classification); *In re* Bridgeport Plumbing Prods., 178 B.R. 563, 566 (Bankr. M.D. Ga. 1994) (stating terms "actual" and "necessary" require actual benefit received by estate for classification as administrative expense).

administrative expense claim will deplete the cash available to the estate.[48] Moreover, because twenty-day claims under section 503(b)(9) claims "by definition" arise pre-petition,[49] well before an estate is created, the section primarily applies to vendors that would otherwise lack administrative priority status and be classified as general unsecured creditors.[50]

However, the priority status conferred by section 503(b)(9) is not absolute. If a case is converted to chapter 7, any chapter 7 administrative expenses will take priority over chapter 11 and chapter 13 administrative expenses.[51] Consequently, twenty-day claimants vehemently contest conversion with some surprising success. For example, in *In re South Star Oil*,[52] the U.S. Trustee and certain creditors moved to appoint a trustee or, alternatively, convert the case where a vendor holding a $1.51 million twenty-day claim refused to settle for less than full payment.[53] The debtor had been unprofitable for three years and had incurred over $3.6 million in unsecured debt.[54] Conversion seemed like the best option, given the debtor's longstanding unprofitability and the court's own conclusion that there was no

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[48] *See In re* Hemingway Transp., 954 F.2d 1, 4–5 (1st Cir. 1992) (noting strict construction of administrative expenses under section 503 to maximize distribution for creditors); *In re* Pilgrim's Pride Corp., 421 B.R. 231, 240 (Bankr. N.D. Tex. 2009) (construing priority claims narrowly due to special treatment afforded claimants); Wilson & Long, *supra* note 9, at 20–21, 57 (noting underlying Code policy of limiting administrative expense provisions to ensure debtor has chance to reorganize).

[49] *In re* Circuit City Stores, Inc. ("*Circuit City II*"), 426 B.R. 560, 571 (Bankr. E.D. Va. 2010); *In re DFI Proceeds, Inc.*, 2009 Bankr. LEXIS 4296, at *1 (noting section 503(b)(9) creates administrative expense claim arising pre-petition); *In re* Bookbinders' Rest., Inc., No. 06-12302ELF, 2006 WL 3858020, at *3–4 (Bankr. E.D. Pa. Dec. 28, 2006) (recognizing previous pre-petition claims as valid administrative expense claims).

[50] Michael D. Zaverton, *Show Me The Money! Bankruptcy Claims Under Section 503(b)(9) Part 2: Getting Paid For Goods Sold 20 Days Before A Customer's Bankruptcy*, WESTLAW J. OF BANKR., Jan. 7, 2011 [hereinafter Zaverton, *Show Me the Money! II*] ("Clearly, this provision is a great boon for businesses that sell goods on credit. Before this change was made, claims related to pre-petition sales of goods generally were treated as unsecured claims and last in line for payment from the debtor's bankruptcy estate."); Morrison & Saitta, *supra* note 7, at 128 ("Under prior law, such claims were relegated to nonpriority general unsecured status."); *see infra* note 48. *But see In re* Rio Valley Motors Co., LLC, No. 11-06-11866-SS, 2008 WL 824271, at *1–2 (Bankr. D.N.M. Mar. 24, 2008) (providing potential example where twenty-day claimant could alternatively have administrative priority status under section 503(b)(1)(A)); *infra* Part III.B.

[51] *See* 11 U.S.C. § 726(b) (ordering section 503 administrative expenses incurred in chapter 11 to lower priority than those incurred in converted chapter 7 cases); *In re* Hembree, 297 B.R. 515, 520 (Bankr. M.D. Tenn. 2002) (prioritizing section 503 claims from chapter 11 to be after those from chapter 7); Samuel K. Crocker & Robert H. Waldschmidt, *Impact of the 2005 Bankruptcy Amendments on Chapter 7 Trustees*, 79 AM. BANKR. L.J. 333, 342 (2005) (noting chapter 11 administrative expenses will not be accorded priority as high as chapter 7 trustees when converted). Although if a case is converted from chapter 7 to another chapter, the reverse is not necessarily true. *See* Crocker & Waldschmidt, *supra*, at 342 (noting, in cases originally under chapter 7, trustees might have to share administrative expense priority with pre-petition reclamation creditors); *see also* Alec P. Ostrow, *The Animal Farm of Administrative Insolvency*, 11 AM. BANKR. INST. L. REV. 339, 341 (2003) (articulating similar claims are classified in same classes under chapter 11, and likewise, debtors who received more would have to pay some back to ensure all similarly classed debtors receive their shares pro-rata).

[52] No. 08-61072-fra11, 2008 WL 4224498 (Bankr. D. Or. Sept. 15, 2008).

[53] *Id.* at *1.

[54] *Id.*

"reasonable likelihood of rehabilitation," but the court opted to appoint a trustee instead.[55] According to the court, dismissal would provide "a speedy liquidation of the debtor's assets, and payment of most of the secured debt," but it would also "severely prejudice" the twenty-day claimant by demoting its priority status.[56] Thus, in protecting the twenty-day claimant, the court forced the estate to bear the debtor's continuing operating losses and the additional costs of a trustee.[57]

B. Section 503(b)(9)'s Impact on Critical Vendor Orders

With an understanding of how section 503(b)(9) operates, it is clear that, from a statutory standpoint, the section does not explicitly address the *K-Mart* decision or critical vendor orders. Critical vendor orders are only implicated insofar as the section creates a statutory bright-line class of preferred vendors that are paid on certain pre-petition claims, potentially before other secured creditors.[58] Therefore, at least for those vendors that qualify under section 503(b)(9), the need to rely on critical vendor orders is arguably reduced.[59] But the section might have created a new kind of animal in that it lowers even the pre-*K-Mart* standard justifying payment of pre-petition claims because "[t]he debtor does not have to demonstrate that the creditor is 'critical' or that payment of the claim is necessary for a successful reorganization."[60]

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[55] *Id.* at *2–3.

[56] *Id.* at *3.

[57] *Id.*

[58] *See Circuit City Unplugged*, *supra* note 8, at 52 (statement of Todd J. Zywicki, Professor, George Mason School of Law) (arguing one purpose of section 503(b)(9) was to "rationalize this previously ad hoc 'critical vendor' analysis by replacing it with a statutory scheme that would serve the same function but without the apparent arbitrariness and unfairness of the discretionary 'critical vendor' regime"); *see also In re* HNRC Dissolution Co., 396 B.R. 461, 484 n.19 (B.A.P. 6th Cir. 2008) (illustrating "Congress demonstrated its ability to give statutory liabilities administrative status" in drafting section 503(b)(9)); *In re* Crawford, 420 B.R. 833, 840, 841 n.18 (Bankr. D.N.M. 2009) (using section 503(b)(9) as Code example where Congress drew "bright lines to be mechanically applied setting periods measured backwards from the commencement of a bankruptcy case").

[59] *See* Cohen, *supra* note 7, at 262 (noting there "has seemingly been a decrease in 'critical vendor' first-day motions, which have apparently been replaced with '503(b)(9) motions'"); *see also Circuit City Unplugged*, *supra* note 8, at 52 (statement of Todd J. Zywicki, Professor, George Mason School of Law) (speculating section 503(b)(9) "may not have created a major increase in overall administrative claims . . . when compared to the actual pre-BAPCPA practice"); Resnick, *supra* note 13, at 206 (believing reliance "on the doctrine of necessity to pay critical vendors will be reduced in future cases because of section 503(b)(9)").

[60] Resnick, *supra* note 13, at 205; *see* 1B-9 SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE § 9.17 (explaining section 503(b)(9) "is not limited to claims of vendors who may be deemed to be 'critical' to the reorganization effort"); Shirley S. Cho, *Chapter 11 Bankruptcy After BAPCPA—A Closer Look At: Critical Trade; Exclusivity; and Dismissal/Conversion*, 63 CONSUMER FIN. L.Q. REP. 79, 80 (2009) [hereinafter Cho, *Chapter 11*] ("[S]ection 503(b)(9) grants administrative priority not just to critical vendors, but to any provider of goods.").

Moreover, as a practical matter, section 503(b)(9) has not eliminated critical orders.[61] Courts continue to routinely approve critical vendor motions even where there are twenty-day claims.[62] Indeed, some courts have made critical vendor orders that pay certain twenty-day claimants before others.[63] Debtors still need to maintain

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[61] *See, e.g.*, *In re* Corner Home Care, Inc., 438 B.R. 122, 125 (W.D. Ky. 2010) ("[C]ritical vendor motions have become standard operating procedure as part of first day orders."); Cho, *Intersection*, *supra* note 17, at 11 (stating post-BAPCPA courts continue to allow critical vendor motions). Bankruptcy practitioner Shirley S. Cho argues that section 503(b)(9) "provides debtors with an additional weapon" that can be used "as an added justification for granting critical vendor motions." Cho, *Intersection*, *supra* note 17, at 11.

> The rationale advanced by debtors is that the BAPCPA now contemplates that suppliers of goods be paid ahead of unsecured creditors as administrative claimants, and because administrative claimants must be paid in full in order to confirm a reorganization plan, why not allow the debtor pay to the claimant at the beginning of the case?

Id. at 11–12. Thus, in cases where twenty-day claims constitute a majority of the trade creditor debt, "the critical vendor motion is, in actuality, nothing more than a request to expedite payment to a group of creditors that must be paid in full in any case." *Id* at 13. However, characterizing section 503(b)(9) as a "weapon" for debtors might be somewhat of a misnomer given that twenty-day claims are filed by creditors whereas critical vendor motions are made by debtors. *See id.* at 11–13.

[62] *See, e.g.*, Cho, *Chapter 11*, supra note 60, at 80 (surveying several unreported court orders approving pre-petition payment of essential twenty-day claimants); Timothy M. Lupinacci & Daniel J. Ferretti, *Recent Trends in Critical Vendor Jurisprudence Post-Kmart*, NORTON BANKR. L. ADVISER, Apr. 2009, at 1, 3 (noting most courts have not completely rejected doctrine of necessity and will typically only allow critical vendor payments when vendors hold twenty-day claims); *see also In re* Arts Dairy, LLC, 414 B.R. 219, 222 (Bankr. N.D. Ohio 2009) (finding no compelling reason why twenty-day claimants should be paid immediately pursuant to section 363(c)(2) where "[t]he Debtor, for example, did not identify the Claimants as a critical vendor, necessary for its reorganization"); *In re* Metaldyne Corp., No. 09-13412 MG, 2009 WL 2883045, at *5 (Bankr. S.D.N.Y. June 23, 2009) (approving DIP financing agreement where debtor indicated it might "pay some § 503(b)(9) claims as part its essential supplier budget"). Richard M. Pachulski, a practitioner who worked on the Circuit City bankruptcy, testified before Congress that the debtor could not avert liquidation in part because:

> most of the vendors . . . not only wanted their Section 503(b)(9) claims, they wanted critical-vendor status. So not only did you have a $215 million problem or $350 million [twenty-day claims] problem, you still had critical-vendor status. BAPCPA did not get rid of critical-vendor status. Cases today still have critical-vendor status. So this concept that somehow the 2005 amendments had anything to do with that is, frankly, preposterous . . . . [W]hat you effectively did is took one group of unsecured creditors and preferred them over other groups.

Circuit City Unplugged, *supra* note 8, at 113 (testimony of Richard M. Pachulski, Attorney, Pachulski Stang Ziehl & Jones, LLP).

[63] *See* Geoffrey S. Goodman, *Is the "Debtor-in-Possession" Not the "Debtor"? Post-petition Transfers and the Subsequent New-Value Defense*, AM. BANKR. INST. J., Sept. 2006, at 73 (discussing cases where "[c]hapter 11 debtors have already begun to seize upon § 503(b)(9) as a way to justify critical-vendor treatment"); *see also* Trey Monsour, *Do Vendors Have Too Much Power in Chapter 11 Cases?*, *in* CREDITORS' RIGHTS IN CHAPTER 11 CASES *4 (Aspatore 2010) ("Some courts recognized that some of the vendors that otherwise needed to be designated as critical were already eligible for administrative claim status pursuant to section 503(b)(9)."); Zaverton, *Show Me the Money! II*, *supra* note 50, at 2 ("Courts routinely enter orders that give Chapter 11 debtors discretionary authority to pay 503(b)(9) claims."). As discussed *infra* note 160 and Part III.B.2, determining when a claim must be paid is a discretionary issue.

post-petition business relationships and obtain DIP financing; immediately paying a creditor with a twenty-day claim can engender vital goodwill.[64] Moreover, in those rare cases where debtors can pay all of their twenty-day claims, paying some claims before others might not matter.[65]

C. Congressional Intent Behind Section 503(b)(9)

Understanding how section 503(b)(9) operates within the Code and how it may have impacted critical vendor orders is relatively clear, but determining what Congress intended with the section is anyone's guess. The legislative history on section 503(b)(9) is virtually nonexistent.[66] Congress included the section under the "Reclamation" section of BAPCPA, suggesting that it may have intended to fortify a vendor's right of reclamation as discussed below.[67] Others argue that section 503(b)(9) is simply the product of trade creditor association lobbying.[68]

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[64] *See In re Corner Home Care, Inc.*, 438 B.R. at 125 (noting sometimes post-petition payment on pre-petition debts is required for post-petition relationship and reorganization); *In re* Metaldyne Corp., No. 09-13412 MG, 2009 WL 2883045, at *5 (Bankr. S.D.N.Y. June 23, 2009) (showing debtor needed to pay certain twenty-day claimant suppliers to maintain post-petition business).

[65] *See* Cho, *Chapter 11*, supra note 60, at 79–80 ("[B]ecause administrative claimants must be paid in full in order to confirm a reorganization plan, why not allow the debtor to pay the claimant the beginning of the case.").

[66] *See In re* TI Acquisition ("*TI Acquisition I*"), 410 B.R. 742, 746 (Bankr. N.D. Ga. 2009) (explaining no legislative history exists for section 503(b)(9)); *In re* Plastech Engineered Prods., Inc. ("*Plastech I*"), 397 B.R. 828, 838 (Bankr. E.D. Mich. 2008) (noting debtor relied on scant legislative history of section 503(b)(9)); William J. Lafferty, *A Concern In Search of a Policy Why Paying Claims Under Section 503(b)(9) and Allowing Claimants to Use the Same Invoices as 'New Value' May Not Be 'Double Counting,'* WESTLAW J. BANKR., Nov. 12, 2010 ("The legislative history behind these amendments is sparse . . . It is unclear to what extent, if any, Congress gave thought to a myriad of issues that the enactment of Section 503(b)(9) created.").

[67] *See In re* Erving Indus., Inc., 432 B.R. 354, 360 (Bankr. D. Mass. 2010) (dismissing debtor's argument that Congress only intended goods reclaimable under section 546(c) to qualify under section 503(b)(9) based solely on section 503(b)(9)'s inclusion under BAPCPA's "Reclamation" heading); Carl N. Kunz III, *It's Not Double-Counting: Using §503(b)(9) Invoices as New Value Defense to Preferences*, AM. BANKR. INST. J., Apr. 2010, at 16 [hereinafter Kunz, *It's Not Double-Counting*] (stating legislative history "suggests that it was aimed at providing relief to sellers of goods who fail to give the required notice under the reclamation provisions of 546(c)").

[68] *See* ELIZABETH WARREN & JAY WESTBROOK, THE LAW OF DEBTORS AND CREDITORS TEXT, CASES, AND PROBLEMS 467 (6th ed. 2009) (crediting trade creditor lobbyists for expanded rights of reclamation through sections 503(b)(9) and 546(c)); McDermott, *supra* note 38, at 427 (stating after *K-mart* pressure existed from lobbyists to deal with critical vendors). Professor Alan N. Resnick suggests that section 503(b)(9) is a latter day incarnation of the "six months rule" which developed in response to railroad receivership cases in the late 1800s. Resnick, *supra* note 13, at 186–87. The rule gave "operating creditors" with claims arising six months before commencement of the receivership proceedings "equitable priority" over other unpaid secured creditors, including mortgagees:

> The justification for the doctrine was that it would be inequitable to operating creditors, supplying the necessary services and products for the railroad's continued existence and revenue generation, if the resulting operating revenue benefited secured creditors, who were not entitled to the operating revenue of the railroad until a receiver was appointed.

Id. at 187.

Nevertheless, over the past five years, four main theories continue to be advanced: (1) the critical vendor order replacement theory; (2) the continued dealings theory; (3) the stockpiling theory; and; (4) the reclamation fortification theory.

1. The Critical Vendor Order Replacement Theory

The critical vendor order replacement theory assumes Congress intended that section 503(b)(9) replace critical vendor orders.[69] Congressional intent can be discerned from the fact that section 503(b)(9) has mitigated the need for critical vendor motions in certain cases.[70] Moreover, by defining critical vendors as those that sell goods to the debtor twenty-days pre-petition, "[a]ll that 503(b)(9) does is rationalize and equalize what had been this ad hoc, and, really, unfair process of how people were being converted into critical vendors."[71] In other words, section 503(b)(9) provides a clear and streamlined mechanism for identifying who are critical vendors.[72]

However, if Congress sought to eliminate the need for critical vendor orders with a statutory provision, section 503(b)(9) certainly fails that goal.[73] First, section

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[69] *See, e.g.*, *Circuit City Unplugged*, *supra* note 8, at 46 (testimony of Todd J. Zywicki, Professor, George Mason School of Law) ("Section 503(b)(9) recognizes the need for the functions previously played by critical vendor orders."); Douglas G. Baird, *Essay: Bankruptcy from Olympus*, 77 U. CHI. L. REV. 959, 965 & n.25 (2010) (stating priority afforded by section 503(b)(9) "is usually enough to keep [vendors] sufficiently happy that a critical-vendor order is not necessary"); Joel Marker, *Get Ready for the Bankruptcy Amendments of 2005*, 18 UTAH B.J. 12, 13 (2005) ("Section 503(b)(9) clarifies the 'critical-vendor doctrine.'").

[70] *See Circuit City Unplugged*, *supra* note 8, at 46 (testimony of Todd J. Zywicki, Professor, George Mason University School of Law) (noting *K-Mart's* "$300 million in critical vendors . . . is about what we see as administrative priorities in the current [post-BAPCPA Circuit City] case"); Baird, *supra* note 69, at 965 & n.25 (citing section 503(b)(9) and pre-bankruptcy planning have "dramatically reduced the need for critical-vendor orders."); Cho, *Intersection*, *supra* note 17, at 12–13 (explaining some portion of ordinary course of business trade creditor's claim usually qualifies under section 503(b)(9)).

[71] *Circuit City Unplugged*, *supra* note 8, at 46 (testimony of Todd J. Zywicki, Professor, George Mason University School of Law).

[72] *See id.*

[73] *See, e.g.*, *In re* TI Acquisition, LLC ("*TI Acquisition II*"), 429 B.R. 377, 382 (Bankr. N.D. Ga. 2010) (positing critical vendors with priority status through court order is treated more favorably than section 503(b)(9) claimants); 1B-9 SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE § 9.17 n.29 (opining section 503(b)(9) does not solve critical vendor problem because administrative priority afforded to *all* vendors). Even Professor Todd Zywicki, seemingly an advocate of the critical vendor replacement rationale, has said:

> I acknowledge that there are still judges out there, and vendors, who want even more. And it would be good if the judges would tell them, "No." 503(b)(9), as I understand it, was an effort to try to get rid of all that critical-vendor rigmarole, and the unfair treatment that arose under it. And so maybe it didn't. But the answer, I think, is to get out of the critical-vendor game at this point, because I think that what it was trying to do is, by and large, satisfied in a more fair and efficient way by 503(b)(9).

Circuit City Unplugged, *supra* note 8, at 118 (testimony of Todd J. Zywicki, Professor, George Mason University School of Law).

503(b)(9) only provides administrative expense protection for *vendors of goods* without regard to whether those vendors are critical.[74] Therefore, if section 503(b)(9) was to provide administrative expense protection for all potential critical vendors, it is under and over-inclusive.[75] The section is under-inclusive by only providing administrative expense protection to vendors of goods when vendors of services may be just as critical to a debtor's post-petition survival.[76] The section is over-inclusive because, as noted earlier, there is no judicial inquiry into whether the vendor's continued business is "critical" to the success of the debtor's reorganization; administrative expense status and the right to full payment are automatically conferred.[77]

Additionally, critical vendor orders are not restricted in scope to vendors that conducted business with the debtor twenty days pre-petition.[78] Moreover, section 503(b)(9) governs "all types of bankruptcy cases—including chapter 7 liquidation cases—indicating that Congress did not intend to link payment of these prepetition vendor claims to the necessity for effective reorganization."[79] Finally, from a procedural standpoint, *debtors* make critical vendor motions and *vendors* file

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[74] *See* 11 U.S.C. § 503(b)(9) (2006).

> A key to the critical-vendor situation is the debtor-in-possession saying to the vendor, "Yes, you are critical to me, but I am not going to make you a critical vendor unless you give me the best credit terms that I had before Chapter 11." You don't get that out of 503(b)(9). All 503(b)(9) does is give you an obstacle to confirmation.

Circuit City Unplugged, *supra* note 8, at 116 (testimony of Harvey R. Miller, Attorney, Weil, Gotshal & Manges, LLP).

[75] *See, e.g.*, *In re* Plastech Engineered Prods., Inc. ("*Plastech III*"), 394 B.R. 147, 151 (Bankr. E.D. Mich. 2008) (explaining section 503(b)(9) provides disparate treatment to vendors of goods); *Circuit City Unplugged*, *supra* note 8, at 46, 113 (testimony of Richard M. Pachulski, Attorney, Pachulski Stang Ziehl & Jones, LLP) (rejecting Zywicki's assertion section 503(b)(9) addresses or impacts critical vendor orders).

[76] *See In re* Bookbinders' Rest., Inc., No. 06-12302ELF, 2006 WL 3858020, at *5 (Bankr. E.D. Pa. Dec. 28, 2006) (rejecting creditor's argument asserting equal treatment for vendor of goods and vendor of services under section 503(b)(9)).

[77] *See* Resnick, *supra* note 13, at 205 (explaining section 503(b)(9) automatically grants priority status to vendor without debtor showing vendor is critical); *see also In re* Corner Home Care, Inc., 438 B.R. 122, 129–30 (Bankr. W.D. Ky. 2010) (allowing non-critical vendor to claim section 503(b)(9) administrative expense).

[78] *See TI Acquisition II*, 429 B.R. at 382 (explaining critical vendor order allows creditor and debtor to negotiate extent of debtor's liability); *In re* TSLC I, Inc., 332 B.R. 476, 477 (Bankr. M.D. Fla. 2005) (approving critical vendor order authorizing debtor to pay portion of accumulated pre-petition debt incurred over twenty-days pre-petition); Cho, *Intersection*, *supra* note 17, at 8 (discussing critical vendor suppliers without referencing any twenty-day pre-petition limitation on critical vendor orders).

[79] Resnick, *supra* note 13, at 205; *see In re* TI Acquisition ("*TI Acquisition I*"), 410 B.R. 742, 745 (Bankr. N.D. Ga. 2009) ("Unlike the other pre-petition expense sections, the applicability of § 503(b)(9) is not limited to involuntary bankruptcy cases or those cases involving the appointment of a receiver."); *Plastech III*, 394 B.R. at 151 ("The presence of this type of pre-petition debt is far more pervasive than the relatively rare types of pre-petition debts that were previously elevated to expenses of administration under § 503(b)(3) and (4). Further, unlike the narrow application of § 503(b)(3) and (4), § 503(b)(9) applies to all cases, voluntary or involuntary.").

administrative expense claims; the two things are simply not driven by the same parties.[80]

2. The Continued Dealings Theory

Although somewhat related to the critical vendor replacement theory, under the "continued dealings" theory, Congress passed section 503(b)(9) "to encourage trade creditors to continue to extend credit to a debtor potentially heading for bankruptcy."[81] Congress believed that, if certain vendors knew they were entitled to an administrative expense claim should their customer file bankruptcy, they would be less likely to stem business with the debtor.[82] Furthermore, because a vendor generally only needs to file a claim with the court to seek an administrative expense, Congress further ensured post-petition business with the debtor.[83] Vendors no longer need to rely on a debtor's willingness to make a critical vendor motion or court approval of the motion.[84]

This theory is also suspect because it hinges on several debatable assumptions. First, merely because a vendor's pre-petition claim now stands an increased likelihood of being repaid does not guarantee that the vendor will want to continue selling to a customer that has filed bankruptcy.[85] Rather, section 503(b)(9) might encourage vendors to just collect on their claim and discontinue business with a financially troubled customer.[86]

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[80] *See In re* K-Mart Corp., 359 F.3d 866, 868 (7th Cir. 2004) (approving debtor's critical vendor motion); *In re* Circuit City Stores, Inc. ("*Circuit City II*"), 426 B.R. 560, 574 (Bankr. E.D. Va. 2010) ("[H]olders of § 503(b)(9) administrative expense claims . . . must file a proof of claim."); Resnick, *supra* note 13, at 206 (speculating certain vendors' decreased reliance on critical vendor motions because section 503(b)(9) will independently provide protection).

[81] *In re* Arts Dairy, LLC, 414 B.R. 219, 222 (Bankr. N.D. Ohio 2009); *see Circuit City Unplugged*, *supra* note 8, at 53 (statement of Todd J. Zywicki, Professor, George Mason School of Law) (stating section 503(b)(9) acknowledges "need to provide assurances to vendors to continue to supply goods on credit to struggling retailers"); Lafferty, *supra* note 66 (positing legislative history indicates intention to provide creditors "additional remedies" to encourage continued dealings with debtors immediately prior to bankruptcy).

[82] *See supra* note 81.

[83] *See* 11 U.S.C. § 503(a) (2006) (allowing administrative expense claims by timely filing request for payment). *But see* Routh, *supra* note 5, at 79 (noting potentially conflicting processes for twenty-day claim assertions).

[84] *See infra* Part II.A.

[85] *See In re* Circuit City Stores, Inc. ("*Circuit City II*"), 426 B.R. 560, 577 n.14 (Bankr. E.D. Va. 2010) ("[I]t appeared that the existence of the § 503(b)(9) administrative expense claims had a chilling effect on the part of the holders of such claims to extend postpetition credit."); *see also* Routh, *supra* note 5, at 79 (listing reasons why repayment may be inadequate incentive); Peter J. Barrett, *The Impact of Recent Legislative Changes and Judicial Decisions on Creditors' Rights*, *in* CREDITORS' RIGHTS IN CHAPTER 11 CASES: LEADING LAWYERS ON REPRESENTING AND ENFORCING THE RIGHTS OF CREDITORS IN BANKRUPTCY MATTERS (Aspatore 2011), *available at* 2011 WL 190429, at *3 (suggesting vendor may prefer immediate liquidation as method of getting full twenty-day claim payment).

[86] *See In re* Payless Cashways, Inc., 268 B.R. 543, 547 (Bankr. W.D. Mo. 2001) ("[T]he bare promise of a priority administrative expense claim . . . cannot be expected to induce suppliers to extend credit to a

Second, it is unclear whether a vendor knows that its customer is financially unsound or heading for bankruptcy.[87] While vendors with extensive or longstanding business relationships with buyers might be aware of their customer's financial position in the twenty days before bankruptcy, it is unclear whether small, far-flung vendors involved in one-shot transactions have the same kind of financial information.[88] Even large multi-national vendors probably lack the time to conduct a financial analysis of their customers, simply to determine the extent of their protection under section 503(b)(9).[89]

Finally, the continued dealings rationale also suggests that critical vendor motions are either an unsuccessful or insufficient means with which to maintain post-petition business with critical vendors. While jurisdictions following the Seventh Circuit's *K-Mart* decision do impose a higher burden for approving a debtor's critical vendor motion, these motions were not entirely eliminated and not all circuits follow *K-Mart*.

3. The Stockpiling Theory

A third argument for why Congress enacted section 503(b)(9) is best described as the "stockpiling" theory. Here, Congress passed section 503(b)(9) "to prevent debtors from acquiring goods at a time where the debtor knew that bankruptcy was imminent" and would be unable to pay for the goods.[90] The twenty-day pre-petition period is therefore Congress's best guess of when debtors are intentionally ordering or stockpiling goods they cannot pay for, but will need in a subsequent

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debtor."); Barrett, *supra* note 85, at *3; Routh, *supra* note 5, at 79 (stating vendors may choose to sell claims prior to collection).

[87] *See Circuit City II*, 426 B.R. at 577 ("Section 503(b)(9) does not encourage the extension of postpetition credit . . . . Although trade vendors may have an idea that a business is troubled, they generally do not know if or when a debtor might file a bankruptcy petition."); Scott H. Bernstein & Robert A. Rich, *Claims for Goods Delivered on the Eve of a Bankruptcy Filing: What Every Business Lawyer Needs to Know*, N.Y. BUS. L.J., Winter 2010, at 26 (noting some businesses have placed large orders with companies unaware of their liquidity problems only days before filing for bankruptcy).

[88] *See* Bifferato et al., *supra* note 16 (explaining vendors "are in an inferior position to the lenders regarding the financial condition of the debtor").

[89] *See Circuit City II*, 426 B.R. 560, 577 (Bankr. E.D. Va. 2010) ("In a prepetition world, it is assumed that creditors take whatever steps are lawfully necessary and appropriate to get their claims preferred and thus paid. It is doubtful that § 503(b)(9) has any significant effect on whether vendors choose to extend credit prepetition."); *see also In re* TI Acquisition, LLC ("*TI Acquisition II*"), 429 B.R. 377, 385 (Bankr. N.D. Ga. 2010) (noting creditor never knows whether debtor will file bankruptcy within twenty days of receiving goods).

[90] 4 COLLIER ON BANKRUPTCY, ¶ 503.16[1] at 503-79 (Alan N. Resnick & Henry J. Sommer eds., 15th ed. rev. 2006); *see also* GFI Wis., Inc. v. Reedsburg Util. Comm'n, 440 B.R. 791, 797 (W.D. Wis. 2010) ("Presumably, one of the reasons § 503(9)(b) was enacted was to prevent debtors from stockpiling "goods" in the days leading up to their bankruptcy filings."); Bernstein & Rich, *supra* note 87, at 26 (describing situations where companies submit large orders to take advantage of unsuspecting vendors just prior to filing bankruptcy); Resnick, *supra* note 13, at 204 (stating apparent congressional intent behind section 503(b)(9) was to curb intentional orders in preparation for bankruptcy).

bankruptcy.[91] Thus, rather than allowing debtors to profit from the mark-up value of the goods received and leaving vendors "to hold the bag on large accounts receivable," Congress gave vendors administrative priority status.[92]

However, the punitive rationale underpinning the stockpiling theory also has its flaws. First, on a practical level, debtors can still avoid the scope of section 503(b)(9) by pre-planning their goods orders on the twenty-first day rather than the twentieth day pre-petition.[93] Second, because the goods must be received in the debtor's "ordinary course" of business, the section can be read to exclude intentional non-ordinary course deliveries within twenty days pre-petition.[94] Congress's failure to include a scienter element[95] also means that section 503(b)(9) does not apply only to debtors who intentionally stockpile. For example, consider the debtor making a large order in anticipation of a high volume sales period:

> A potential debtor, particularly a retailer, may increase orders for a holiday season in anticipation of increased sales but find itself forced to file for bankruptcy protection while its stores are full. Even without malicious intent, the secured lender benefits from the third-party supplier's misfortune.[96]

A similar situation arises where a store expects to sell out of a prized new product (think iPad) and increases its orders accordingly with a future bankruptcy merely an afterthought. Thus, by not including a scienter element in section 503(b)(9), Congress must have egregiously drafted the provision.

Finally, if Congress intended to prevent debtor's from stockpiling, section 503(b)(9) fails to necessarily address *who* might be promoting the practice. As alluded to above, a secured creditor's blanket lien will attach to any inventory the debtor may acquire, regardless of whether the vendor is awarded a section 503(b)(9) administrative expense.[97] By encouraging the debtor to load up on inventory, the secured creditor will retain the rights to the proceeds from the collateral and the

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[91] *See supra* note 90.

[92] Carl N. Kunz, III, *Section 503(b)(9) Claims and Bar Dates: Creditors Must Be Vigilant*, AM. BANKR. INST. J., July/Aug. 2008, at 20 [hereinafter Kunz, *Creditors Must Be Vigilant*].

[93] *See In re* Crawford, 420 B.R. 833, 840 n.18 (Bankr. D.N.M. 2009) (analogizing to strict twenty day bright line rule of section 503(b)(9)); *In re* First Magnus Fin. Corp., No. 4:07BK01578-JMM, 2008 WL 5046596, at *1 (Bankr. D. Ariz. Oct. 16, 2008) (distinguishing between products sold to debtor within twenty days pre-petition and those sold earlier); *see also* Peter A. Zisser, *Reclamation: The Right of Reclamation In Bankruptcy; The Code Giveth and the Code Taketh Away*, BANKR. L. DAILY, Nov. 21, 2007 ("[O]nce Buyer finds itself in a precarious financial situation, it may try to over-order goods it knows it will need in the 20-day period before that period actually begins.").

[94] *See* 11 U.S.C. § 503(b)(9) (2006); *see also In re* Plastech Engineered Prods., Inc. ("*Plastech III*"), 394 B.R. 147, 151 (Bankr. E.D. Mich. 2008) ("Nor does it extend to the value of goods . . . if such goods were not received in the *ordinary course* of a debtor's business.").

[95] *See* 11 U.S.C. § 503(b)(9).

[96] Bifferato et al., *supra* note 16.

[97] *See id.*

vendor will be entitled to a twenty-day claim, assuming section 503(b)(9)'s requirements are met.[98] Thus, in addition to ceding the goods back to the secured creditor, the debtor now must pay an administrative expense: both the creditor and the twenty-day claimant may benefit to the debtor's detriment.[99]

4. The Reclamation Fortification Theory

Finally, many believe that Congress enacted section 503(b)(9) to fortify a vendor's right of reclamation under section 546(c).[100] Recognizing the longstanding difficulties associated with exercising reclamation rights, Congress therefore intended that section 503(b)(9) provide an additional remedy to vendors. The statutory support for this theory comes from section 546(c)(2), the only BAPCPA amended Code provision that explicitly cross-references section 503(b)(9).[101] This provision provides that, where vendors fail to comply with the requirements for reclamation, they "still may assert the rights contained in section 503(b)(9)."[102] Additionally, the reclamation theory is further supported by Congress's choice to include section 503(b)(9) under the "Reclamation" title of BAPCPA.[103] However, the true merits of the theory lie in how one interprets the BAPCPA amendments to section 546(c) generally and whether those amendments actually work in conjunction with section 503(b)(9) to enhance a vendor's reclamation right.

The right of reclamation originated under the Uniform Commercial Code ("U.C.C.") and was incorporated under the Code with several changes through section 546(c)(1).[104] Section 546(c)(1) allows a vendor to "reclaim" goods it sold to the debtor "in the ordinary course" of the vendor's business within forty-five days

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[98] *See id.*; George H. Singer, *The New Rules of Bankruptcy for Chapter 11 Business Reorganizations under the B.A.P.C.P.A.*, 28 CAL. BANKR. J. 194, 204 (2006) (acknowledging vendor's entitlement to payment of twenty-day day claim junior in priority to secured inventory lender); *see also* U.C.C. § 9-315(a)(2) (2005) ("[A] security interest attaches to any identifiable proceeds of collateral.").

[99] *See* Bifferato et al., *supra* note 16.

[100] *See In re* Brown & Cole Stores, LLC, 375 B.R. 873, 875 n.3 (B.A.P. 9th Cir. 2007) (citation omitted) ("The legislative history of § 503(b)(9) 'suggests that it was aimed at providing relief to sellers of goods who fail to give the required notice under the reclamation provisions of 546(c)' . . . ."); Cho, *Intersection*, *supra* note 17, at 11 ("Although the legislative history of section 503(b)(9) suggests that it was aimed at providing relief to sellers of goods who fail to give the required notice under the reclamation provision, the section is now increasingly used as an added justification for granting critical vendor motions."); Glasgow, *supra* note 14, at 339 (reading apparent congressional intent for section 503(b)(9) to operate with section 546(c) as basis to extend prior lien defense to section 503(b)(9)).

[101] 11 U.S.C. § 546(c) (2006) (providing if seller fails to provide requisite notice for reclamation demand, seller "still may assert the rights contained in section 503(b)(9)"); Glasgow, *supra* note 14, at 315.

[102] 11 U.S.C. § 546(c)(2).

[103] *See* Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 1227(b), 119 Stat. 23, 199–200 (codified at 11 U.S.C. § 503(b)(9) (2006)).

[104] *See In re* Circuit City Stores, Inc. ("*Circuit City I*"), 416 B.R. 531, 536 (Bankr. E.D. Va. 2009) (recognizing Code reclamation right under section 546(c) acts to protect and limit U.C.C. § 2-702 reclamation right). *Compare* U.C.C. § 2-702 (2005) (expanding reclamation period indefinitely where buyer misrepresented solvency three months prior to delivery), *with* 11 U.S.C. § 546(c) (determining reclamation period by later of expiration of 45 days post-delivery or 20 days post-petition).

after the debtor received the goods, or if that period will expire post-petition, twenty days post-petition.[105] The debtor must have "received" the goods while "insolvent" and the vendor must make its reclamation demand "in writing."[106] If the vendor fails to comply with the requirements of section 546(c)(1), then the vendor's sole remedy is to claim an administrative expense to the extent the sale of goods would qualify under section 503(b)(9).[107] The vendor will have a general unsecured claim for any sales that do not fall under section 503(b)(9).[108]

Practical realities make section 546(c) an unlikely remedy for vendors. The timely written demand requirement means that vendors are charged with monitoring their customer's financial status.[109] Moreover, many vendors are simply unaware of

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[105] 11 U.S.C. § 546(c)(1). The section reads:

> (1) Except as provided in subsection (d) of this section [relating to grain producers and fisherman] and in section 507(c), and subject to the prior rights of a holder of a security interest in such goods or the proceeds thereof, the rights and powers of the trustee under sections 544(a), 545, 547, and 549 are subject to the right of a seller of goods that has sold goods to the debtor, in the ordinary course of such seller's business, to reclaim such goods if the debtor has received such goods while insolvent, within 45 days before the date of the commencement of a case under this title, but such seller may not reclaim such goods unless such seller demands in writing reclamation of such goods—
>
> (A) not later than 45 days after the date of receipt of such goods by the debtor; or
>
> (B) not later than 20 days after the date of commencement of the case, if the 45-day period expires after the commencement of the case.
>
> (2) If a seller of goods fails to provide notice in the manner described in paragraph (1), the seller still may assert the rights contained in section 503(b)(9).

[106] *Id.*

[107] *See id.* § 546(c)(2); *In re* Commissary Operations, Inc., 421 B.R. 873, 877 (Bankr. M.D. Tenn. 2010) (noting section 503(b)(9) functions as alternative remedy to reclamation).

[108] *See In re* Circuit City Stores, Inc. ("*Circuit City V*"), 441 B.R. 496, 512 (Bankr. D. Va. 2010) (reclassifying reclamation claims not entitled to section 503(b)(9) priority as general unsecured claims); *In re* First Magnus Fin. Corp., No. 4:07-BK01578-JMM, 2008 WL 5046596, at *2 (Bankr. D. Ariz. Oct.16, 2008); *Circuit City I*, 416 B.R. at 539 (holding predominant purpose test should be used to determine if claim constitutes sale of goods or general unsecured claim).

[109] *See* Lisa S. Gretchko, *Seller Beware! Is Your Reclamation Claim as Strong As You Think It is?*, AM. BANKR. INST. J., Mar. 2003, at 50 (noting knowing customer's financial condition and watching for indications of insolvency protects vendor's reclamation right); Eric R. Wilson & Robert L. Lehane, *Secured Lenders' Pre- and Post-Petition Liens Trump Reclamation Rights Under Amended § 546(c)*, AM. BANKR. INST. J., Mar. 2007, at 27 (imploring vendors to monitor buyer's financial condition before extending credit and demand cash prior to delivering goods). A vendor may be able to avoid reclamation altogether by making routine financial checklists. *See* Zisser, *supra* note 93, at 4 (listing questions seller should ask regarding buyer activities). Vendors should ask themselves: "Has Buyer recently started to pay late? Has Buyer started to increase its orders over historical amounts? Has Buyer experienced recent layoffs? Has there been a general downturn in Buyer's industry (which may also be Seller's industry)?" *Id.* If a vendor believes any of these questions might be true, it should then:

> (i) tighten terms by allowing for no more than 20 days open shipping, thus ensuring that all (or most) of the money owed will be treated as an administrative expense, (ii) eliminate all open terms and go to pre-payments or COD, or (iii) a combination of the two (20 day open terms and COD thereafter).

Id.

their reclamation right and, consequently, never exercise it.[110] Even where the diligent vendor seeks to reclaim its goods, too often they have been resold by the debtor.[111] The vendor is generally without remedy because the case law holds that reclamation rights are subordinate to good-faith purchasers of the goods.[112] If the debtor intentionally disregarded the vendor's timely request for a return of the goods, the vendor would need to obtain an injunction or sue the debtor in bankruptcy.[113] Finally, a court may use the "equitable powers" granting provision of section 105 to prohibit reclamation when it would be detrimental to a reorganization.[114]

The statutory exceptions embedded in section 546(c)(1) further water-down the right of reclamation. Reclamation cannot be exercised against grain producers and fisheries under section 546(d), those holding fraudulent tax claims under section 507(c), and, most importantly, the right is explicitly "subject to the prior rights of a holder of a security interest in such goods or the proceeds thereof . . . ."[115] This last exception was a BAPCPA addition, which codified longstanding case law holding that a vendor's right of reclamation is subject to a prior secured creditor's floating lien.[116] When the vendor tries to reclaim the good, the secured creditor will assert the "prior lien defense" and, if the lien is undersecured by the value of the goods (a

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[110] *See* Stephen M. Packman, *Increased Cash Requirements Cause Debtor's Dilemma: Section 503(b)(9) May Prevent Some Small Midsized Companies From Reorganizing*, N.J.L.J., Jan. 14, 2008; *see also* Richard J. Maire, Jr., *Reclamation: Remedy of Last Resort or Fool's Errand?*, AM. BANKR. INST. J., Oct. 2000, at 24 (stressing typical vendor needs attorney consultation to learn of reclamation right).

[111] Joseph L. Steinfeld, Jr. & Gregory S. Abrams, *New Value and Reclamation Post-BAPCPA: How §503(b)(9) (Twenty-Day Claims) Has Cut a Slice Out of the Preference Pie*, AM. BANKR. INST. J., Feb. 2007, at 60 ("[T]he expanded time-frame for reclamation might be of little or no value in the "real world" where goods are often sold before a reclamation demand is made."); *see also* Resnick, *supra* note 13, at 207–08 (noting reclamation right may be exercised only to extent debtor still possess goods). *See generally In re* Deephouse Equip. Co., Inc., 22 B.R. 255 (Bankr. D. Conn. 1982) (holding defrauded seller had no reclamation right when buyer resold purchased goods after failing to comply with section 546(c)).

[112] *See* Pester Refining Co. v. Ethyl Corp. (*In re* Pester Refining Co.), 964 F.2d 842, 844 (8th Cir. 1992) (explaining U.C.C. makes unsecured seller's reclamation right "subject to" rights of good faith purchaser); Resnick, *supra* note 13, at 208 (noting "good faith" purchasers include buyers who take for value and secured creditors with liens on goods and proceeds thereof); Zisser, *supra* note 93, at 2 (describing how "good faith purchaser" includes secured creditors holding prior floating liens).

[113] *See In re* Sunstate Dairy & Food Prods. Co., 145 B.R. 341, 343 (Bankr. M.D. Fla. 1992) (deciding reclaiming seller's motion for preliminary injunction to prevent debtor from reselling ice cream bars); *In re* Buyer's Club, Inc., 100 B.R. 35, 35–36 (Bankr. D. Colo. 1989) (granting reclaiming vendor preliminary injunction pending outcome of suit); Wilson & Long, *supra* note 9, at 20 (protecting reclamation right forces vendors to commence adversary proceedings and seek restraining orders to prevent debtor's resale of goods).

[114] *See* Bostonian v. Schapiro (*In re* Kansas City Journal-Post Co.), 144 F.2d 791, 805 (8th Cir. 1944) (discussing cases regarding courts' equitable powers to deny reclamation claims); *In re* T.D. Veru, Inc., No. 1-81-00353, Adv. No. 1-81-0453, 1983 Bankr. LEXIS 5166, at *13–15 (Bankr. M.D. Pa. 1983) (using equitable powers to deny reclamation of seller's product).

[115] 11 U.S.C. § 546(c)(1) (2006).

[116] *See* Resnick, *supra* note 13, at 208 (calling change insignificant when pre-BAPCPA reclamation right was already subordinate to "good faith" purchasers, which included secured creditors).

probable scenario), the vendor is once again generally without remedy.[117] A vendor can only hope that the oversecured creditor is willing to make a concession.[118]

With this overview of section 546(c), the merits of the reclamation fortification theory at first seem valid. On one hand, goods sold and delivered twenty days pre-petition will always come within section 503(b)(9). Vendors will not need to make a timely demand, determine whether the debtor was insolvent at the time it received the goods, or worry about whether the property is in the debtor's possession and unencumbered, so long as they file their twenty-day claims applications with the court.[119] Section 503(b)(9)'s less stringent requirements might also encourage vendors to walk away with their twenty-day claim and draw them away from the uncertainty inherent in litigating reclamation claims.[120]

However, whether section 503(b)(9) might have displaced the need to rely on reclamation overlooks the fact that through BAPCPA, Congress ultimately weakened section 546(c). Congress did enlarge the timetable for written demand from ten to forty-five days after the debtor's receipt of the goods, but apart from subsection (2), which says, in effect, "go to section 503(b)(9) if you cannot exercise your right of reclamation," Congress actually reduced the remedies available to vendors.[121] Amended section 546(c)(2) replaces two remedial provisions that granted a vendor either a priority claim or a lien in cases where the court denied the vendor's valid right to reclaim goods.[122] Therefore, amended section 546(c)(2)

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[117] *In re* Dana Corp., 367 B.R. 409, 421 (Bankr. S.D.N.Y. 2007) (holding reclamation claims valueless where goods subject to prior lien defense); Bifferato et al., *supra* note 16 (stating undersecured lender's lien on debtor's inventory prevents supplier from recovering on claim); Lisa S. Gretchko, *The Bankruptcy Reform Act One Year Later: A Disappointment For Trade Creditors*, AM. BANKR. INST. J., Feb. 2007, at 45 [hereinafter Gretchko, *Bankruptcy Reform Act*] (describing how many argue oversecured creditor cannot defeat reclamation claim regardless of availability of estate funds).

[118] *See* Zisser, *supra* note 93, at 2 (noting reclamation claim rendered useless if no surplus remains after satisfaction of secured creditors' lien); *see also* Packman, *supra* note 110 (stating debtors contest even timely reclamation demand by claiming solvency when goods were delivered or arguing goods subject to secured creditor's lien).

[119] *See In re* Rio Valley Motors Co., LLC, No. 11-06-11899-SS, 2008 WL 824271, at *2 n.3 (Bankr. D.N.M. 2008) (noting section 503(b)(9) lacks demand on debtor requirement); Leslie Ann Berkoff, *Are the Holders of § 503(b)(9) Claims Entitled to Separate and Distinct Representation in a Case?*, 17 NORTON J. BANKR. L. & PRAC. 403, 404 (2008) (arguing reclamation claims are now mainly important only 21 to 45 days pre-petition); *see also* Berlin et al., *supra* note 7, at 364–65 (characterizing section 503(b)(9) as "super reclamation claim"); Zisser, *supra* note 93, at 4 (suggesting section 503(b)(9) relief superior to section 546(c) relief).

[120] *See* Zisser, *supra* note 93, at 5 (suggesting Congress wanted vendors to sit back and accept their twenty-day claim).

[121] *See, e.g.*, Bifferato et al., *supra* note 16 (reiterating even with section 503(b)(9), suppliers still bear majority of risk); Gretchko, *Bankruptcy Reform Act*, *supra* note 117, at 18 (highlighting how section 546(c) continues to disappoint trade creditors, despite BAPCPA's reclamation period extension); Deborah L. Thorne, *Reclamation Under the New § 546(c)(1): Illusory as Ever, In re Dana Corp. and Incredible Auto Sales LLC*, AM. BANKR. INST. J., June 2007, at 46 (detailing cases where expansion to forty-five days has not improved seller outcomes).

[122] *Compare* 11 U.S.C. § 546(c)(2) (2006) ("If a seller of goods fails to provide notice in the manner described . . ., the seller still may assert the rights contained in section 503(b)(9)."), *with* 11 U.S.C. § 546(c)(2) (2000) ("[T]he court may deny reclamation . . . only if the court—(A) grants the claim of such a

provides *different*, rather than greater, protection. Technically, section 546(c)(2) does not even provide reclamation remedy protection *per se*, but merely draws a vendor's attention to section 503(b)(9), another remedial provision under the Code.[123] Moreover, Congress could not have intended to strengthen reclamation rights with section 503(b)(9), when, as noted above, it amended section 546 to explicitly acknowledge that vendors are subject to secured lenders' floating liens.[124]

Finally, even if Congress intended that section 503(b)(9) fortify reclamation rights, the section still leaves an "unsecured gap period" in the twenty-one to forty-five days pre-petition, leaving the vendor subject to all of section 546(c)'s exceptions. For example, in *In re First Magnus Financial Corp.* ("*First Magnus*"),[125] the debtor ignored a timely reclamation demand, and instead forwarded the goods to its secured lender who resold them and credited the sale to the debtor's debt.[126] Although the debtor intentionally disregarded the vendor's demand, the court held that only the goods delivered in the twenty-days pre-petition qualified under section 503(b)(9).[127] The court explained that section 546(c) does not cover situations where the vendor fails to promptly seek court intervention after the debtor intentionally ignores the vendor's reclamation demand.[128] Thus, the debtor was permitted to "sell into the secured creditor's blanket lien," and the vendor's remaining claim was deemed a general unsecured claim.[129]

III. THE SECTION 503(B)(9) CASE LAW

Despite the legislative mystery behind section 503(b)(9), courts must still render decisions based on the ambiguously drafted provision. As noted earlier, section 503(b)(9) lacks definitions for key terms and has virtually not been cross-

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seller priority as a claim of a kind specified in section 503(b) of this title; or (B) secures such claim by a lien."). The BAPCPA amendments to section 546(c) also raised fundamental questions on the very status of reclamation rights. BAPCPA deleted the statutory language grounding the right of reclamation under "statutory or common-law," initially prompting the question of whether Congress created a new federal right of reclamation. *See* Paramount Home Entm't Inc. v. Circuit City Stores, Inc., 2010 WL 3522089, at *3 (E.D. Va. 2010) (stating BAPCPA did not create federal reclamation right); *In re* Incredible Auto Sales LLC, No. 06-60855-11, 2007 WL 927615, at *6 (Bankr. D. Mont. Mar. 26, 2007) (considering whether BAPCPA created reclamation right after amendments to section 546(c) and addition of section 503(b)(9)). *See generally* Stacey L. Meisel & Lauren Hannon, *With Bated Breath: Do the Revision to § 546(c) Create a Federal Right of Reclamation for Sellers?*, AM. BANKR. INST. J., Apr. 2007.

[123] *See In re* Plastech Engineered Prods., Inc. ("*Plastech III*"), 394 B.R. 147, 151–52 (Bankr. E.D. Mich. 2008) (holding section 546(c) does not limit rights claimant has under section 503(b)(9)); *In re* First Magnus Fin. Corp., No. 4:07BK01578-JMM, 2008 WL 5046596, at *2 (Bankr. D. Ariz. Oct. 16, 2008) (stating section 546(c) gives claim only to extent it qualifies under section 503(b)(9)).

[124] *See supra* notes 116 & 122.

[125] *In re* First Magnus Fin. Corp., No. 4:07-BK01578-JMM, 2008 WL 5046596 (Bankr. D. Ariz. Oct.16, 2008).

[126] *Id.* at *1.

[127] *Id.*

[128] *Id.* at *2.

[129] *Id.*

referenced elsewhere in the Code. Consequently, the section continues to foster divergent decisions and approaches by courts as they are bombarded with twenty-day claims issues. This Part provides an overview of the current legal issues involving the twenty-day claim created by section 503(b)(9) with an eye towards understanding how these issues implicate the theories behind the section and how they impact a debtor's prospects for reorganization. Specifically, this section tackles four broad categories: (A) allowance and payment of a claim; (B) basis for a claim; (C) scope of a claim; (D) setoff and preference liability; and, finally, (E) claimant representation.

A. Allowance and Payment of a Claim

The questions of when a twenty-day claim must be raised and when the claims must be paid were some of the first section 503(b)(9) issues to be litigated. These two issues bear directly on how much the debtor's administrative expense liability will be and when that liability will become due.

1. When Must a Twenty-Day Claim be Raised?

Section 503(b)(9) says nothing about when a twenty-day claim must be raised.[130] Because Section 503(b)(9) is an administrative expense, it is only governed by section 503(a), which simply requires that "[a]n entity may timely file a request for payment of an administrative expense" or "tardily file" a request if permitted by the court "for cause."[131] Rule 9013 of the Federal Rules of Bankruptcy Procedure ("Bankruptcy Rules") attempts to fill in this rather vague provision by allowing each bankruptcy court to promulgate local rules for compliance.[132] Most courts require an administrative expense claimant to file a motion seeking

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[130] 11 U.S.C. § 503(b)(9) (2006).

[131] *Id.* § 503(a); *see* Judith Greenstone Miller & Jay L. Welford, *503(b)(9) Claimants—The New Constituent, a/k/a "the 500 Pound Gorilla," at the Table*, 5 DEPAUL BUS. & COMM. L.J. 487, 490 (2007) ("There is no current Code or Bankruptcy Rule that provides for the assertion of administrative claims through the proof of claim process.").

[132] *See* FED. R. BANKR. P. 9013 (governing motion practice procedures); *see also In re* DFI Proceeds, Inc., No. 08-11955, 2009 Bankr. LEXIS 4296, at *3 (Bankr. N.D. Ind. Dec. 21, 2009) (asserting Bankruptcy Rules do not specifically address how to assert § 503(b)(9) claim); *Jumping the Queue: Administrative, Priority and Reclamation Claims in Chapter 11 Cases*, BUS. REORGANIZATION COMM. NEWSL. (Am. Bankr. Inst., Alexandria, Va.), June 2009, at 7 [hereinafter *Jumping the Queue*], http://www.abiworld.org/committees/newsletters/busreorg/vol8num6/queue.pdf (commenting local rules govern compliance with Rule 9013). Usually the Official Forms included with the Bankruptcy Rules offer guidance on how a claim should be filed, but they were not amended to accommodate twenty-day claims. *See, e.g., In re DFI Proceeds, Inc.*, 2009 Bankr. LEXIS 4296, at *3–4 ("No official form or procedure has been promulgated specifically addressing [section 503(b)(9)] . . . . [P]arties must either try to improvise an appropriate procedure, working from the existing rules and forms, or seek greater clarity by asking the court to establish a procedure . . . ."); Jonathan Carson & Gil Hopenstand, *BAPCPA's Five-Year Anniversary: Transformative Influence or Negotiable Challenge?*, WESTLAW J. BANKR., Nov. 29, 2010, at 2–3 (concluding official proof-of-claim inappropriate filing paper for asserting section 503(b)(9) claims).

allowance and payment of its claim, but the court's scheduling order may provide otherwise.[133] Moreover, for reasons discussed in Part III.D, a court might require a twenty-day claimant to file a "proof of claim," which is traditionally used by unsecured creditors—sometimes in addition to a motion for allowance.[134]

To deal with the potential onslaught of individually filed twenty-day claims, courts have devised a myriad of procedures for establishing twenty-day claims filing deadlines ("bar dates"), which vary considerably.[135] Some courts have enacted their own bar date rules,[136] while others have set bar dates in their first scheduling order[137] or approved them under a confirmed reorganization plan.[138] A number of courts allow bar dates to be set by motion either by the unsecured creditors committee[139] or by the debtor.[140] After the bar date is set, the debtor is charged with notifying all potential twenty-day claimants of the deadline.[141] Upon filing their

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[133] *See, e.g.*, Miller & Welford, *supra* note 131, at 490 (discussing various administrative expense claim filing procedures); *Jumping the Queue*, *supra* note 132, at 7 (commenting valid motions usually include information establishing goods delivered to debtor twenty days pre-petition).

[134] *See infra* Part III.D (discussing split over whether section 501 requires filing proof of claim for twenty-day claims); *see also In re* Circuit City Stores, Inc. ("*Circuit City II*"), 426 B.R. 560, 574 (Bankr. E.D. Va. 2010) (distinguishing "creditor" status of twenty-day claimants as requiring proof of claim filing unlike other administrative expense claims); *In re* Bridgeview Aerosol, LLC, No. 09-41021, 2010 WL 5505353, at *1 (Bankr. N.D. Ill. Feb. 24, 2010) ("[R]equests for payment of administrative expenses are not submitted by proofs of claim."); *In re* Dana Corp., No. 06-10354(BRL), 2007 WL 1577763 at *3 (Bankr. S.D.N.Y. May 30, 2007) (noting twenty-day claimant did not file proof of claim).

[135] *See, e.g.*, *In re* SemCrude, L.P., 416 B.R. 399, 402 (Bankr. D. Del. 2009) ("The need for coherent and efficient procedures for Twenty-Day Claims was apparent from the outset of these cases, in that the Debtors expected thousands of creditors to assert Twenty-Day Claims aggregating into the hundreds of millions of dollars."); Carson & Hopenstand, *supra* note 132, at 3 (explaining without filing procedures debtor incurs significant costs individually responding to twenty-day claims motions); Kunz, *Creditors Must be Vigilant*, *supra* note 92, at 20 (discussing way debtors have capitalized on lack of uniform bar date procedures).

[136] Currently only two courts have local twenty-day claims rules. *See* D. MASS. LOCAL BANKR. R. 3002-1 (requiring twenty-day claim filings "in writing with the Court within 60 days of the first date set for the meeting of creditors pursuant to Section 341, unless the court orders otherwise"); E.D. MICH. LOCAL BANKR. R. 3003-1 (requiring twenty-day claimants file claims within 90 days of first meeting of creditors).

[137] *See In re* Mercedes Homes, Inc. 431 B.R. 869, 872 (Bankr. S.D. Fla. 2009) (referencing twenty-day claim scheduling order); *In re* Congoleum Corp., No. 03-51524, 2008 WL 314699, at *2 (Bankr. D.N.J. Feb. 4, 2008) (discussing court's ability to set bar date).

[138] *See In re* Eusa Liquidation Inc., No. 09-15008 (SMB), 2010 WL 4916559, at *15 (Bankr. S.D.N.Y. June 10, 2010) (delineating administrative claims bar dates for twenty-day claimants in reorganization plan); *In re* Electroglas, Inc., No. 09-12416(PJW), 2010 WL 2821868, at *10 (Bankr. D. Del. May 26, 2010); *In re* Oldco M. Corp., No. 09-13412 (MG), 2010 WL 2910136, at *16 (Bankr. S.D.N.Y. Feb. 23, 2010).

[139] *See In re* DFI Proceeds, Inc., No. 08-119552009, 2009 Bankr. LEXIS 4296, at 2 (Bankr. N.D. Ind. Dec. 21, 2009) (recalling granted motion by unsecured creditors committee's motion to establish deadline and procedure for filing twenty-day claims).

[140] *See In re* Pilgrim's Pride Corp., No. 08-45664, 2008 Bankr. LEXIS 3685, at *1 (Bankr. N.D. Tex. Dec. 31, 2008) (granting debtor's extensive motion to establish and implement procedures for twenty-day claims filings); *see also In re* Circuit City Stores, Inc. ("*Circuit City IV*"), 432 B.R. 225, 227 (Bankr. E.D. Va. 2010) (noting debtor requested bar date set through motion); *In re* Carraway Methodist Health Sys., No. 06-03501-TOM-11, 2008 WL 2937781, at *2 (Bankr. N.D. Ala. July 23, 2008).

[141] *See In re* Celotex Corp., 245 B.R. 174, 176 & n.3 (Bankr. M.D. Fla. 2000) (summarizing debtor's extensive method of claimant notification); *see also In re* Cunningham, No. 05-32951-SGJ-13, 2008 WL 1696756, at *12 (Bankr. N.D. Tex. Apr. 9, 2008) (discussing debtor's bar date notice obligations to

claim, twenty-day claimants must notify the court and may be required to notify all other creditors.[142]

The confusion created by the often ad hoc bar date procedures tends to benefit the debtor. For example, in *In re DFI Proceeds, Inc.*,[143] the court deemed an untimely twenty-day claim filed by a *pro se* claimant to be a general unsecured claim, despite recognizing that the claimant "may not have understood all of the subtle nuances" of the procedures order or the court's local rules.[144] The claimant had filed its motion for allowance well before the bar date set by the court and referred to section 503(b)(9) in its motion, but failed to notify all creditors of its claim in violation of the court's notification requirements.[145] Therefore, the court deemed the claim to have never been filed, rather than tardily filed under section 503(a).[146] As a sophisticated corporate claimant, it should have hired counsel as was suggested in the court's first notice to creditors.[147] The claimant could not "strike out on [its own] path and hope that everything w[ould] turn out to be okay."[148]

Other courts have been more lenient toward tardily filed twenty-day claims. Typically these courts have determined that "excusable neglect" under Bankruptcy Rule 9006(b) existed and that allowing the tardily filed claim would not prejudice the other parties to the case.[149] A forgiving approach to untimely claims may be warranted, considering that debtors occasionally try to "bury" twenty-day claims bar dates in the notices they send creditors.[150] Debtors have also capitalized on

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claimants); Frank R. Kennedy & Gerald K. Smith, *Postconfirmation Issues: The Effects of Confirmation and Postconfirmation Proceedings*, 44 S.C. L. REV. 621, 663 (1993) (noting debtor required to notify claimants of bar date deadline).

[142] *See, e.g.*, *In re DFI Proceeds, Inc.*, 2009 Bankr. LEXIS 4296, at *9 (highlighting twenty-day claimant's failure to provide requisite notice to creditors and other parties in interest); *In re* Rio Valley Motors Co., No. 11-06-11866 SS, 2009 WL 2922835, at *3 (Bankr. D.N.M. June 8, 2009) (conditioning administrative expense claim allowance on notification to all parties in interest); *In re* Dana Corp., No. 06-10354 (BRL), 2007 WL 1577763, at * 3 (Bankr. S.D.N.Y. May 30, 2007) (describing how twenty-day claimants provide notice to creditors by filing proofs of claim).

[143] No. 08-11955, 2009 Bankr. LEXIS 4296 (Bankr. N.D. Ind. Dec. 21, 2009).

[144] *Id.* at *5–6, 8.

[145] *Id.* at *6, 9.

[146] *Id.* at *9.

[147] *Id.* at *5 & n.3.

[148] *Id.* at *8.

[149] *See, e.g.*, *In re* Bridgeview Aerosol, LLC, No. 09 B 41021, 2010 WL 2465401, at *4 (Bankr. N.D. Ill. June 16, 2010) (finding excusable neglect where "no bad faith, no flouting of the deadline, and no acts more sinister than carelessness or negligence"); *In re* Modern Med. Prods. Co., No. 08-B-73908, 2009 WL 3020142, at *1–2 (Bankr. N.D. Ill. Sept. 16, 2009) (holding excusable neglect where bar date missed by fourteen days, no bad faith, and where vendor's counsel "misread" procedure order). *But see In re* Dana Corp., No. 06-10354, 2007 WL 1577763, at *6 (Bankr. S.D.N.Y. May 30, 2007) (denying vendor's late claim after receiving notice to prevent untenable precedent).

[150] *See* Kunz, *Creditors Must be Vigilant*, *supra* note 92, at 80 (discussing deceptive tactics debtors have used); *see also* Michael D. Fielding, *Elevating Business Above The Constitution: Arbitration and Bankruptcy Proofs of Claim*, 16 AM. BANKR. INST. L. REV. 563, 578 (2008) (allowing extension of bar date where excusable neglect exists).

counsel's expectations that twenty-day claims will have specific procedures by setting collective bar dates for administrative expenses.[151]

Ultimately, most debtors probably stand to benefit from transparent bar date procedures with early deadlines. By having clear procedures set forth before a case even begins, the debtor will be able to "cap and evaluate its exposure to § 503(b)(9) administrative claims."[152] Additionally, having streamlined procedures outlining what is necessary for a valid twenty-day claim reduces the expenses incurred in responding to individual motions and avoids the extensive discovery necessary to evaluate the merits of each claim.[153] However, until some kind of uniform bar date procedure is adopted, practitioners continually stress the need for twenty-day claimants to remain "vigilant" during a bankruptcy case to ensure that they meet the court's filing requirements.[154]

2. When Must a Twenty-Day Claim be Paid?

In addition to setting the rules governing allowance of twenty-day claims, courts are also left to determine when the claims must be paid.[155] Payment of administrative expenses is only tied to sections 503(b) and 1129(a). Section 503(b) tersely states that, "after notice and a hearing," administrative expenses "shall be allowed."[156] Courts interpret section 1129(a)'s requirement of full payment on the effective date of the plan as setting only an "outside limit" on disbursement.[157] This

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[151] *See* Kunz, *Creditors Must be Vigilant*, *supra* note 92, at 80. In one case the debtor included the twenty-day claims bar date notice within a group of claims that were not subject to the deadline. *Id.* Additionally, the debtor failed to define section 503(b)(9) within the notice, further suggesting the debtor's trickery. *Id. But see In re* Circuit City Stores, Inc. ("*Circuit City VI*"), No. 08-35653, 2010 WL 4956022, at *1 (Bankr. E.D. Va. Dec. 1, 2010) (establishing specific twenty-day claims bar dates); *In re* Plastech Engineered Prods., Inc. ("*Plastech III*"), 394 B.R. 147, 149 (Bankr. E.D. Mich. 2008) (setting particular twenty-day claims bar dates).

[152] Kunz, *Creditors Must be Vigilant*, *supra* note 92, at 80. In these cases the debtor typically supplies a checklist alerting the vendor of the requirements for allowance twenty-day claims. *See id*.

[153] *See id.*

[154] *See id.* at 81 (advising creditors to be cognizant of bar dates); *see also* Miller & Welford, *supra* note 131, at 490 (imploring creditors to read bankruptcy notices to avoid losing right to assert twenty-day claim).

[155] *See In re* Bookbinders' Rest., Inc., No. 06-12302ELF, 2006 WL 3858020, at *4 (Bankr. E.D. Pa. Dec. 28, 2006) (concluding courts may determine when section 503(b)(9) claims are paid); Resnick, *supra* note 13, at 204–05 ("The Code does not, however, specify when payment will be made. It remains to be seen whether courts in Chapter 11 cases will allow payment of these vendor claims before confirmation of a plan of reorganization . . . ."); David B. Wheeler, *20-Day Sales Claims Under §503(b)(9): Finding Your Way Through Uncharted Territory*, AM. BANKR. INST. J., Nov. 2008, at 16 (discussing court decisions on timing of 503(b)(9) payments).

[156] 11 U.S.C. § 503(b) (2006); *see In re* Arts Dairy, LLC, 414 B.R. 219, 222 (Bankr. N.D. Ohio 2009) ("Nothing in § 503(b)(9), or elsewhere in the Bankruptcy Code, explicitly authorizes the immediate payment of an administrative expense arising under § 503(b)(9).").

[157] *In re Arts Dairy*, 414 B.R. at 221 (noting courts can authorize payment of administrative expenses before effective date of plan); Miller & Welford, *supra* note 131, at 491 (discussing how section 1129(a)(9)(A)'s outside limit can conceivably be altered by creditor's agreement to different treatment under plan).

statutory freedom gives a court several repayment options from which to choose.[158] A court could authorize payment the moment it allows the claim, or it could delay payment until the effective date of the plan.[159] A court could allow the debtor to determine when payments will be made, or the court could retain the discretion.[160] Two decisions, *In re Global Home Prods., LLC*, ("*Global*")[161] and *In re Bookbinders' Rest., Inc.*, ("*Bookbinders*"),[162] handed down less than a week apart, first tackled this issue when aggressive vendors sought immediate payment of their twenty-day claims.

In *Global*, a twenty-day claimant filed a motion for allowance and payment of its claim, a month after the bankruptcy filing.[163] The debtor-kitchenware retailer objected, arguing that immediate payment would require using DIP financing funds in violation of its lending agreement.[164] Moreover, the debtor maintained that these funds were insufficient to cover the claims and the debtor's principal testified requiring immediate payment would cause the debtor's reorganization efforts to "collapse."[165]

After the parties stipulated that the payment of administrative expense claims was within the court's discretion, the court applied the *In re Garden Ridge* factors.[166] These factors, formulated to address the timing of paying section 503(b)(1)(A) administrative expenses, require the court to evaluate: "(1) the prejudice to the debtors, (2) hardship to claimant, and (3) potential detriment to other creditors."[167]

As applied, the court held that compelling immediate payment would significantly prejudice the debtor because the order would in all likelihood destroy the debtor's attempted reorganization.[168] Second, the claimant failed to demonstrate hardship, given that its annual sales exceeded $400 million.[169] Third, ruling for the debtor would preserve unsecured creditors' pro-rata distribution.[170] Moreover, the

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[158] *See id.*; Routh, *supra* note 5, at 78–79 (describing options bankruptcy courts have in paying twenty-day claims).

[159] *See* Routh, *supra* note 5, at 79; *see also In re Arts Dairy*, 414 B.R. at 221 (acknowledging courts have authorized payment of 503(b)(9) claims before plan's effective date); *In re Bookbinders' Rest.*, 2006 WL 3858020, at *4 (determining Congress intended to allow courts to determine when 503(b)(9) claims are paid).

[160] *See In re* Garden Ridge Corp., 323 B.R. 136, 143 (Bankr. D. Del. 2005) (finding court has discretion to determine when administrative expense paid); *In re* HQ Global Holdings, Inc., 282 B.R. 169, 173 (Bankr. D. Del. 2002) (determining timing of administrative expense payment within court's discretion).

[161] No. 06-10340, 2006 WL 3791955 (Bankr. D. Del. Dec. 21, 2006).

[162] No. 06-12302ELF, 2006 WL 3858020 (Bankr. E.D. Pa. Dec. 28, 2006).

[163] *In re Global Homes Prods., LLC*, 2006 WL 3791955, at *2.

[164] *Id.*

[165] *Id.* at *2, 4. At the time, some $2.1 million and counting in administrative expense claims had been filed. *Id.* at *4.

[166] *Id.* at *3–4.

[167] *Id.* at *4 (citing *In re* Garden Ridge Corp., 323 B.R. 136, 143 (Bankr. D. Del. 2005)).

[168] *Id.* (discussing testimony of debtor's chief restructuring officer).

[169] *Id.* at *5.

[170] *Id.*

court also expressed concern that granting the claimant's motion would create what one commenter deemed a "snowball effect" by prompting other creditors to request immediate payment and thereby stem the debtor's cash flow.[171]

The court in *Bookbinders* reached a similar result, although the claimant did not concede that the court had the discretionary authority to pay twenty-day claims. In *Bookbinders*, the vendor asserted an unqualified right to immediate payment of its twenty-day claim, just like the post-petition vendors the debtor was paying in its ordinary course of business payments under section 363(c)(1).[172] The court disagreed, noting that, unlike administrative expense payments, ordinary course of business payments can be made without court authorization.[173] The claimant had overlooked an important distinction between vendors conducting routine post-petition business with the debtor versus vendors seeking payment for pre-petition business.[174] Furthermore, the court was unconvinced that immediate payment in this case justified an "exception to the general rule" that payment of administrative expenses be left to the court's discretion.[175]

Most courts now apply the *Garden Ridge* factors to twenty-day claims, with nearly all of them deferring payment.[176] One of the only cases authorizing a motion for immediate payment involved local dairy farmers clamoring for payment from the debtor, a non-profit agricultural cooperative.[177] Given these facts, the court granted the farmers' motion.[178] The farmers could neither "be expected to finance the debtor's operations . . . [nor] afford to wait for payment."[179]

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[171] William J. Burnett & Colleen A. Garrity, *Two New Judges, Two New Opinions: Too Bad for 503(b)(9) Suppliers*, UNSECURED TRADE CREDITORS COMM. NEWSL. (Am. Bankr. Inst., Alexandria, Va.), Oct. 2007, http://abiworld.net/newsletter/utc/vol5num1/TwoNewOpinions.html; *see also* Thorne, *supra* note 121, at 89 (warning twenty-day claimants to monitor debtor's solvency to determine whether claims can be paid).

[172] *In re* Bookbinders' Rest., Inc., No. 06-12302ELF, 2006 WL 3858020, at *2 (Bankr. E.D. Pa. Dec. 28, 2006).

[173] *Id.* at *3.

[174] *Id.* at *6 (contrasting section 503(b)(9) with section 363(c)(1)).

[175] *Id.* at *5.

[176] *See, e.g.*, *In re* Modern Metal Prods. Co., 422 B.R. 118, 125 (Bankr. N.D. Ill. 2009) (denying immediate payment of approximately $19,000 twenty-day claim where potentially significant hardship to other creditors and where possibility debtor would be unable to pay all administrative expenses where not all twenty-day claimants had yet filed); *In re* TI Acquisition ("*TI Acquisition I*"), 410 B.R. 742, 743 (Bankr. N.D. Ga. 2009) (denying immediate payment). *But see In re* Humboldt Creamery, LLC, No. 09-11078, 2009 WL 2820552, at *1 (Bankr. N.D. Cal. Apr. 23, 2009) (holding Bankruptcy Rule 6003 establishes default rule against immediate payment of twenty-day claims). In *In re Arts Dairy, LLC*, the court denied a motion requesting immediate payment of an approximately $4000 twenty-day claim. 414 B.R. 219, 222 (Bankr. N.D. Ohio 2009). Prompt payment would not "noticeably" impact a reorganization plan, but delaying payment would also not impose serious hardship on the claimants given the "relatively small size" of the claim. *Id.* at 221. Ultimately, the court ruled that the third factor—the potential detriment to the other creditors—weighed against immediate payment, because funds would have to come from using another creditor's cash collateral. *Id.* at 222.

[177] *In re Humboldt Creamery, LLC*, 2009 WL 2820552, at *1.

[178] *Id.*

[179] *Id.*

Deferring payment of twenty-day claims may work to gut section 503(b)(9). In bankruptcy the general rule holds that "*when* a creditor gets paid may very well translate into *whether* a creditor gets paid."[180] Moreover, because section 503(b)(9) effectively curtails the chances of a successful reorganization, the likelihood that a debtor will be later deemed administratively insolvent and unable to pay deferred twenty-day claims increases.[181] In cases where the court has authorized payment of certain twenty-day claimants either after applying the *Garden Ridge* factors or through critical vendor motions, the debtor could subsequently liquidate, potentially leaving the remaining twenty-day claimants with nothing.[182]

B. Basis for a Claim

Like the allowance and payment issues touched on above, courts are also on their own to refine and fashion the standing, pleading, and burden of proof requirements for twenty-day claims. Much of this area is in its infancy, leaving open the likelihood of widely divergent future decisions.

1. Who Can Assert a Twenty-Day Claim?

While section 503(b)(9) protects certain vendors of goods, it says nothing about whether these vendors need to be unsecured. The Bankruptcy Appellate Panel for the Ninth Circuit first tackled this issue in *Brown & Cole Stores LLC v. Associated Grocers Inc.* (*In re Brown & Cole Stores, LLC*) ("*Brown*")[183] when it ruled that secured creditors have standing under section 503(b)(9). In *Brown*, a secured creditor held a first-position lien on the debtor's stock.[184] Because the stock's value had yet to be determined and the secured creditor feared that it was undersecured, it filed a motion to classify $6.4 million of its claim as a section 503(b)(9) administrative expense.[185]

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[180] Burnett & Garrity, *supra* note 171; *see* Berlin et al., *supra* note 7, at 364 (remarking discretionary authority to pay administrative expenses means "it is one thing to get it allowed, but it is another thing as to when you get it paid"); *see also In re* Corner Home Care, Inc., 438 B.R. 122, 130 (W.D. Ky. 2010) (conditioning allowance of potential twenty-day claim on vendor's return of post-petition payments); *In re* Fashion Shop of Ky., Inc., 364 B.R. 283, 284–85 (Bankr. W.D. Ky. 2007) (overruling objection to pay financial advisor before twenty-day claim when advisor retained as professional under section 327 and expressly allowed interim compensation under section 331).

[181] *See In re* Modern Metal Prods. Co., No. 08 B 73908, 2009 WL 1362632, at *3 (Bankr. N.D. Ill. May 13, 2009) (disallowing payment prior to plan confirmation); *In re* Bookbinders Rest., Inc., No. 06-12302ELF, 2006 WL 3858020, at *3 (Bankr. E.D. Pa. Dec. 28, 2006) (explaining how section 503(b)(9) increases likelihood of rendering debtor administratively insolvent).

[182] *See* Packman, *supra* note 110. Similarly, the timing of paying administrative expenses might also be moot issue where the debtor is deemed administratively insolvent on the petition date. *See id.* (explaining how administratively insolvent debtors paying twenty-day claims early in case might not have enough operating cash and how those who wait might be unable to put plan into effect).

[183] 375 B.R. 873, 875 (B.A.P. 9th Cir. 2007).

[184] *Id.* at 875 & n.3.

[185] *Id.* (noting parties disputed whether creditor was over or undersecured).

The debtor-grocery store retailer objected to the claim, arguing that the court should interpret section 503(b)(9) by looking to the legislative history of section 503(b)(1)(B)(i), which provides an administrative expense for certain taxes incurred by the estate.[186] Courts were initially split over whether this section applied to secured tax claims, but BAPCPA resolved the issue by amending the provision to apply to all tax claims "whether secured or unsecured."[187] The debtor argued that Congress's failure to include such explicit language in section 503(b)(9) evidenced its intention for the section to only apply to unsecured claims.[188] The *Brown* majority rejected this position, holding that its only obligation was to enforce the statute by its plain language.[189] In any event, Congress omitted both "secured" and "unsecured" from the statute, highlighting its intention to give "all claims arising from twenty-day sales" administrative priority status.[190]

Additionally, the debtor—and later dissenting Judge Joroslovsky—argued that allowing secured creditors to make twenty-day claims could "be inequitable to other creditors."[191] Judge Joroslovky stressed that, while administrative expense claims and secured claims must be paid in full in a reorganization, only the latter can be modified under the cramdown provision of section 1129(b)(2)(A) to allow for a confirmable reorganization plan.[192] Therefore, to afford secured creditors with dual protection under section 503(b)(9) would work to "unravel[] other provisions of the Code meant to facilitate reorganization."[193] Secured creditors would then have veto power over reorganization plans, which would undermine the "sound bankruptcy policy . . . that a secured creditor can be forced to accept a plan which is fair and equitable to it, honors its secured status and pays its secured claim in full over time."[194]

The *Brown* majority contended that it was only following whatever Congressional policy was articulated in the statutory language of the Code.[195] The wisdom of that policy was not for the court to question:

> Congress gave tremendous leverage to a twenty-day sales claimant . . . by permitting it to demand full payment as of confirmation, and

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[186] *Id.*

[187] *Id.* at 878; *see also* 11 U.S.C. § 503(b)(1)(B)(i) (2006); *In re* Soltan, 234 B.R. 260, 269 (Bankr. E.D.N.Y. 1999) (summarizing pre-BAPCPA split of authority).

[188] *In re Brown & Cole Stores, LLC*, 375 B.R. at 878; *see also* Hon. Randolph Baxter, *Bench View: A Further Examination of § 503(b)(9)*, UNSECURED TRADE CREDITORS COMM. NEWSL. (Am. Bankr. Inst., Alexandria, Va.), Aug. 2010, http://www.abiworld.org/committees/newsletters/UTC/vol6num2/UTC_August_2008_When_Circuits_Collide_Bench_View.pdf (discussing debtor's grounds for opposing secured creditor's twenty-day claim in *Brown*).

[189] *In re Brown & Cole Stores, LLC*, 375 B.R. at 878.

[190] *Id.*

[191] *Id.* at 878; *see also id.* at 881–82 (Joroslovsky, J., concurring in part and dissenting in part).

[192] *Id.* at 881 (noting policy considerations impacted by allowing secured creditors twenty-day claims).

[193] *Id.* at 882.

[194] *Id.* at 881–82.

[195] *Id.* at 878 (majority opinion).

> in doing so, perhaps dramatically affecting the outcome of the case. The fact that [a] claim is also secured represents less leverage (albeit more than held by non-priority general unsecured claims) than having administrative priority. It is not our place to reallocate that leverage.[196]

Secured creditors would have "less leverage" because any funds allocated to paying the twenty-day claim would be deducted from their secured claim and thereby reduce their veto power over a reorganization plan.[197] The reduced lien would then "free up" collateral "for the benefit of other creditors."[198] Yet the majority seemed to contradict itself in rebutting Judge Joroslovky. The court said that, even if Joroslovsky's "either-or" view was the law, a twenty-day claimant "could simply waive its security, obtain administrative priority, and have equally powerful influence over the outcome of the case."[199]

While the *Brown* majority's statutory arguments adhere to the text of section 503(b)(9), from a policy standpoint, the court misunderstood the typical secured creditor's decision-making process. Given the potential for conversion and the likelihood that there might not be enough funds to pay administrative expenses, it seems unlikely that a secured creditor would cede its collateral in favor of a twenty-day claim, unless it is either certain that the claim will be repaid or it is so undersecured that conversion will not affect its distribution.[200]

In any event, both the dissent and majority recognized that secured creditors with twenty-day claims will now have considerably more leverage in cases where the debtor is sure to emerge intact from a reorganization.[201] Nothing should stop secured creditors from filing as large a twenty-day claim as they believe a debtor can pay, purely to avoid the undesirable possibility of deferred payment under cramdown.[202] Additionally, a secured creditor can always threaten to file a twenty-day claim in order to exert greater influence on a proposed reorganization plan.[203]

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[196] *Id.* at 878 n.8.
[197] *See id.*
[198] *Id.* at 878.
[199] *Id.* at 878 n.8.
[200] *See supra* notes 117–18 and accompanying text.
[201] *In re Brown & Cole Stores, LLC*, 375 B.R. at 878 n.8; *id.* at 881–82 (Jaroslovsky, J., concurring in part and dissenting in part) (recognizing considerable power bestowed upon secured creditors with twenty-day claims).
[202] *See id.* at 878 (majority opinion); Stuart Larsen, *Ninth Circuit BAP Teaches Creditors Something New About § 503(b)(9) Priority Claims*, AM. BANKR. INST. J., Dec./Jan. 2008, at 50 (noting twenty-day claimant guaranteed payment upon confirmation and claim not subject to "cramdown").
[203] *See In re Brown & Cole Stores, LLC*, 375 B.R. at 878 n.8 (acknowledging "tremendous leverage" of secured creditors holding twenty-day claims); Larsen, *supra* note 202, at 50 (observing twenty-day sales claimants can "dramatically affect[] the outcome of the case").

2. Can a Creditor Alternatively Assert a Twenty-Day Claim?

A variation of the standing issue addressed in *Brown* involves whether a creditor can alternatively assert a twenty-day claim as a section 503(b)(1)(A) administrative expense, covering the "actual" and "necessary costs" associated with "preserving the estate."[204] One case, *In re Rio Valley Motors Company* ("*Rio Valley*"),[205] suggests that alternatively asserting administrative expense claims might be possible. In *Rio Valley*, the creditor was involved in a vehicle and check swapping arrangement with the debtor-car dealership.[206] The debtor traded vehicles and checks with the creditor, enabling both to update their inventory while keeping their books balanced.[207] At some point, creditor delivered a truck and check to the debtor, which the debtor promptly resold for a profit.[208] The debtor never wrote a check to the creditor.[209]

Due to the debtor and creditor's conflicting versions of when the exchange took place, the court could not tell whether the good (*i.e.*, the truck) was received twenty days pre-petition or post-petition.[210] Despite stressing that the exchange date was irrelevant given that the creditor provided a necessary benefit to the estate under section 503(b)(1)(A), the court still ducked the issue of an "either/or claim" by reserving judgment until the actual swap date was discerned.[211] Thus, the case provides a potential factual scenario where a vendor, absent section 503(b)(9)'s protection, might still receive administrative expense treatment under section 503(b)(1)(A).

3. Who has the Burden of Proving a Twenty-Day Claim?

The uncertainty in *Rio Valley* concerning when the debtor received the truck underscores the larger issue of determining when the elements of a valid twenty-day

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[204] *See* 11 U.S.C. § 503(b)(1)(A) (2006) (indicating post-petition wages, salaries, and commissions may qualify as administrative expenses); *see also* 5 COLLIER ON BANKRUPTCY, ¶ 503.06, at 503-26 (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2010) (noting section 503(b)(1)(A) does not specifically enumerate allowable administrative claims); Jeffrey S. Theuer, *Aligning Environmental Policy and Bankruptcy Protection: Who Pays for Environmental Claims Under the Bankruptcy Code?*, 13 T.M. COOLEY L. REV. 465, 506–07 (1996) (arguing for narrow construction of administrative expenses).

[205] 2008 WL 824271 (Bankr. D.N.M. Mar. 24, 2008).

[206] *Id.* at *1 (noting creditor swapped Ford for debtor's Chevy).

[207] *Id.*

[208] *Id.*

[209] *Id.*

[210] *Id.* at *1 n.2 (stating neither party provided documentary evidence to assist court in fact determination). Because jurisdictions vary on what may qualify as a section 503(b)(1)(A) expanse, *see supra* note 47 and accompanying text, the claimant in *Rio Valley* would have to satisfy the Tenth Circuit two-prong test. *In re Rio Valley Motors Co.*, 2008 WL 824271, at *1. The claimant would need to demonstrate (1) an expense arising out of a transaction between the trustee or debtor-in-possession and (2) "consideration supporting the creditor's right to payment [that is] . . . both supplied to and beneficial to the debtor-in-possession in the operation of the business." *Id.*

[211] *See In re Rio Valley Motors Co*., 2008 WL 824271, at *2; *see also* Wheeler, *supra* note 155, at 16, 50.

claim under section 503(b)(9) are met. Because claimants derive the benefit of an administrative expense classification, they have the burden of establishing a *prima facie* claim.[212] If no party objects to the claim, it is deemed *prima facie* valid.[213] But assuming a party objects and the claimant has otherwise complied with the court's bar dates,[214] three statutory requirements must be met. The claimant must establish that: "(1) the [vendor] sold 'goods' to the debtor; (2) the goods were received within 20 days prior to the bankruptcy filing; and (3) the goods were sold 'in the ordinary course of [the debtor's] business.'"[215] Courts must also assume a fourth requirement in that the vendor was not compensated for the sale.[216]

Usually a claimant can produce an invoice dated twenty-days pre-petition (a "twenty-day invoice") and satisfy its evidentiary burden, yet claims often fail to meet the statutory requirements.[217] Sometimes claims fail because they involve novel concepts of what constitutes a "good."[218] More commonly, claims fail when it is unclear whether the debtor prepaid for the goods shipped within the twenty-day period.[219] In these cases, the court weighs the evidence by looking to notations on

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[212] *See, e.g.*, *In re* SemCrude, L.P., 416 B.R. 399, 403 (Bankr. D. Del. 2009) (providing burden of proof on claimant seeking allowance of administrative claim); *see also In re* Renew Energy, LLC, No. 09-10491, 2009 WL 3320420, at *2 (Bankr. W.D. Wis. Sept. 30, 2009) (finding claimant bears burden of establishing administrative claim entitlement), *aff'd*, Polsky v. Renew Energy, LLC, No. 09-cv-701-bbc, 2010 WL 842317 (W.D. Wis. Mar. 5, 2010); *In re* Wetco Rest. Group, LLC, No. 07-51169, 2008 WL 1848779, at *2 (Bankr. W.D. La. Apr. 23, 2008) ("[Claimant] has the burden to establish that the value of the 20-Day Goods qualifies for administrative expense treatment under section 503(b)(9).").

[213] *See In re SemCrude, L.P.*, 416 B.R. at 404 ("[A] threshold presumption of validity has attached to the Twenty-Day Claims that were scheduled by the Debtor without qualification or set forth in the Notice and constitutes prima facie evidence of the validity and amount of the Twenty-Day Claim."); *see also* 11 U.S.C. § 502(d) (2006) (deeming any claim filed under section 501 allowed unless party in interest objects); *In re* Circuit City Stores, Inc. ("*Circuit City II*"), 426 B.R. 560, 571 (Bankr. E.D. Va. 2010) (applying section 502(d) to section 503(b)(9) and allowing twenty-day claims unless objection made to particular claim).

[214] *See In re* Goody's Family Clothing, Inc., 401 B.R. 131, 136 (Bankr. D. Del. 2009) (denying alleged twenty-day claim for re-ticketing apparel where claimant had not initially filed application for allowance); *see also In re* BH S&B Holdings, LLC, 435 B.R. 153, 164–65 (Bankr. S.D.N.Y. 2010) (explaining significance of administrative expense bar dates in notifying parties of those making claims against estate and their general amount).

[215] *In re Goody's Family Clothing, Inc.*, 401 B.R. at 133 (citing *In re* Brown & Cole Stores, LLC, 375 B.R. 873, 878 n.7 (9th Cir. B.A.P. 2007)); *see also In re SemCrude, L.P.*, 416 B.R. at 403 (articulating similar three requirements); *In re* Pilgrim's Pride Corp., 421 B.R. 231, 235 (Bankr. N.D. Tex. 2009).

[216] *See* Berkoff, *supra* note 119, at 404 (indicating obligation must remain outstanding for valid section 503(b)(9) claim); *see also In re* Commissary Operations, Inc., 421 B.R. 873, 878 (Bankr. M.D. Tenn. 2010) (explaining fully paid vendors lack claimant status under section 503(b)(9)); Lisa Gretchko, *Last in Line: Sixth Circuit's Phar-Mor Decision Breathes New Life into Reclamation Remedy*, AM. BANKR. INST. J., Sept. 2008, at 55 (discussing how section 503(b)(9) can be seen as remedy for uncompensated vendor).

[217] *See, e.g.*, *In re* Arts Dairy, LLC, 417 B.R. 495, 505 (Bankr. N.D. Ohio 2009) (denying twenty-day claim where receipt of corn silage occurred more than half year post-petition); *In re* Roland Pugh Constr., Inc., No. BK 06-71769-CMS-11, 2007 WL 509225, at *4 (Bankr. N.D. Ala. Feb. 12, 2007) (holding section 503(b)(9) inapplicable where claimants failed to reference when goods were received by debtor).

[218] *See infra* Part III.C.1.

[219] *See, e.g.*, *In re* Renew Energy, LLC, No. 09-10491, 2009 WL 3320420, at *3 (Bankr. W.D. Wis. Sept. 30, 2009) (deciding whether payments in twenty-day period were prepayments or payments on old invoices), *aff'd sub nom.* Polsky v. Renew Energy, LLC, No. 09-cv-701-bbc, 2010 WL 842317 at *7 (W.D. Wis. Mar.

invoices and bills, as well as the payment and delivery cycles between the parties.[220] Remarkably, some courts have held that if the intention of the parties was to require the debtor to prepay for goods, then goods delivered twenty days pre-petition will be deemed prepaid.[221]

The requirements for a valid twenty-day claim also highlight an important distinction from the requirements for reclamation. Section 546(c) merely requires the sale to be in the *seller's* ordinary course of business whereas section 503(b)(9) looks at whether the sale is in the *debtor's* ordinary course of business.[222] For example, in *In re Magwood*,[223] the court held that the claimant used car dealership did not have a twenty-day claim when it sold a car to the chapter 13 debtor "because, *inter alia*, the debtor [was] not in the business of buying vehicles."[224] Under section 546(c), this fact is irrelevant. Consequently, section 503(b)(9) puts an additional burden on vendors to be aware of whether their customers' purchases are within their ordinary course of business.[225] Moreover, in individual and small business bankruptcies where the debtor tends to have limited purchasing power and, therefore, less ordinary course of business activities, the reach of section 503(b)(9) is considerably reduced.

5, 2010); *In re* Wetco Rest. Group, LLC, No. 07-51169, 2008 WL 1848779, at *3 (Bankr. W.D. La. Apr. 23, 2008) (holding claimant did not overcome evidence indicating debtor prepaid for goods shipments made twenty days pre-petition); *see also In re* TI Acquisition ("*TI Acquisition I*"), 410 B.R. 742, 748 (Bankr. N.D. Ga. 2009) (determining debtor's payments were on prior invoices and not prepayments for goods received in twenty-day period).

[220] *See In re Renew Energy, LLC*, 2009 WL 3320420, at *3 (indicating prepayment because wire transfers had label "prepay"); *In re Wetco Rest. Group, LLC*, 2008 WL 1848779, at *2 (finding no twenty-day claim where vendor booked payments as "prepaid," required wire transfer payment before shipment, and when payments corresponded to vendor's oldest outstanding invoice); *see also TI Acquisition I*, 410 B.R. at 748 (determining prepayment because parties agreed they intended pre-petition payments to be applied to oldest invoices).

[221] *See In re Renew Energy, LLC*, 2009 WL 3320420 at *3 (holding corn deliveries prepaid where evidence established parties intended prepaid deliveries); *TI Acquisition I*, 410 B.R. at 748 (construing evidence as "clearly establishing" payments on prior invoices where undisputed by parties); *In re* WETCO Rest. Group, LLC, No. 07-51159, 2008 WL 1848779 at *2 (Bankr. W.D. La. Apr. 23, 2008) (focusing prepayment inquiry on parties' intent and finding intent to prepay). Clearly, the benefit of equating intention of prepayment to actual prepayment inures to debtor who now has one less administrative expense about which to worry.

[222] *See* James A. Sullivan & Gary O. Ravert, *A Vendor's Guide to Bankruptcy*, 1 BLOOMBERG CORP. L.J. 494, 519 (2006), *available at* http://www.mwe.com/info/pubs/bloomberg_sullivan_ravert.pdf (noting swapped party standard for two sections' ordinary course of business requirements). *Compare* 11 U.S.C. § 503(b)(9) (2006) *with id.* § 546(c).

[223] No. 07-11288-DHW, 2008 WL 509635 (Bankr. M.D. Ala. Feb. 22, 2008).

[224] *Id.* at *1 n.1.

[225] *See* 11 U.S.C. § 503(b)(9) (requiring goods be sold in ordinary course of debtor's business); Kate Stickles & David Dean, *A Roadmap For Managing §503(b)(9) Claims and Objections: The Debtor's Perspective*, AM. BANKR. INST. J., Oct. 2008, at 75–76 (explaining debtor must be in business of buying goods at issue).

C. Scope of a Claim

The most heavily litigated twenty-day claims issues involve the subject matter or the scope of section 503(b)(9).[226] These issues primarily arise from Congress's failure to define section 503(b)(9)'s choice terms like "goods," "received," and "value." Generally, courts have applied U.C.C. definitions given the statute's near national adoption and the perception that the U.C.C.'s definitions are the most consistent with the expectations of parties to a commercial transaction.[227] Furthermore, some courts view section 503(b)(9)'s inclusion under the "Reclamation" section of BAPCPA as an indication to apply U.C.C. definitions to a U.C.C.-based right.[228]

However, applying U.C.C. definitions by no means definitively resolves what kinds of claims are covered by section 503(b)(9). As with any statute, the U.C.C. definitions leave room for interpretation. Thus, with creditors pushing for an expansive interpretation of section 503(b)(9)'s terms and debtors pushing for a narrowed reading of the section, courts inevitably reach different results. Ultimately, the more expansive the court's definition or interpretation, the greater the debtor's potential administrative expense liability and the more cash it must allocate away from a reorganization plan.

1. Does the Claim Involve a "Good"?

Courts almost universally agree that when defining the term "good" under section 503(b)(9), the U.C.C.'s goods definition should apply.[229] Under U.C.C. § 2-105(1), "goods" are defined as:

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[226] *See* Kunz, *It's Not Double-Counting*, *supra* note 67, at 16 ("[T]o the extent that the express language of § 503(b)(9) can be litigated, debtors and creditors are locking horns on nearly every word."); Wilson & Long, *supra* note 9, at 20 (noting litany of issues being litigated regarding section 509(b)(9)'s scope); *see also In re* Goody's Family Clothing, Inc., 401 B.R. 131, 134 & n.13 (Bankr. D. Del. 2009) (listing cases concerning subject matter of section 503(b)(9)).

[227] *See* Bernstein & Rich, *supra* note 87, at 27 (noting forty-nine states have adopted U.C.C., and U.C.C. definitions tend to be consistent with "ordinary usage" of section 503(b)(9)'s terms); *see also In re* Circuit City Stores, Inc. ("*Circuit City IV*"), 432 B.R. 225, 228 (Bankr. E.D. Va. 2010) (rejecting state law definition of "received" due to impracticality in large bankruptcies and because Congress "contemplated a consistent, uniform approach to its interpretation"); *In re* SemCrude L.P., 416 B.R. 399, 405 (Bankr. D. Del. 2009) ("The terms at issue here—'received', 'sold', 'ordinary course of business'—are not defined in the Bankruptcy Code . . . . There is nothing in the Code or in the legislative history accompanying the recent enactment of § 503(b)(9) suggesting that Congress intended that bankruptcy courts should look beyond the Uniform Commercial Code to construe or define these terms as they apply to sales of goods."); Tom McNamara, *Graduating from Obscurity: The U.N. International Sale of Goods Convention*, HG.ORG, June 24, 2004, http://www.hg.org/articles/article_1224.html (observing U.C.C. is familiar to U.S. traders and reflects expectations of U.S. business community).

[228] *See* Bernstein & Rich, *supra* note 87, at 27 (noting court's reliance on BAPCPA subtitle); *see In re* Circuit City Stores, Inc. ("*Circuit City I*"), 416 B.R. 531, 536 (Bankr. E.D. Va. 2009) (alluding to section 503(b)(9)'s placement in BAPCPA as grounds for adopting U.C.C. definition of "goods").

[229] *See In re* Erving Indus., Inc., 432 B.R. 354, 365 (Bankr. D. Mass. 2010*)* (adopting U.C.C. definition when "hardly plausible that Congress expected bankruptcy judges to roll up their sleeves and set to work

> . . . all things (including specially manufactured goods) which are movable at the time of identification to the contract for sale other than the money in which the price is to be paid, investment securities and things in action . . . and other identified things . . . to be severed from realty.[230]

Yet even this definition causes its own headaches for courts as vendors seeking administrative expense treatment under section 503(b)(9) continue to push the envelope of what constitutes a "good."[231] Courts have held that costs associated with inspecting and repackaging apparel,[232] removing garbage and sewage,[233] shipping goods,[234] and advertising in a creditor's phonebook all do not involve the sale of goods.[235] On the other hand, courts have held that salt and chloride de-icer, processed plastic pellets, and parts used for engine testing are all "goods" eligible for protection under section 503(b)(9).[236]

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reinventing the proverbial wheel"); *In re Goody's Family Clothing, Inc.*, 401 B.R. at 134 (applying U.C.C. § 2-105(1) "goods" definition); *In re* Pilgrim's Pride Corp., 421 B.R. 231, 237 (Bankr. N.D. Tex. 2009) (utilizing U.C.C. definition); *In re* Plastech Engineered Prods., Inc. ("*Plastech I*"), 397 B.R. 828, 838 (Bankr. E.D. Mich. 2008) (using U.C.C. definition). *But see* Steve Krause & Irina Boulyjenkova, *'Would You Like Fries With That?': Goods vs Services Under § 503(b)(9) of the Bankruptcy Code*, BANKR. STRATEGIST, Aug. 2010, at 1 (noting differences in court reliance on U.C.C. "goods" definition).

[230] U.C.C. § 2-105(1) (2005). Curiously, courts and commentators originally believed that Article 9 of the U.C.C. (governing secured transactions) contained the appropriate U.C.C. "goods" definition to apply to section 503(b)(9). *See, e.g.*, *In re* Deer, No. 06-02460, 2007 WL 6887241, at * 2 (Bankr. S.D. Miss. June 14, 2007) (applying U.C.C. § 9-201 definition of "goods"); 4 COLLIER ON BANKRUPTCY ¶ 503.16[1] at 503-95 (Matthew Bender 15th rev. ed. 2005) (believing courts will likely use Article 9 definition); Miller & Welford, *supra* note 131, at 489 (suggesting courts look to Article 9 as guide for defining term).

[231] *See* William L. Medford & Bruce H. White, *Utilities As Providers of Goods Under § 503(b)(9)*, AM. BANKR. INST. J., Dec./Jan. 2010, at 22 ("[M]any creditors have asserted that §503(b)(9)'s provisions extend to services."); *see also* GFI Wis., Inc. v. Reedsburg Util. Comm'n, 440 B.R. 791, 801 (W.D. Wis. 2010) (asserting "goods" definition may be stretched to include electricity provided by service company). *But see In re* Samaritan Alliance LLC, No. 07-50735, 2008 WL 2520107, at *4 (Bankr. E.D. Ky. June 20, 2008) (holding definition of "goods" does not include electricity though acknowledging courts are split).

[232] *See In re Goody's*, 401 B.R. at 136–37 (rejecting administrative expense claim for tagged, inspected, and repackaged garments). The court did suggest that the creditor would have had a twenty-day claim if it had presented evidence regarding the value of the tags used to ticket the repackaged apparel. *Id.*

[233] *See In re Pilgrim's Pride Corp.*, 421 B.R. at 241–42.

[234] *Id.* at 242–43.

[235] *In re Deer*, 2007 WL 6887241, at *2 (rejecting claim under U.C.C. § 9-201).

[236] *In re* Plastech Engineered Prods., Inc. ("*Plastech I*"), 397 B.R. 828, 838–39 (Bankr. E.D. Mich. 2008). The case of the plastic pellets is particularly noteworthy given how they were made and sold to the debtor. The pellets were made from the debtor's scrap waste that was picked up by the creditor under contract and then processed. *Id.* at 833. The debtor would then order the pellets from the creditor who charged the debtor below market value. *Id.* The court held that neither the pellet production process nor the price charged for the pellets was relevant to their classification as "goods." *Id.* at 839. *But see In re* Modern Metal Prods. Co., No. 08-73908, 2009 WL 3020142, at *1, *3 (Bankr. N.D. Ill. Sept. 16, 2009) (determining no sale of "goods" where creditor processed debtor-owned steel).

a. Do Utility Providers Sell Goods?

Courts have considerable difficulty differentiating between goods and services in the context of utility companies providing gas, water, and electricity to customers. Debtors primarily argue that courts must decide these issues by looking to the BAPCPA amendments to section 366.[237] Courts argue that, because Congress enhanced the rights of utility companies with the BAPCPA amendments to section 366, section 503(b)(9) should be foreclosed as applied to them.[238] Specifically, debtors point to subsection (c)(4), which Congress amended to allow utilities to "set off" or "recover" a debtor's pre-petition security deposit at any time without judicial notice or permission.[239] Although courts concede that Congress probably did not mean for utilities to have the joint protections of sections 366(c) and section 503(b)(9), they hold that the statutory language of both provisions does not prohibit that result.[240] Thus, the primary inquiry for courts is whether a utility provider sells a "good" under the U.C.C.

In deciding whether utility providers of gas and water have twenty-day claims, courts look to U.C.C. § 2-107(1), which governs mineral contracts. This section provides:

> A contract for the sale of minerals or the like (including oil and gas) or a structure or its materials to be removed from realty is a contract for the sale of goods . . . if they are to be severed by the seller . . . .[241]

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[237] *See* Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 417, 119 Stat. 23, 108 (introducing amendments to 11 U.S.C. § 366); *see, e.g.*, GFI Wis., Inc. v. Reedsburg Util. Comm'n, 440 B.R. 791, 801 (W.D. Wis. 2010) (rejecting debtor's argument utility providers cannot recover under section 503(b)(9) due to protections of section 366); *In re* Erving Indus., Inc., 432 B.R. 354, 357 (Bankr. D. Mass. 2010) (describing debtor's argument against allowing section 503(b)(9) protection to utilities when they are specifically addressed within section 366).

[238] *See, e.g., Plastech I*, 397 B.R. at 839 (overruling objection of debtor that existence of section 366 precludes utilities from claims under section 503(b)(9)); Debtor's Omnibus Reply to Section 503(b)(9) Objections at 9–10, *In re* Pilgrim's Pride Corp., 421 B.R. 231 (Bankr. N.D. Tex. 2009) (No. 08-45664) (arguing Congress did not intend for utilities to have claims under section 503(b)(9)); *supra* note 237.

[239] 11 U.S.C. § 366(c)(4) (2006) (authorizing utility providers to recover or set off debtor's post-petition delinquencies from pre-petition deposit); *accord In re* Weisel, 400 B.R. 457, 474 (Bankr. W.D. Pa. 2009) (holding utility provider entitled to unilaterally terminate service without judicial notice after debtor became delinquent on post-petition payments). *See generally* Geida D. Sanlate, *Tilting the Scale in Favor of Debtors in Light of BAPCPA's Amendment of Section 366*, 4 RUTGERS BUS. L.J. 42, 66 (2007).

[240] *See GFI Wis., Inc.*, 440 B.R. at 801 (explaining utilities providers may be protected by both sections 366 and 503(b)(9) because these sections not mutually exclusive); *In re Pilgrim's Pride Corp.*, 421 B.R. at 241 (noting utilities can benefit from both provisions because court bound by plain language of statutes, irrespective of whether Congress intended this result); *Plastech I*, 397 B.R. at 839 (stating section 366 does not prevent provider of utility service from having section 503(b)(9) claim).

[241] U.C.C. § 2-107(1) (2005) (defining contracts for minerals as contracts for sale of goods).

The court in *In re Pilgrim's Pride Corp.* ("*Pilgrim's Pride*")[242] applied this definition and concluded that, because gas had been delivered by truck, it was "severed from the realty" and constituted a good.[243] The court also held that municipally-supplied water involved the sale of goods after determining that water was a "mineral" under section 2-701(1).[244] The court noted that, although Congress probably did not intend for utilities to have claims under section 503(b)(9), "it would be remiss to ignore the plain language of the statute simply because of any doubts it may have about Congress's intent."[245]

Due in part to electricity's inherent scientific complexity and speed, courts sharply disagree over whether electricity is a good when delivered by utility companies or other third party providers.[246] For example, in *In re Erving Indus., Inc.* ("*Erving*"),[247] the court held that electricity was a good under an arrangement where the claimant bought electricity from power companies and resold it to a debtor that had independently contracted for its delivery.[248]

The court recognized that "even great physicists tell us [electricity's] essential nature remains unknown," but applied U.C.C. § 2-105(1) anyway.[249] The court concluded that electricity is "moveable" because it flows as a current through wires, "identifiable" because it can be measured when it passes through an energy meter, and "identifiable to the contract for sale" the moment it passes through the meter.[250] But the court went beyond the U.C.C. analysis by stressing that, in the deregulated electricity market, electricity is routinely bought and sold like any other commodity.[251] Thus, the debtor was slapped with a $281,667.88 twenty-day claim.[252]

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[242] 421 B.R. 231 (Bankr. N.D. Tex. 2009).

[243] *Id.* at 240–41.

[244] *Id.* at 242 (relying further on *Black's Law Dictionary* definition of "mineral"). Unfortunately, the court did not directly address whether the water was in fact severed from realty. *Id.*

[245] *Id.* at 241 n.10.

[246] *See In re* Grede Foundries, Inc., 435 B.R. 593, 596 (Bankr. W.D. Wis. 2010) (noting courts have more easily determined whether gas and water, rather than electricity, are "goods"), *aff'd sub nom.* GFI Wis., Inc. v. Reedsburg Util. Comm'n, 440 B.R. 791 (W.D. Wis. 2010); *In re* Erving Indus., Inc., 432 B.R. 354, 374 (Bankr. D. Mass. 2010) (holding electricity to be "good"); *In re* Pilgrim's Pride Corp., 421 B.R. 231, 240 (Bankr. N.D. Tex. 2009) (stating electricity providers are service providers); *In re* Samaritan Alliance, LLC, No. 07-50735, 2008 WL 2520107, at *4 (Bankr. E.D. Ky. June 20, 2008) (concluding electricity is service).

[247] 432 B.R. 354 (Bankr. D. Mass. 2010).

[248] *Id.* at 362–64. Under this type of arrangement, the energy industry would consider the claimant a "competitive supplier." *Id.* at 362.

[249] *Id.* at 366.

[250] *Id.* at 369–70; *see also In re Grede Foundries, Inc.*, 435 B.R. at 595 (using U.C.C. § 2-501's insurable interest rules for sale of goods contract as further indication "good" includes electricity).

[251] *In re Erving Indus., Inc.*, 432 B.R. at 369 n.34 (analogizing electricity with commodity because it can be bought and sold); *see also GFI Wis., Inc.*, 440 B.R. at 798 (extending *Erving* to hold electricity sold directly by utility company constituted goods).

[252] *In re Erving Indus., Inc.*, 432 B.R. at 356.

Other courts consider electricity analogous to television or internet signals as opposed to a "good."[253] These courts have also implicitly suggested that electricity is not inherently reclaimable because the instant after it is identified to the contract (via the energy meter), it is "impossible for the consumer to return electricity to the provider."[254] Moreover, some courts have declined the invitation to read section 503(b)(9) so broadly, citing the judicial policy to narrowly construe administrative expenses.[255] As one court noted, "[i]t seems unlikely that Congress intended such a fundamental change to administrative claims effecting so many bankruptcy cases in the absence of clearer language."[256]

Ultimately, holding that utility providers sell goods creates two potential problems. First, these decisions create the issue of differentiating between goods and services where the claimant invokes both section 366 and section 503(b)(9).[257] Section 366 is titled "Utility Service," and, apart from subsection (c)(4), the section discusses a utility provider's rights for providing a "service."[258] Therefore, depending on what the utility provider claims the sold goods were, a court would have to determine the "services" and their worth under section 366. This would be a mandatory determination where the utility provider recovered the debtor's deposit under subsection (c)(4) and the deposit was made twenty-days pre-petition.

Second, the courts that have held that utility providers sell "goods" directly undercut the reclamation fortification theory.[259] These courts have explicitly rejected the notion that a "good" must be reclaimable under section 546(c) to come within section 503(b)(9). They do not read this requirement from the "plain meaning" of section 503(b)(9).[260] Remarkably, in holding that electricity is a

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[253] *See In re* Pilgrim's Pride Corp., 421 B.R. 231, 238 (Bankr. N.D. Tex. 2009) ("[O]ne can have property rights in trademarks, patents, and copyrights, but no one would argue that intellectual property falls under the U.C.C. definition of 'goods.'"); *see also In re* MBS Mgmt. Servs., Inc., 430 B.R. 750, 753 (Bankr. E.D. La. 2010) (characterizing electricity as commodity); *In re* Samaritan Alliance, LLC, No. 07-50735, 2008 WL 2520107, at *4 (Bankr. E.D. Ky. June 20, 2008) ("[E]lectricity provided is more properly characterized as a 'service.'"). The *Erving* court rejected this comparison by differentiating electricity as "*the thing* that the customer seeks to purchase" whereas communication signals are a "*mechanism*" to transmit valued intellectual property. *In re Erving Indus., Inc.*, 432 B.R. at 368.

[254] *In re Pilgrim's Pride Corp.*, 421 B.R. at 239.

[255] *See In re* TI Acquisition, LLC ("*TI Acquisition II*"), 429 B.R. 377, 382 (Bankr. N.D. Ga. 2010) (noting application of "stringent test" pursuant to section 509(b)(3) claims); *see also In re Pilgrim's Pride Corp.*, 421 B.R. at 240 n.9 (acknowledging precedent narrowly construing section 503(b)(1)(A) administrative expense claims to conclude "goods" under section 503(b)(9) should be narrowly construed to exclude electricity).

[256] *In re Samaritan Alliance*, 2008 WL 2520107, at *3.

[257] *See infra* Part III.C.1.b.

[258] 11 U.S.C. § 366 (2006); *see* GFI Wis., Inc. v. Reedsburg Util. Comm'n, 440 B.R. 791, 801 (W.D. Wis. 2010) (holding utility company provided "service" under section 366 and delivered "goods" under section 503(b)(9)); *In re Erving Indus.*, 432 B.R. at 370 ("[E]lectricity constitutes a good within the meaning of the U.C.C. and § 503(b)(9).").

[259] *See supra* Part II.C.4.

[260] *See GFI Wis., Inc.*, 440 B.R. at 802 (finding sections 503(b)(9) and 546(c) are independent of each other and rejecting idea administrative claims require ability to reclaim goods); *In re* Plastech Engineered Prods., Inc. ("*Plastech I*"), 397 B.R. 828, 838 (Bankr. E.D. Mich. 2008) ("Section [] 546 does not limit or control in any way the rights that a claimant has under § 503(b)(9)."); COLLIER ON BANKRUPTCY, ¶ 546.04

"good," one court said that, "[i]n some circumstances, electricity might well be reclaimable, as when it is stored in a battery."[261] But is the good here the electricity or the battery?

b. How do Mixed or Hybrid Goods and Services Claims Qualify?

As alluded to above, even where courts have determined what qualifies as a good, they must still decide how claims arising from transactions involving goods and services (so-called "mixed" or "hybrid" claims) may qualify under section 503(b)(9). As with most issues arising under section 503(b)(9), Congress's lack of statutory guidance has led to markedly different approaches in how courts treat hybrid claims. Courts are essentially split into two camps: those favoring the "primary" or "predominant" test and those relying on an allocation approach.[262]

Currently, only one court has applied the predominant purpose test.[263] The test was originally formulated to determine whether the U.C.C., which solely governs the sale of goods, would apply to certain contracts involving certain services or service-related elements.[264] The test looks to whether "goods [are] incidentally involved (*e.g.*, contract with artist for painting) or . . . [whether] labor [is] incidentally involved (*e.g.*, installation of a water heater in a bathroom)."[265] As applied to hybrid claims, the court will not consider whether *any* goods are involved, but rather whether the *entire* claim is *predominantly based* on a sale of goods transaction.[266] The court in *In re Circuit City* ("*Circuit City I*"),[267] adopted the

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(Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2011), *available at* LEXIS, 5-546 Collier on Bankruptcy P 547.04 (explaining plain reading of sections 503(b)(9) and 546(c)(2) support conclusion administrative expense priority does not require "independent right to reclamation").

[261] *In re* Grede Foundries, Inc., 435 B.R. 593, 596 (Bankr. W.D. Wis. 2010).

[262] *See In re* Circuit City Stores, Inc. ("*Circuit City I*"), 416 B.R. 531, 538 (Bankr. E.D. Va. 2009) (holding primary purpose of transaction must be to sell goods under section 503(b)(9); otherwise, transaction is deemed general unsecured claim); *Plastech I*, 397 B.R. at 837 (rejecting predominant purpose test in favor of bifurcation of claim into goods portion and services portion through valuation of goods delivered); Krause & Boulyjenkova, *supra* note 233 (discussing two competing theories for handling hybrid goods and services claims).

[263] *Circuit City I*, 416 B.R. at 539.

[264] *See* BMC Indus., Inc. v. Barth Indus., Inc., 160 F.3d 1322, 1329 (11th Cir. 1998) (noting application of predominant purpose test outside of bankruptcy used to determine if "hybrid contracts are transactions in goods, and therefore covered by the U.C.C., or transactions in services, and therefore excluded"); *Plastech I*, 397 B.R. at 837 (explaining predominant purpose test often used in U.C.C. law, products liability law and tax law to determine if particular body of law applies to contract).

[265] Bonebrake v. Cox, 499 F.2d 951, 960 (8th Cir. 1974).

[266] *See* Princess Cruises, Inc. v. Gen. Elec. Co., 143 F.3d 828, 833 (4th Cir. 1998) ("[C]ourts generally examine the transaction to determine whether the sale of goods predominates."); *BMC Indus., Inc.*, 160 F.3d at 1330 (discussing factors in determining if contract is for goods or services are language of contract itself, manner contract was billed, and whether goods movable); Coakley & Williams, Inc. v. Shatterproof Glass Corp., 706 F.2d 456, 460 (4th Cir. 1983) (emphasizing "(1) the language of the contract, (2) the nature of the business of the supplier, and (3) the intrinsic worth of the materials involved" as integral factors in determining whether goods or services predominate contract).

[267] 416 B.R. 531 (Bankr. E.D. Va. 2009).

predominant purpose test approach for three principal reasons. First, the court held that an allocation approach would cover all materials received by the debtor, rather than only goods that have been sold to the debtor as required by the statute.[268] Second, the court held that applying a test used to determine the U.C.C.'s applicability extended the tradition of using the U.C.C. itself in other gap filling situations.[269] Finally, the court was dissuaded by the potential for "fact intensive evidentiary hearings" it considered inherent under an allocation approach.[270]

Most courts favor an allocation approach where if the goods sold to the debtor can be delineated from the overall transaction, they will be entitled to administrative expense treatment under section 503(b)(9).[271] Courts base this approach on section 503(b)(9)'s statutory language "any value of goods . . . sold to the debtor," which they read as providing absolute administrative expense protection for any goods, however incidental, to a predominantly service transaction.[272] For example, in *In re* Plastech ("*Plastech I*"),[273] the court dissected a claim stemming from snow removal operations and held that de-icing products qualified as section 503(b)(9) expenses, whereas the costs associated with shoveling—a service—did not.[274] The court in *Plastech I* also rejected the predominant purpose test because it was hesitant about applying a U.C.C. contract law analysis to govern a bankruptcy provision.[275] Moreover, the court did not believe that an allocation approach would result in prolonged evidentiary hearings when it had twenty-day invoices clearly listing the price of the goods involved in the transaction.[276]

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[268] *Id.* at 537.

[269] *Id.* at 535–36 (explaining U.C.C. "goods" definition governs other Code provisions such as section 503(b)(9)).

[270] *Id.* at 538 (quoting *In re* Plastech Engineered Prods., Inc. ("*Plastech I*"), 397 B.R. 828, 838 (Bankr. E.D. Mich. 2008)). However, the continuing validity of the predominant purpose test seems uncertain. *See In re* Circuit City Stores, Inc. ("*Circuit City III*"), No. 3:10CV397, 2010 WL 2976526, at * 3 (E.D. Va. July 16, 2010) (permitting claimant's appeal of bankruptcy court's final order "as a matter of right" without deciding whether predominant purpose test should have been applied to deem claimant unsecured creditor).

[271] *See* GFI Wis., Inc. v. Reedsburg Util. Comm'n, 440 B.R. 791, 803 (W.D. Wis. 2010) ("[T]he predominant purpose test has no place in § 503(b)(9). Nothing in that statute calls for disqualifying a § 503(b)(9) claim just because the contract under which the eligible goods were sold also provides for the sale of services."); *In re* Erving Indus., Inc., 432 B.R. 354, 372 (Bankr. D. Mass. 2010) (noting even if sale of electricity involved delivery of service to debtor, "the predominant factor test would be irrelevant to the determination of the value of goods received by a debtor within the meaning of § 503(b)(9)"); *In re* Modern Metal Prods. Co., No. 08-73908, 2009 WL 2969762, at *3 (Bankr. N.D. Ill. Sept. 16, 2009) (rejecting adoption of predominant purpose test when only services involved); *Plastech I*, 397 B.R. at 837 ("The predominant purpose test does not inform the Court as to whether a particular thing that has been sold is or is not 'goods.' Therefore, the predominant purpose test is unnecessary.").

[272] *See In re Erving Indus., Inc.*, 432 B.R. at 372 (articulating priority status under 503(b)(9) disregards characterization of "goods"); *Plastech I*, 397 B.R. at 837 (requiring categorization of transaction as sale of goods irrelevant under section 503(b)(9)).

[273] 397 B.R. 828 (Bankr. E.D. Mich. 2008).

[274] *Id.* at 838 (denying debtor's objections regarding all goods, since 503(b)(9) encompassed *any goods*).

[275] *Id.* at 837 (explaining "winner take all" approach from U.C.C. is unnecessary under 503(b)(9)).

[276] *Id.* at 838 (arguing even if invoices were not available, "efficiency considerations do not trump the plain language of the statute"). Although, somewhat ironically, the court had already heard testimony from claimants and witnesses in support of their claims. *Id.* at 832–33.

The two approaches can result in drastically different outcomes. Courts using the predominant purpose test may exclude substantial quantities of valuable goods from administrative expense protection in "borderline" cases where goods make up approximately fifty percent of the claim.[277] In these cases it is also unclear how a court will decide whether a claim predominantly involves goods without some kind of bitterly contested evidentiary hearing. However, under an allocation approach, case expediency and estate resources will be drained where a vendor lacks twenty-day invoices or billing records that allow the court to quickly determine the extent of the goods involved in the transaction.[278] Moreover, an allocation approach arguably increases the incentive for creditors to "mis-characterize" their predominantly service-related claims as goods in the hopes of receiving some protection under section 503(b)(9).[279] In any event, these tests suggest that, without meticulous record-keeping, vendors may have no claim at all.[280]

2. When has the Debtor "Received" Goods?

After a court determines the extent with which a claim involves protectable goods, questions can arise concerning whether the debtor "received" the goods twenty-days pre-petition.[281] Once again, most courts guide their analysis by applying the U.C.C.'s definition for "receipt," defined as "taking physical possession."[282] Thus far, the case law reveals that the issue of receipt arises in one of two situations.[283]

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[277] *See In re* Circuit City Stores, Inc. ("*Circuit City I*"), 416 B.R. 531, 538 (Bankr. E.D. Va. 2009) (noting inclusion of *any* goods under allocation approach). *But see* GFI Wis., Inc. v. Reedsburg Util. Comm'n, 440 B.R. 791, 804 (W.D. Wis. 2010) (rejecting application of predominant purpose test when raised for first time on appeal and consequently allowing any "unbundled" services rendered in connection with electricity delivery as part of twenty-day claim).

[278] *See Circuit City I*, 416 B.R. at 538 (expressing concern over protracted litigation under allocation approach); *see also In re* Pilgrim's Pride Corp., 421 B.R. 231, 243–44 (Bankr. N.D. Tex. 2009) (suggesting market commodity price could be used where billing information unavailable and recognizing difficulty with valuating water).

[279] *See generally In re* Plastech Engineered Prods., Inc. ("*Plastech I*"), 397 B.R. 828 (Bankr. E.D. Mich. 2008) (searching evidentiary record for protectable goods in hybrid claims).

[280] *See* Rudolph J. Di Massa Jr. & Matthew E. Hoffman, *UCC Definition of "Goods" Applies to §503(B)(9)*, AM. BANKR. INST. J., Sept. 2009, at 26, 64 (emphasizing *Plastech II* highlights importance of drafting contracts delineating price of goods sold from services rendered); Miller & Welford, *supra* note 131, at 489 ("Query, whether the manner in which the invoice refers to what was shipped to the debtor impacts whether the item for which 503(b)(9) treatment is being sought will be accorded that classification? . . . [t]he writing on the invoice may be a starting point for the analysis and evidence of the parties' intent . . . .").

[281] Here, the issue is not whether the goods were received pre- or post-petition, but rather what the term "received" actually means. *See generally* Routh, *supra* note 5, at 24 ("When are goods 'received?' Is it simply when goods are considered 'delivered' under state law? Again, state law should apply because the Bankruptcy Code itself provides no guidance.").

[282] U.C.C. § 2-103(1)(*l*) (2005); *see In re* Pridgen, No. 007-04531-8-RDD, 2008 WL 1836950, at *4 (Bankr. E.D.N.C. Apr. 22, 2008) (using U.C.C. definition); *see also Circuit City I*, 416 B.R. at 537 (adopting U.C.C. definition as federal definition for "receipt"). *But see In re* Plastech Engineered Prods., Inc. ("*Plastech II*"), No. 08-42417, 2008 WL 5233014, at *4 (Bankr. E.D. Mich. Oct. 7, 2008) (finding *Pridgen*

The first situation involves cases where the vendor has delivered goods to a third party at the debtor's request.[284] In *In re Plastech* ("*Plastech II*"), the vendor contended that, although the debtor did not have physical possession over the goods, it retained "constructive possession" over them upon third party delivery.[285] However, the court did not entertain this argument because it could not tell from the record whether the debtor's agent actually took possession of the goods.[286] The vendor alternatively asserted that, even if the debtor had not received the goods, the debtor still had received the "value" of the goods.[287] The court rejected this argument because Congress gave no indication that only "value" needed to be received as it had done through other provisions like section 547(b)(1), which broadly describes certain avoidable transfers made "to or for the benefit of a creditor."[288] Thus, the court differed a ruling on the validity of the claim until the factual record was resolved.[289]

The issue of receipt has arisen in the context of consignment agreements. For example, in *In re Pridgen* ("*Pridgen*"),[290] the vendor pumped gas into the debtor's service station tanks pursuant to a consignment agreement.[291] To bring the gas delivery within twenty days pre-petition, the vendor argued that under their agreement, title did not pass to the debtor, and therefore receipt did not occur, until the gas was pumped from the debtor's premises into a customer's gas tank.[292] Noting that the agreement neither defined nor equated a transfer of title with receipt, the court denied the vendor's twenty-day claim.[293]

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analysis "of little help" where evidentiary record not "sufficiently developed" to determine whether third party took actual physical possession of the goods).

[283] *See* Michael D. Zaverton, *Show Me the Money! Bankruptcy Claims Under Section 503(B)(9) Part 1: Getting Paid for Goods Sold 20 Days Before a Customer's Bankruptcy*, WESTLAW J. BANKR., Oct. 1, 2010 [hereinafter Zaverton, *Show Me The Money I*] (describing creditor's *Pridgen*-based argument in *Plastech II* for definition of receipt); *see also* U.C.C. § 2-103(1)(*l*) (defining "receipt"); *Circuit City I*, 416 B.R. at 537 (adopting U.C.C. definition of "receipt").

[284] *See Plastech II*, 2008 WL 5233014, at *4.

[285] *Id.*at *2 (discussing creditor's argument constructive possession of goods satisfies receipt requirement of 503(b)(9)).

[286] *See* Zaverton, *Show Me The Money I*, *supra* note 283 at 1 (stating court deferred ruling on constructive possession argument until further evidence could be submitted).

[287] *See id.* (discussing creditor's argument receipt of value of goods and not goods themselves satisfies section 503(b)(9) receipt requirement).

[288] 11 U.S.C. § 547(b)(1) (2006) (permitting trustee to avoid preferential transfers "to or for the benefit of a creditor"); *Plastech II*, 2008 WL 5233014, at *3 (noting section 550(a)(1) as another example where Code recognizes claims against entities for whose benefit transfers were made); Johnson v. First Nat'l Bank, 81 B.R. 87, 88 (Bankr. N.D. Fla. 1987) (declining to recognize valid section 548 fraudulent transfer where debtor received reasonably equivalent value though third party).

[289] *Plastech II*, 2008 WL 5233014, at *4.

[290] No. 007-04531-8-RDD, 2008 WL 1836950 (Bankr. E.D.N.C. Apr. 22, 2008).

[291] *Id*. at *1.

[292] *Id*. at *2.

[293] *Id*. at *4. Other courts have followed *Pridgen* in holding that transfer of title will not be equated with receipt unless specified within the consignment agreement. For example, in *In re Circuit City Stores, Inc.* ("*Circuit City IV*"), the court held that, because a consignment agreement did not indicate a meaning for the term "received," the court adopted the U.C.C. definition for "receipt" as a federal definition. 432 B.R. 225,

In the absence of a statutory definition, *Plastech II* and, more directly, *Pridgen* suggest that the debtor and creditor might be able to contractually define what will constitute "receipt" under section 503(b)(9).[294] If true, creditors may be able to contract around the more literal and restrictive interpretations of "receipt."[295]

3. What is "Value"?

Finally, even if a debtor has received goods, courts must determine what Congress meant by section 503(b)(9)'s undefined term "value."[296] Borrowing again from contract law principles, most courts have used the invoice or purchase price as the "presumptive" determinant of value rather than the resale or market priced advocated by debtors.[297] A party may rebut this presumption by showing that "the facts and circumstances of a particular transaction [suggest that] the purchase or invoice price is not an appropriate or relevant indicator of the 'value' obtained by the Debtors."[298] Alternatively, if the purchase or invoice price is inappropriate, one court has held that value should equal the "replacement cost—*i.e.*, what the debtor

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228–30 (Bankr. E.D. Va. 2010). Because this definition defined "receipt" as "taking physical possession," the court held that the goods were received outside of the twenty-days pre-petition and, therefore, reclassified the claim as a general unsecured claim. *Id.* at 230.

[294] *See In re Pridgen*, 2008 WL 1836950, at *4 (implying "receipt" may be defined by written agreement).

[295] A creditor's ability to contract around the "receipt" requirement could also stem litigation over online sales transactions where debtors have purchased items for third parties that were delivered twenty-days pre-petition.

[296] *See In re* Pilgrim's Pride Corp., 421 B.R. 231, 243–44 (Bankr. N.D. Tex. 2009) (proposing determination of value based on purchase price during relevant commodity market period); *see also* Miller & Welford, *supra* note 131, at 489 ("Presumably, the invoice price of the goods (exclusive of interest, freight or other charges) would be the applicable amount in valuing the claim, so long as it represents the price that was ordinarily used between the parties."); Singer, *supra* note 99, at 204 n.35 (indicating value typically determined using contract price). Professor Resnick recognized this problem back in 2005:

> It is worth noting that section 503(b)(9) refers to the "value" of the goods received by the debtor within the twenty-day period before bankruptcy. It does not refer to "purchase price" or "claim" arising from the sale. It can be expected that value will be the same as the purchase price in most cases, especially if any arguable difference in the two amounts is not so material as to warrant litigation over that issue. Nevertheless, the language of the section leaves open the argument that value, in a particular case, may be an amount that is either higher or lower than the purchase price.

Resnick, *supra* note 13, at 205.

[297] *See In re* SemCrude, L.P., 416 B.R. 399, 405 (Bankr. D. Del. 2009) (noting invoice price presumptively best determinant of value); *see also In re Pilgrim's Pride Corp.*, 421 B.R. at 243–44 (discussing how one measure of valuing commodities is purchase price); *In re* Plastech Engineered Prods., Inc. ("*Plastech I*"), 397 B.R. 828, 838 (Bankr. E.D. Mich. 2008) (applying invoice price where twenty-day claimants' invoices provided breakdowns between goods delivered and services rendered).

[298] *In re SemCrude, L.P.*, 416 B.R. at 405. For example, purchase or invoice price might not always be appropriate where the price is below market value as compensation for other business. *See Plastech I*, 397 B.R. at 838–39 (analyzing various items on invoice); *cf. In re Pilgrim's Pride*, 421 B.R. at 243 n.13 (discussing how contract price of goods was "good starting place" to determine value and how not all goods are easily valued).

would pay to acquire similar property."[299] In these cases, the market commodity price of the goods at the time of delivery could be an appropriate indicator of replacement cost.[300] Thus, the case law suggests that, if a claimant can establish that the debtor received the goods twenty days pre-petition, courts will find a way to determine the value of the goods.

D. Setoff and Preference Liability

While issues related to the scope of section 503(b)(9) involve the limits of a permissible twenty-day claim, section 503(b)(9) litigation involving setoff and preference liability centers on the debtor's ability to procedurally mitigate the impact of twenty-day claims. Here, the statutory validity of the claim is undisputed and instead the debtor seeks to either modify the claim, condition allowance of the claim on the return of preferential payments, or prevent the claim from being used as a tool to defend against a preference. Like the issues of when a claim must be raised and paid, setoff and preference liability issues also directly relate to when the debtor will be able to fully assess its twenty-day claims liability and prospects for reorganization.

1. Can a Twenty-Day Claim be Setoff?

Whether a twenty-day claim can be setoff under section 553(a) speaks most directly to a debtor's goal of mitigating administrative expenses. Section 553(a) provides that if a debtor and creditor owe debt to each other, the debtor can reduce the creditor's claim according to the amount of the over-lapping debt.[301] For example, if a creditor has a $100,000 twenty-day claim and the creditor owes the debtor $50,000 in undelivered goods, the creditor's twenty-day claim will be reduced by $50,000. Because most administrative expense claims arise post-petition when the DIP is considered a different entity than the pre-petition debtor, they traditionally could not be setoff against pre-petition debt.[302] However, twenty-day claims arise pre-petition, and the Bankruptcy Appellate Panel ("B.A.P.") for the

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[299] *In re Pilgrim's Pride*, 421 B.R. at 243 (adopting definition used in Assocs. Commercial Corp. v. Rash, 520 U.S. 953, 960 (1997)).

[300] *See id.* at 243, 244 & n.15 (proposing value for natural gas could be deduced from New York Mercantile Exchange). Even this accommodating court recognized that water supplied by a utility company "may not be so easily valued" and provided no valuation suggestion. *Id.* at 244.

[301] *See* 11 U.S.C. § 553(a) (2006) (establishing Code does not affect setoff right); *see also In re* Lawndale Steel Co., 155 B.R. 990, 992 (Bankr. N.D. Ill. 1993) (noting setoff is state-created right); *In re* Voight, 24 B.R. 983, 986 (Bankr. N.D. Tex. 1982) (acknowledging right to setoff subject to certain Code limitations).

[302] *See In re* Brown & Cole Stores, LLC, 375 B.R. 873, 879 (B.A.P. 9th Cir. 2007) (discussing how provisions of section 553(a) "provide for setoff of mutual debts which arise before bankruptcy, [but] do not apply to most administrative priority claims"); *see also In re* Plastech Engineered Prods., Inc. ("*Plastech III*"), 394 B.R. 147, 152 (Bankr. E.D. Mich. 2008) (noting courts have had to grapple with whether administrative expense claims are subject to setoff); Larsen, *supra* note 202, at 50 (discussing whether administrative claims are subject to setoff).

Ninth Circuit held in *Brown* that this "crucial difference" allows a debtor to setoff section 503(b)(9) administrative expenses from pre-petition debt.[303]

Notably, in permitting setoff, the *Brown* court explicitly undercut the stockpiling rationale. The bankruptcy court had held that the debtor was "equitably estopped" from setoff, having ordered goods from the creditor while "contemplating bankruptcy."[304] The Ninth Circuit B.A.P. disagreed, ruling that a "debtor contemplating reorganization is under no legal obligation to inform suppliers that it is contemplating a bankruptcy filing."[305] The court further added that a rule requiring debtors "to warn all its suppliers that it is contemplating a filing would make reorganization much more difficult and in many cases impossible."[306] Moreover, even if there was a duty to "warn" a creditor of an impending filing, the evidentiary record established that the creditor—both secured and entitled to a 503(b)(9) claim—was unharmed.[307] Thus, the debtor could "setoff [the creditor's] prepetition breach of contract claim against the 20-day claim."[308]

2. Does Section 502(d) Apply to Twenty-Day Claims?

Debtors have also tried to reduce the impact of twenty-day claims by arguing that section 503(b)(9) is subject to section 502. Section 502 governs the process for filing and allowing general unsecured claims.[309] If section 502 applies to section 503(b)(9), then under section 502(d) a twenty-day claim would only be allowed after the claimant returned all preferential payments to the estate.[310] Procedurally, debtors could block any attempt to allow or require payment of the claim until the claimant returned the preferential transfer.

From the debtor's perspective, applying section 502(d) to section 503(b)(9) lowers case administration costs by allowing the debtor to first litigate the value of the preferential payment and then reduce the creditor's twenty-day claim

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[303] *In re Brown & Cole Stores, LLC*, 375 B.R. at 879. The court did not clarify whether the debtor's claim would also have to arise within or without the twenty-day period. *See id.* at 881.

[304] *Id.* at 876.

[305] *Id.* at 879.

[306] *Id.* at 880.

[307] *Id.*

[308] *Id.* at 881. Not all debtors have been successful in making setoff arguments. In *In re TI Acquisition, LLC* ("*TI Acquisition I*"), the debtor argued that twenty-day claims should be reduced by payments made twenty-days pre-petition. 410 B.R. 742, 747 (Bankr. N.D. Ga. 2009). In "netting goods shipped against payments received" by the vendor, the value of the twenty-day claim would be reduced accordingly. *Id.* at 747–48. However, the court rejected this "net value theory" first on the grounds that "the plain language" of section 503(b)(9) did not "permit the interpretation." *Id.* at 748. Second, the court noted that some of the payments were made for prior deliveries, meaning that the payments were not prepayments for goods shipped twenty days before filing. *Id.*

[309] 11 U.S.C. § 502 (2006).

[310] A preference is a transfer to a creditor on account of an antecedent debt occurring within the ninety days pre-petition while the debtor is insolvent (presumed when within ninety days pre-petition) that enables the creditor to get more than it would in a chapter 7 liquidation. *See* 11 U.S.C. § 547.

accordingly.[311] Otherwise, the debtor would have to pay the twenty-day claim and then initiate a preference action to recoup the payment.[312] However, most courts have adopted the creditor-vendor position and hold that section 502(d) is inapplicable to section 503(b)(9).[313] These courts view the two sections as creating separate filing regimes for unsecured claims and administrative expenses.[314]

The majority position rests on sections 501, 502, and 503. Section 501 generally governs pre-petition claims by requiring a creditor to "file a proof of claim."[315] Section 502(a) holds that a claim filed under 501 "is deemed allowed, unless a party in interest" objects.[316] If a party objects, the court will determine the validity of the objection under Section 502(b).[317] Section 502(d) then specifies that "notwithstanding" subsections (a) and (b), "the court shall disallow any claim of any entity from which property is recoverable," including debt subject to setoff and preferential transfers.[318] Lastly, as previously discussed, section 503 creates allowance process for administrative expense claims. Section 503(a) states that "[a]n entity may timely file a request for payment of an administrative expense,"

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[311] *See In re* Circuit City Stores, Inc. ("*Circuit City II*"), 426 B.R. 560, 571 (Bankr. E.D. Va. 2010) (stating court is allowed to adjudicate both preferential payment and creditor's twenty-day claim issues together). *But see In re* Plastech Engineered Prods., Inc. ("*Plastech III*"), 394 B.R. 147, 151 (Bankr. E.D. Mich. 2008) (stating section 503(b)(9) may significantly increase debtor's cash needed prior to confirming plan of reorganization); Cohen, *supra* note 7, at 261 (asserting *Plastech III* to hold section 502(d) inapplicable to section 503(b)(9) creates added burdens and costs to estate).

[312] *See Circuit City II*, 426 B.R. at 577–78 (positing to hold section 502(d) inapplicable to section 503(b)(9) would permit creditors to recover value of administrative expense and thereafter be immune to preference action by using new value defense); Cohen, *supra* note 7, at 261.

[313] *Compare TI Acquisition I*, 410 B.R. at 751 (holding section 502(d) inapplicable to section 503(b)(9) claims) *and Plastech III*, 394 B.R. at 161 (stating section 502(d) only applies to pre- and post-petition claims governed by sections 501 and 502) *with Circuit City II*, 426 B.R. at 579 (concluding section 502(d) applies to 503(b)(9) claims); *see also* 3 NORTON BANKRUPTCY LAW AND PRACTICE § 49:16 at 49–97 (William L. Norton, Jr. ed., 3d ed. 2008) (commenting section 503's caption, "allowance of administrative expenses," suggests section 502 provides separate filing process). Recently, the Second Circuit held that section 502(d) does not generally apply to section 503(b) while explicitly reserving judgment on whether the section governed section 503(b)(9). *See* ASM Capital, LP v. Ames Dep't Stores, Inc. (*In re* Ames Dep't Stores, Inc.), 582 F.3d 422, 432 (2d Cir. 2009); *see also* Paul R. Hage, *Does Section 502(d) Apply to Administrative Expenses?—The Second Circuit Joins the Debate in In re Ames Department Stores*, 18 NORTON J. BANKR. L. & PRAC. 657, 666 (2009) (predicting courts following *Ames* will hold inapplicability of section 502(d) to section 503(b)(9) administrative expenses because court's rationale applicable regardless of whether administrative expense arose pre-or post-petition).

[314] *See In re* MicroAge, Inc., 291 B.R. 503, 511 (B.A.P. 9th Cir. 2002) (ruling section 502(d) only applies to certain enumerated claims); *TI Acquisition I*, 410 B.R. at 750 (holding section 502(d) only applies to claims governed by section 501); *Plastech III*, 394 B.R. at 161 (stating section 502(d) creates "separate universe" for non-administrative claims filings).

[315] 11 U.S.C. § 501(a). *But see In re* Fernstrom Storage & Van Co., 938 F.2d 731, 733 (7th Cir. 1991) (stating section "501(a) allows, but does not require, creditors . . . to file proofs of claim").

[316] 11 U.S.C. § 502(a).

[317] *Id.* § 502(b)

[318] *Id.* § 502(d); *see In re Ames Dep't. Stores, Inc.*, 582 F.3d at 427 (explaining section 502(d) disallows claim of entities until they return voidable preferential payments or transfers from debtor's estate); *Circuit City II*, 426 B.R. at 571 (ruling section 502(d) may temporarily disallow claim up to amount of preferential transfer).

and subsection (b) provides that, "[a]fter notice and a hearing," the claim "shall be allowed."[319]

Courts holding section 502 inapplicable begin by noting that subsection (d)'s qualifier "notwithstanding" subsections (a) and (b) incorporates those provisions by reference.[320] Those provisions only apply when a claim is filed under section 501.[321] However, with the exception of certain non-administrative post-petition claims in section 501(d), section 501 only governs the proof of claim process for general unsecured pre-petition claims.[322] Essentially, because section 503(b)(9) claims are not included in section 501, they are not governed by that section and, by extension, the disallowance process of section 502(d).[323]

Second, most courts also construe section 503 as the sole filing and allowance provision for administrative claims.[324] They consider section 503(b)'s prerequisites of notice and a hearing for administrative claims allowance to directly conflict with section 501 and section 502's policy of deeming claims allowed absent an objection.[325] Thus, to construe section 503's filing procedures as an alternative or an additional requirement to filing an administrative expense claim would render section 503(a) meaningless and section 502(d)'s "notwithstanding" language superfluous.[326] In any event, sections 501 and 502 would have surely cross-referenced section 503(b) if they were viewed as statutorily dependent or related.[327]

Finally, courts holding section 502(d) inapplicable to section 503(b)(9) reiterate they are merely reaffirming precedent. They note that, pre-BAPCPA, courts held

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[319] 11 U.S.C. §§ 503(a)–(b).

[320] *See In re Ames Dep't Stores, Inc.*, 582 F.3d at 430 ("The plain language thus introduces section 502(d) as an exception to the automatic allowance of proofs of claims under sections 502(a) and (b), and suggests that the subsection's scope is limited to that process and does not extend to claims allowable under section 503."); *In re* TI Acquisition, LLC ("*TI Acquisition I*"), 410 B.R. 742, 750 (Bankr. N.D. Ga. 2009) (asserting word "notwithstanding" in section 502(d) indicates 502(d)'s limited applicability to sections 501 and 502); *In re* Plastech Engineered Prods., Inc. ("*Plastech III*"), 394 B.R. 147, 161 (Bankr. E.D. Mich. 2008) (noting 502(d)'s references to subsections (a) and (b) suggests limited applicability).

[321] *See* 11 U.S.C. §§ 502(a)–(b); *see also* Travelers Cas. & Sur. Co. of America v. Pac. Gas and Elec. Co., 549 U.S. 443, 449 (2007) (noting subsections 502(a) and (b) apply only to claims filed under section 501); *Plastech III*, 394 B.R. at 161.

[322] *See* 11 U.S.C. § 501 (detailing filing requirement for claims); *see also In re* Packard Props., Ltd., 118 B.R. 61, 63 (Bankr. N.D. Tex. 1990) (noting creditor with pre-petition claim may file proof of claim); Hage, *supra* note 313, at 657 (noting certain post-petition claims may be filed under section 501).

[323] *See TI Acquisition I*, 410 B.R. at 750 (asserting section 502(d) inapplicable to section 503(b)(9) because section 503(b)(9) is not governed by section 501); *Plastech III*, 394 B.R. at 161. *But see Circuit City II*, 426 B.R. at 571 (finding 503(b)(9) claims are included in section 501 and governed by section 502).

[324] *See In re Ames Dept. Stores, Inc.*, 582 F.3d at 429; *TI Acquisition I*, 410 B.R. at 750; *Plastech III*, 394 B.R. at 161.

[325] *See TI Acquisition I*, 410 B.R. at 750; *Plastech III*, 394 B.R. at 161; *In re* Renew Energy, LLC, No. 09–10491, 2009 WL 3320420, at *4 (Bankr. W.D. Wis. 2009) ("[C]ourts have held that § 503(b) and § 502(d) are in irreconcilable conflict, since the former mandates allowance of claims while the latter mandates disallowance.").

[326] *See In re Ames Dep't Stores, Inc.*, 582 F.3d at 430; *Plastech III*, 394 B.R. at 161 (stating phrase "notwithstanding subsections (a) and (b)" would be rendered unnecessary).

[327] *See TI Acquisition I*, 410 B.R. at 750 (stating section 502 does not reference administrative expenses of any kind); *Plastech III*, 394 B.R. at 161 (noting importance of absence of cross-reference in statute).

section 502(d) generally inapplicable to section 503(b) at a time when other pre-petition administrative expense provisions existed.[328] The court, in *In re TI Acquisition, LLC* ("*TI Acquisition I*"),[329] read this longstanding precedent as suggesting an overarching continued dealings policy between vendors and debtors.[330] In holding section 502(d) inapplicable to section 503(b)(9), the court acknowledged being "persuaded" by the notion that, "if trade vendors felt that a preference could be used to prevent the payment of their administrative claims, they would be extremely reluctant to extend post-petition credit to a chapter 11 debtor."[331] Therefore, if Congress sought to break from precedent, it could have indicated this intention explicitly.[332]

Conversely, the minority position, which holds that section 502(d) applies to section 503(b)(9), is based on sections 101(5) and 101(10), two sections the majority position tends to downplay.[333] Section 101(5)(A) broadly defines "claim" as "a right to payment."[334] Section 101(10) defines "creditor" as an "entity that has a claim against the debtor" arising pre-petition.[335] In applying these two sections, the minority position advocates that a vendor does not cease being a "creditor" with a "claim" merely because the vendor is entitled to administrative expense treatment under section 503(b)(9).[336] Rather, they view administrative expense treatment as an

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[328] *See Plastech III*, 394 B.R. at 151; *In re* Durango Ga. Paper Co., 297 B.R. 326, 330–331 (Bankr. S.D. Ga. 2003) ("Subsection 502(d)'s context makes it clear that § 502(d) is to apply only to claims for which proofs must be filed under § 501, *not* to requests for expenses filed under § 503."); Jeremy M. Campana & Jonathan S. Hawkins, *Short Circuited: Section 502(d) May Be Applied to § 503(b)(9)*, AM. BANKR. INST. J., June 2010, at 29. For example, sections 503(b)(3)–(4), which provide for administrative expenses for pre-petition costs related to filing an involuntary bankruptcy petition, existed pre-BAPCPA. 11 U.S.C. § 503(b)(3)–(4) (2006); *accord In re* NJB Prime Investors, 3 B.R. 553, 554 n.5 (Bankr. S.D.N.Y. 1980); *In re Durango Ga. Paper*, 297 B.R. at 330 (holding, pre-BAPCPA, section 502(d) does not apply in any way to section 503).

[329] 410 B.R. 742 (Bankr. N.D. Ga. 2009).

[330] *See id.* at 750 (finding *In re* Lids Corp., 260 B.R. 680, 683 (Bankr. D. Del. 2001) policy-based rationale persuasive).

[331] *Id.* (quoting *In re Lids Corp.*, 260 B.R. at 684). But this argument once again begs the question of whether vendors are specifically relying on section 503(b)(9)'s protections when conducting business with buyers.

[332] *See, e.g.*, *In re* MicroAge, Inc., 291 B.R. 503, 510 (B.A.P. 9th Cir. 2002); *Plastech III*, 394 B.R. at 163–64 (noting Congress could have created a "special class" of pre-petition claims, but explicitly did not). *But see TI Acquisition I*, 410 B.R. at 749–50 (finding court's reasoning in *In re MicroAge* unpersuasive).

[333] *See In re* Circuit City Stores, Inc. ("*Circuit City II*"), 426 B.R. 560 (Bankr. E.D. Va. 2010); *In re* Renew Energy, LLC, No. 09-10491, 2009 WL 3320420, at *5 (Bankr. W.D. Wis. Sept. 30, 2009) ("A minority of courts have found that § 502(d) requires disallowance of § 503(b) claims. Those courts have been persuaded that the definition of a claim in 11 U.S.C. § 101(5) is broad enough to cover administrative expenses."); *Plastech III*, 394 B.R. at 164 (holding section 502(d) inapplicable to section 503(b)(9) despite not addressing whether section 503(b)(9) administrative expenses constitute a "claim").

[334] 11 U.S.C. § 101(5)(A) (2006).

[335] 11 U.S.C. § 101(10); *accord* Ronald Barliant, Dimitri G. Karcazes & Anne M. Sherry, *From Free-Fall to Free-For-All: The Rise of Pre-Packaged Asbestos Bankruptcies*, 12 AM. BANKR. INST. L. REV. 441, 458 (2004) (describing creditor status for purposes of section 101).

[336] *See, e.g.*, *Circuit City II*, 426 B.R. at 576–77; *In re MicroAge, Inc.*, 291 B.R. at 508. *But see TI Acquisition I*, 410 B.R. at 750 n.3.

additional status.[337] Because nothing mandates reading sections 501 and 502 as being mutually exclusive from section 503, those provisions can also govern section 503(b)(9).[338]

In *In re Circuit City* ("*Circuit City II*"),[339] the court adopted the minority position, in part, after considering "the goals of equitable distribution and efficiency."[340] In *Circuit City II*, many twenty-day claimants were potential defendants in future preference litigation, and the court noted that:

> Temporarily disallowing the Claims and holding them in abeyance until the preference litigation takes place would allow this Court to adjudicate these issues together and ensure that Claimants do not receive windfalls to the detriment of other creditors.[341]

The "windfalls" to which the court alluded involve situations where the court authorizes paying a twenty-day claimant, only to subsequently learn that the claimant received a larger preference. This is problematic, for reasons discussed *infra* Part III.D.3, because the court might not be able to compel the claimant to return the money.

Although the court in *Circuit City II* rejected allegations that it was creating a "gauntlet" of a claims allowance process, the court's holding does require claimants to jump through all the hoops of sections 501, 502, and 503.[342] According to the court, the claimant would file a single proof of claim, which would satisfy sections 501(a) and 503(a).[343] The filed proof of claim would request administrative expense treatment and serve as evidence of a "claim" under section 101(A)(5).[344] The court would deem the claim allowed under section 502(a) unless a party in interest objected.[345] However, even if no party objected, another hearing would still be required under section 503(b).[346]

It is unclear whether the majority or the minority position is more judicially efficient, and which conserves estate resources. Some believe that the *Circuit City*

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[337] *See supra* note 336.

[338] *See Circuit City II*, 426 B.R. at 570–71 (arguing Federal Rules of Bankruptcy Procedure require non-mutually exclusive reading "in cases of § 503(b)(9) claims"). *But see* ASM Capital, LP v. Ames Dep't Stores, Inc. (*In re* Ames Dep't Stores, Inc.), 582 F.3d 422, 428–29 (2d Cir. 2009) (distinguishing between "claims" and "requests for administrative expenses" and not applying sections 501 and 502 to section 503 administrative expense claims); *TI Acquisition I*, 410 B.R. at 750 ("Section 502(d) does not contain any language or reference which would make it applicable to administrative expenses of any kind.").

[339] 426 B.R. 560 (Bankr. E.D. Va. 2010).

[340] *Id.* at 571.

[341] *Id.*

[342] *Id.* at 575.

[343] *Id.*

[344] *See id.* at 571.

[345] *See id.* at 575.

[346] *See id.*

II framework simply creates new administrative inefficiencies.[347] For example, it is uncertain under *Circuit City II* how the court would treat a creditor with an allowed claim under section 502 who subsequently requests section 503(b)(9) treatment on all or part of that claim.[348] Moreover, even if section 502(d) applies, most payments are likely to be treated as ordinary course of business payments, which is a defense to a preference under section 547(c)(2).[349] Others argue that the majority position exemplified by *TI Acquisition I* unduly burdens the estate and increases litigation costs.[350] The money paid to twenty-day claims and the funds spent separately litigating for the return of those funds ultimately "must be borne by the general unsecured creditors in the case."[351]

Ultimately, both positions have their weaknesses in cases where the debtor wants to pay twenty-day claims on the petition date or close thereto.[352] For example, if the debtor wants DIP financing from lenders holding twenty-day claimants, the debtor might need to pay these claims immediately to demonstrate its goodwill. In these situations, the scrutiny associated with the added *Circuit City II* hurdles might dissuade potential lenders. Conversely, where the debtor seeks DIP financing elsewhere, it will need to quickly determine the extent of its twenty-day claims liability by calculating its future avoidance actions. Under *TI Acquisition I* and the majority approach, this assessment cannot be readily made and could thwart the debtor's ability to get DIP financing.[353] Thus, in certain circumstances, twenty-day claimants can effectively determine the probability and the terms of any DIP financing.[354]

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[347] *See* Campana & Hawkins, *supra* note 328, at 60 (describing *Circuit City II* decision as possibly imposing its own "procedural tangle"); *see also* Aaron G. York & Thomas M. Horan, *Protecting Trade Creditors' Rights in Bankruptcy*, AM. BANKR. INST. J., Sept. 2010, at 53 (observing because of *Circuit City II*, "timing and extent of payment of the section 503(b)(9) claim may not be as simple as it first appears").

[348] Campana & Hawkins, *supra* note 328, at 60.

[349] *See* Gretchko, *Bankruptcy Reform Act*, *supra* note 117, at 19; *see also In re* Archway Cookies, 435 B.R. 234, 237 (Bankr. D. Del. 2010) (granting creditor's summary judgment motion because preferential transfers were made in ordinary course of business and thus not avoidable); *In re* Waccamaw's Homeplace, 325 B.R. 524, 534–35 (Bankr. D. Del. 2005) (finding, although 502(d) pre-petition claim was allowed, it had no bearing on determination of payments as "ordinary course of business").

[350] *See* Adam D. Wolper, § *502(d) No Bar to Administrative Expense Claims*, AM. BANKR. INST. J., Nov. 2009, at 70 (noting under *TI Acquisition I*, administrative claimants may wait years for recovery); Cohen, *supra* note 7, at 268 (highlighting every allowed administrative expense reduces available assets for creditors).

[351] Cohen, *supra* note 7, at 261.

[352] *See id.* at 262 (discussing need to pay 503(b)(9) claims on first day of case to keep vendors satisfied).

[353] *See* Berlin et al., *supra* note 7, at 366–67 (discussing case where paying 503(b)(9) claim was condition of approving DIP financing); Cohen, *supra* note 7, at 262 (describing this situation as "adding insult to injury" when twenty-day claimants pre-BAPCPA would be unsecured creditors); Gretchko, *Bankruptcy Reform Act*, *supra* note 117, at 19 (noting inability of debtors to get financing as one reason creditors may not get paid).

[354] *See* Cohen, *supra* note 7, at 262 ("[Prohibiting debtors from using their] complete arsenal to maximize recoveries for all creditors in its Chapter 11 cases could be a serious impediment to reorganization cases, especially for manufacturers and retailers–those most likely to be hardest hit with significant 503(b)(9)

3. Can a Twenty-Day Claim Count in a "New Value" Defense to a Preference?

Whether section 502(d) is applicable to twenty-day claims is closely related to how section 503(b)(9) alters—if at all—a creditor's preference liability.[355] However, creditors have several statutory defenses to a preference under section 547(c), including the so-called "new value defense" or "subsequent new value defense" under subsection (c)(4).

The new value defense allows creditors to setoff their preference liability by deducting "the value of the goods shipped subsequent to receipt of the preferential transfers, but prior to the petition date from the aggregate preference demand amount."[356] In other words, preference liability is absolved to the extent of the new value provided to the debtor.[357] There are two principal justifications behind the defense. First, the defense reduces the "harm" to the estate "to the extent of the benefit provided to the debtor from [the] new value."[358] Second, by affording creditors with limited protection from preference liability, the defense "encourages creditors to continue to conduct business with financially troubled debtors, with an eye toward avoiding bankruptcy altogether."[359]

A successful new value defense requires the creditor to prove: (1) a "contemporaneous exchange"; (2) "made in the 'ordinary course'" of business; and (3) where the creditor "subsequently provided 'new value' to the debtor."[360] Because

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Claims."); Gretchko, *Bankruptcy Reform Act*, *supra* note 117, at 19 (discussing first-priority given to lender in DIP financing orders).

[355] As noted earlier, a preference is generally a pre-petition transfer that allows a creditor to get more than it would in a chapter 7 liquidation. *See* 11 U.S.C. § 547(b)(5) (2006).

[356] Hage & Mohan, *supra* note 14, at 471.

[357] *See* Charisma Inv. Co. v Airport Sys., Inc. (*In re* Jet Fla. Sys., Inc.), 841 F.2d 1082, 1083 (11th Cir. 1988) (discussing exception of subsequent advance so creditors contributing new value are not treated as having depleted estate); *In re* Prescott, 805 F.2d 719, 731 (7th Cir. 1986) (noting amount of preferential transfer returned to estate is reduced to extent of unsecured new value given to debtor); Brad B. Erens & Scott J. Friedman, *Section 503(b)(9) of the Bankruptcy Code and Preference Liability*, 3 PRATT'S J. BANKR. L. 153, 155 (2007) (stating purpose of section 547(c)(4) as excusing preference liability for creditors who provide debtor with new value). Payments made in the "ordinary course of business" are another defense usually raised in these situations. Erens & Friedman, *supra*, at 154; *see also In re* Waccamaw's Homeplace, 325 B.R. 524, 535 (Bankr. D. Del. 2005) (articulating if creditor satisfies section 547(c)(4) then setoff is permitted in amount of new value added); *In re* Roberds, 315 B.R. 443, 468 (Bankr. S.D. Ohio 2004) (explaining policy behind section).

[358] Erens & Friedman, *supra* note 357, at 155l; *see* Steinfeld & Abrams, *supra* note 111, at 28 n.2 (suggesting new value defense encourages replenishment of estate).

[359] Steinfeld & Abrams, *supra* note 111, at 28 n.2 (citing *In re* IRFM Inc., 52 F.3d 228, 232 (9th Cir. 1995)); *see also In re* TI Acquisition, LLC ("*TI Acquisition II*"), 429 B.R. 377, 384 (Bankr. N.D. Ga. 2010) (noting objective of new value defense is to encourage credit extension to financially troubled entities); *In re* Commissary Operations, Inc., 421 B.R. 873, 876 (Bankr. M.D. Tenn. 2010) (stating new value helps creditors reduce preference liability).

[360] Erens & Friedman, *supra* note 357, at 154. Jurisdictions are split over whether the new value given by the creditor must remain unpaid. *Compare* Charisma Inv. Co. v. Airport Sys., Inc. (*In re* Jet Fla. Sys., Inc.), 841 F.2d 1082, 1083 (11th Cir. 1988) (holding new value must remain unpaid) *with In re* Ladera Heights Cmty. Hosp., Inc., 152 B.R. 964, 968 (Bankr. C.D. Cal. 1993) (holding new value need not remain unpaid).

the Code defines "new value" under section 547(a)(2) to include "money's worth in goods," section 503(b)(9) is implicated.[361]

In the context of 503(b)(9), the new value defense arises in the following situation. The debtor pays the creditor $50 within the preference for goods to be delivered. The creditor then delivers $25 worth of goods twenty days pre-petition. The debtor files bankruptcy and the creditor files a twenty-day claim for $25. The debtor then sues to recover the $50 payment it made to the creditor. The issue: can the creditor-vendor use the twenty-day invoices, which were the basis for its $25 twenty-day claim, as "new value" to reduce its preference liability from $50 to $25?

Essentially, section 503(b)(9)'s effect on the new value defense controversy involves a calculation issue over whether a twenty-day claim constitutes "new value."[362] Creditor-vendors argue that having an allowed twenty-day claim does not relinquish their right to use the goods they delivered as evidence of new value supplied to the debtor.[363] Conversely, debtors argue that the twenty-day invoices can only be used once: either in a new value defense or as evidence for establishing the value of a twenty-day claim under section 503(b)(9).[364]

Vendors base their position on several grounds. First, they note that deliveries of goods encompassed by their twenty-day claim meet the definition of "new value" under section 547(a)(2).[365] Second, by the "plain language" of sections 547(c) and 503(b)(9), vendors assert that they are not prevented from using twenty-day claims in a new value defense.[366] Third, vendors differentiate twenty-days claims from the right of reclamation, which bars a new value defense when properly exercised.[367] They stress that the right of reclamation can be exercised pre-petition, whereas

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[361] 11 U.S.C. § 547(a)(2) (2006); *see also In re Commissary Operations, Inc.*, 421 B.R. at 876 (giving definition of "new value"); *In re* Circuit City Stores, Inc. ("*Circuit City II*"), 426 B.R. 560, 571 (Bankr. E.D. Va. 2010) (explaining how definition of "new value" implicates section 503(b)(9)).

[362] In cases where the twenty-day invoice encompasses the total "new value" alleged and the jurisdiction does not permit using invoices as a new value for defense purposes, the creditor will be totally exposed to preference liability unless the creditor can point to another defense. *See* 11 U.S.C. § 547(c)(1) (allowing contemporaneous exchange for new value exception to a preference); *id.* § 547(c)(4) (permitting ordinary course of business exception to preference).

[363] *See, e.g., In re Commissary Operations, Inc.*, 421 B.R. at 876 (explaining creditors' argument new value defense cannot be excluded); *In re* Murray, Inc., No. 04-13611, 2007 WL 5595447, at *2 (Bankr. M.D. Tenn. June 6, 2007) (holding post-petition new value to not be excluded from section 547(c)(4) defense); *see also* Hage, *supra* note 313 (stating section 503(b)(9) relates to goods provided to debtor within twenty days of petition date).

[364] *In re* Phoenix Rest. Grp., Inc., 373 B.R. 541, 551 (M.D. Tenn. 2007) (restating debtor's argument of no valid reclamation claim); Hage, *supra* note 313 (stating vendors must choose one claim or other).

[365] *See In re Commissary Operations, Inc.*, 421 B.R. at 878; *Circuit City II*, 426 B.R. at 571; *In re* Pro Page Partners, LLC., 292 B.R. 622, 628 (Bankr. E.D. Tenn. 2003).

[366] *See In re Commissary Operations, Inc.*, 421 B.R. at 879 (noting congressional intention to prevent vendors from using twenty-day claim in new value defense would have been explicitly reflected in either section); *Circuit City II*, 426 B.R. at 578 n.16.

[367] *See In re Commissary Operations, Inc.*, 421 B.R. at 877–78. *But see In re Phoenix Rest. Grp. Inc.*, 373 B.R. at 551 (restating debtor's contention reclamation claim should not preclude debtor from using new value defense).

twenty-day claims arise post-petition after allowance by a court.[368] Moreover, the remedies of the two provisions are different. Section 546(c) only gives the vendor a right to receive the returned goods, while section 503(b)(9) provides for an administrative expense claim.[369] Finally, creditors argue that forcing a vendor to choose between filing a twenty-day claim and asserting a new value defense would run counter to sections 546(c)(4) and 503(b)(9)'s policy of encouraging creditors "to continue to do business with a troubled debtor."[370]

Conversely, debtors argue that permitting a vendor to use its twenty-day invoices amounts to "double dipping" that harms "the estate and other creditors."[371] The estate is harmed because it renders a new value defense based solely on twenty-day invoices potentially uncontestable. For example, any twenty-day claims payments made before a new value defense is asserted are not recoupable because they are authorized by court order or through a confirmed plan.[372] Moreover, other creditors are harmed, because allowing certain vendors to reduce or eliminate their preference liability—based purely on their fortuitous status as twenty-day claimants—vitiates the absolute priority rule.[373] Finally, debtors contend that double-counting invoices is "tantamount to allowing reclamation of the goods, but then allowing the value of the goods to be a defense to the preference."[374]

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[368] *See infra* Part II.C.4; *see also In re* TI Acquisition, LLC ("*TI Acquisition II*"), 429 B.R. 377, 381 (Bankr. N.D. Ga. 2010); *In re Commissary Operations, Inc.*, 421 B.R. at 877.

[369] *See infra* Parts I.A, II.C.4; *see also TI Acquisition II*, 429 B.R. at 381; *In re Commissary Operations, Inc.*, 421 B.R. at 877.

[370] *In re Commissary Operations, Inc.*, 421 B.R. at 876.

[371] *Id.* (discussing debtor's double recovery argument); *see also* Hage & Mohan, *supra* note 14, at 472 (stating debtors and trustees argue permitting payment on twenty-day invoices harms estate); Kunz, *It's Not Double-Counting*, *supra* note 67, at 60 (examining debtor's argument including section 503(b)(9) claims in new value defense will amount to windfall for creditor).

[372] Hage & Mohan, *supra* note 14, at 472.

> If a Twenty-Day Claim is construed to be the equivalent of a properly perfected and enforceable reclamation claim, then it follows that so long as administrative claims are paid in full the Twenty-Day Claim invoices no longer would qualify as allowed new value . . . once a creditor is paid in full on its reclamation claim, "the 'new value' has become unavoidable . . . and does not replenish the estate to protect earlier transactions from constituting preferences." Stated another way, whatever "new value" the debtor initially received was "restored" to the creditor via the granting of the administrative claim. Once that administrative claim is paid, the new value is on account of "an otherwise unavoidable transfer" as set forth in § 547(c)(4)(B).

Steinfeld & Abrams, *supra* note 111, at 28 (quoting *In re* Ariz. Fast Foods LLC, 299 B.R. 589, 597 (Bankr. D. Ariz. 2003)).

[373] *See* 11 U.S.C. § 1129(b)(2)(B)(ii) (2006) (codifying absolute priority rule under Code); *In re Commissary Operations, Inc.*, 421 B.R. at 876 (remarking new value can potentially help creditor lower preference liability); David S. Kupetz, Note, *Assignment for the Benefit of Creditors: Exit Vehicle of Choice for Many Dot-Com, Technology, and Other Troubled Enterprises*, 11 NORTON J. BANKR. L. & P. 71, 81 (2001) ("If there are insufficient funds to pay the unsecured claims in full, then these claims will be paid pro rata.").

[374] Kunz, *It's Not Double-Counting*, *supra* note 67, at 60.

In tackling the new value defense and section 503(b)(9), the court in *In re Commissary Operations, Inc.* ("*Commissary*"),[375] eventually adopted the creditor position after addressing many of the points of both positions. The court adopted all of the statutory "plain language" and policy arguments of the creditor position, but the court's decision was largely tied to its comparison of twenty-day claims to reclamation claims, and, curiously, to critical vendors.[376]

The court's analysis began with *In re Phoenix Restaurant Group, Inc.* ("*Phoenix Restaurant*"),[377] a pre-BAPCPA decision tackling the new value defense in the context of section 546(c). In *Phoenix Restaurant*, the court held that goods subject to a vendor's right of reclamation were not "shipped free of the seller's strings" and, therefore, any new value provided to the debtor was "negated" after the estate compensated the reclaiming vendors.[378]

However, in *Commissary*, the court held that *Phoenix Restaurant* did not extend to section 503(b)(9) because, unlike a right of reclamation, administrative expense claims only exist in bankruptcy.[379] Moreover, the court mentioned BAPCPA-amended section 546(c)(2)'s provision allowing sellers to "still assert the rights contained in section 503(b)(9)," as further evidence that twenty-day claims should be treated differently from reclamation claims.[380]

The court's decision also stemmed from its remarkable conclusion that "section 503(b)(9) claims are analogous to critical vendor claims" in that both are paid post-petition for pre-petition transactions with the debtor.[381] Because fully paid critical vendors may still assert a new value defense, the court concluded that twenty-day claimants should be given the same latitude.[382] To hold otherwise would create an absurd result where critical vendors, generally paid through the penumbras of various Code provisions, would "occupy a more favorable position as preference defendants than [statutorily protected] § 503(b)(9) claimants."[383]

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[375] 421 B.R. 873 (Bankr. M.D. Tenn. 2010).
[376] *See id.* at 877–78.
[377] No. 301-12036, 2004 WL 3113719 (Bankr. M.D. Tenn. Dec. 16, 2004).
[378] *Id.* at *13.

> The argument against allowing new value for invoices that are the subject of a reclamation claim is very strong. Unlike Twenty-Day Claims, a true reclamation claim is the equivalent of rescission: The creditor is entitled to get its goods back . . . . How does a debtor receive 'new value' if the goods are 'returned' to the creditor?

Steinfeld & Abrams, *supra* note 111, at 60.
[379] *In re Commissary Operations, Inc.*, 421 B.R. at 877.
[380] *Id.*
[381] *Id.* at 878.
[382] *See id. See* Kunz, *It's Not Double-Counting*, *supra* note 67, at 60 (noting critical vendors not "stripped" of new value defense).
[383] *In re Commissary Operations*, 421 B.R. at 878; *see also* Kunz, *It's Not Double-Counting*, *supra* note 67, at 60.

Lastly, during oral arguments, the court felt that uncertainty would accompany reducing new value "on account of § 503(b)(9) payments . . . in cases where §503(b)(9) claims would not be paid in full."[384] This would render the value of twenty-day claims indeterminable until the conclusion of preference actions.[385] Consequently, a claimant asserting a "new value defense would never know the true amount of the appropriate offset during the pendency of its case."[386]

Conversely, in *In re TI Acquisition, LLC* ("*TI Acquisition II*"),[387] the court adopted the debtor position and held that *Phoenix Restaurant* does apply to twenty-day claims, at least where the claims will be fully paid.[388] In *TI Acquisition II*, the court stressed that the *Commissary* decision incorrectly focused on the different pre-petition rights of reclamation and twenty-day claims "instead of the enhanced priority afforded to holders of both types of claims."[389] Under this analysis, the court held that any discernable difference between the two types of claims would only relate to the value provided to the estate.[390]

The court also rejected the *Commissary* court's analogy between twenty-day claims and critical vendor orders.[391] The court stressed that critical vendor orders typically reflect negotiations between the debtor and creditor and often include rules governing the critical vendor's future preference liability.[392] Moreover, even after the critical vendor motion has been negotiated, the order must be approved, a difficult hurdle in *K-mart* jurisdictions.[393] In contrast, payment of twenty-day claims is mandatory and non-negotiable, unless the claimant agrees to different treatment.[394]

Moreover, the court questioned the policy-based rationales of the vendor position. First, the court repudiated the continued dealings justification for section 503(b)(9). The court noted that barring a new value defense would not discourage vendors from continuing post-petition business with debtors because vendors "never know" whether the debtor will file bankruptcy twenty days after shipping goods.[395] Second, the court held that "allowing BOTH new value credit and payment of the § 503(b)(9) claim elevates the claim of that creditor and results in double payment."[396]

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[384] Kunz, *It's Not Double-Counting*, *supra* note 67, at 60.
[385] *Id.*
[386] *Id.*
[387] 429 B.R. 377 (Bankr. N.D. Ga. 2010).
[388] *Id.* at 384.
[389] Hage & Mohan, *supra* note 14, at 479 (noting focus should be on priority afforded both reclamation and 503(b)(9) claims); *TI Acquisition II*, 429 B.R. at 381.
[390] *TI Acquisition II*, 429 B.R. at 381.
[391] *Id.* at 382–83; *see* Hage & Mohan, *supra* note 14, at 479 (noting *TI Acquisition II* distinguished critical vendor claims from 503(b)(9) claims as receiving favorable treatment due to priority).
[392] *TI Acquisition II*, 429 B.R. at 381–82; *see* Hage & Mohan, *supra* note 14, at 479.
[393] *See* Hage & Mohan, *supra* note 14, at 480 (noting critical vendor claims require court approval after negotiation); *supra* Part I.B (discussing *K-mart*).
[394] *See* Hage & Mohan, *supra* note 14, at 480.
[395] *TI Acquisition II*, 429 B.R. at 385.
[396] *Id.*

Finally, the court shared the debtor's concerns regarding the finality of paying twenty-day claims in recognizing that, if paid, the estate "would be unable to recover a preference payment that would otherwise be available for distribution to other creditors."[397] However, the court qualified its decision by noting that if the debtor was deemed administratively insolvent, "there may be no basis to hold that the [twenty-day] claim was paid."[398]

The merits of holding the new value defense inapplicable to twenty-day claimants is unclear. Commentators have called *Commissary* "an excellent illustration of statutory interpretation driven by the 'plain meaning' of the statutory words and not by subjective notions of fairness and equity."[399] Yet, even they concede that the decision gives creditors "a windfall in the form of a 'double recovery.'"[400] The *Commissary* decision might also tell debtors that they can defeat a new value defense by making pre-petition payments on deliveries made twenty days pre-petition with the intention of later challenging these payments as preferences.[401]

However, *TI Acquisition II* might merely be a "Pyrrhic victory" for debtors because any preferential payment turned over by a vendor to a trustee still could give rise to a priority claim under section 502(h).[402] This section provides that a "claim 'arising' from the [trustee's] recovery . . . [will] be allowed . . . as if [the] claim had arisen" pre-petition and, as noted earlier, twenty-day claims, by definition, arise pre-petition.[403] Thus, when a vendor returns a preferential transfer to the estate that was made for a delivery of goods twenty-days pre-petition, the vendor is back to where it started: holding a priority claim under section 503(b)(9).[404] Moreover, vendors might also be able to circumvent the new value issue entirely by arguing that any preferential payments within twenty days pre-

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[397] *Id.*

[398] *Id.*

[399] Lawrence T. Burick & Jennifer L. Maffett, *The Effect of § 503(b)(9) on the § 547(c)(4) Subsequent New Value Defense: Does Commissary Operations Make a Good First Impression?*, NORTON BANKR. L. ADVISER, June 2010, at 11. ("[T]the holding is consistent with the underlying purposes of §§ 547(c)(4) and 503(b)(9) . . . to encourage creditors to deal with failing debtors.").

[400] Burick & Maffett, *supra* note 399, at 12 (advocating legislative intervention to fix 503(b)(9) issue); *see also* Miller & Welford, *supra* note 131, at 496 ("To allow otherwise would, in essence, be giving the creditor a windfall.").

[401] *See* Erens & Friedman, *supra* note 357, at 159. Of course, the debtor would need sufficient funds to attempt this strategy. *See id*.

[402] *See* Lafferty, *supra* note 66, at 1; *see also* Fleet Nat'l Bank v. Gray (*In re* Bankvest Capital Corp.), 375 F.3d 51, 67 (1st Cir. 2004) (finding secured status imputed to 502(h) claim); *In re* Falcon Prods., No. 4:07-CV-1495 CAS, 2008 WL 363045, at *9 (E.D. Mo. Feb. 8, 2008) (holding 502(h) claim can retain priority status of original claim).

[403] 11 U.S.C. § 502(h) (2006); *see* Lafferty, *supra* note 66, at 1.

[404] *See* Lafferty, *supra* note 66, at 1; *see also In re Bankvest Capital Corp.*, 375 F.3d at 67 (asserting 502(h) claims take on characteristics of original claim); *In re Falcon Prods.*, 2008 WL 363045, at *9 (determining 502(h) claim can have priority status).

petition were made in the debtor's "ordinary course of business," which is another defense to a preference under section 547(c)(2).[405]

Ultimately, whether the new value defense is inapplicable to twenty-day claimants potentially impacts a jurisdiction's position on whether section 502(d) applies to section 503(b)(9). In *Circuit City II* jurisdictions where section 502(d) governs section 503(b)(9), a ruling that twenty-day invoices cannot be used again as new value would mean that a twenty-day claimant would only be paid after *all* preference litigation involving twenty-day claims is resolved.[406] In a *TI Acquisition I* jurisdiction where section 502(d) does not apply to section 503(b)(9), a holding that twenty-day invoices cannot be used again as new value would suggest that, for all practical purposes, section 502(d) would apply in administratively insolvent cases.[407] In these jurisdictions, presumably all preference litigation would first need to be resolved in order to determine each twenty-day claimant's *pro rata* distribution, if any.

E. Claimant Representation

The last and least litigated area concerning section 503(b)(9) involves how twenty-day claimants are represented in a bankruptcy case. Although section 503(b)(9) effectively creates a "new constituent at the bargaining table" with widely divergent interests from secured and unsecured creditors, the section's effect on bankruptcy negotiations has been largely left to discussion by commentators.[408] Nevertheless, this issue warrants serious attention, given twenty-day claimants' ability to influence various parties in a bankruptcy.

1. The Bankruptcy Committee System

Apart from voting on a reorganization plan, representation through committee is the principal avenue available to a creditor hoping to influence a bankruptcy case. Committees closely monitor a debtor's financial status, critique reorganization

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[405] *See* 11 U.S.C. § 547(c)(2); *see also In re* Brook Mays Music Co., No. 06-32816-SGJ-11, 2007 WL 4960375, at *2, (Bankr. N.D. Tex. August 1, 2007) (prohibiting trustee from instituting preference actions against twenty-day claimants); Gretchko, *Bankruptcy Reform Act*, *supra* note 117, at 45 (questioning how ordinary course will be determined in upcoming cases).

[406] *See In re* Circuit City Stores, Inc. ("*Circuit City II*"), 426 B.R. 560, 571 (Bankr. E.D. Va. 2010); Campana & Hawkins, *supra* note 328, at 28 (stating courts using *Circuit City II* reasoning allow section 502(d) to be used to temporarily disallow section 503(b)(9) expense); Steinfeld & Abrams, *supra* note 111, at 28 (stating if administrative claims paid in full, twenty-day claims not qualified as new value). To prevent "double-dipping," debtors will bring actions to either disallow the twenty-day claims or preserve objections to these claims. *See* Steinfeld & Abrams, *supra* note 111, at 29; *see also* Miller & Welford, *supra* note 131, at 496; Stickles & Dean, *supra* note 225, at 76.

[407] *See In re* TI Acquisition ("*TI Acquisition I*"), 410 B.R. 742, 750 (Bankr. N.D. Ga. 2009) (concluding section 502(d) does not contain language applying it to administrative expenses); *see also* ASM Capital, LP v. Ames Dep't Stores, Inc. (*In re* Ames Dep't Stores, Inc.), 582 F.3d 422, 432 (2d Cir. 2009); *In re* Plastech Engineered Prods., Inc. ("*Plastech III*"), 394 B.R. 147, 161 (Bankr. E.D. Mich. 2008).

[408] Miller & Welford, *supra* note 131, at 488. *See generally* Berkoff, *supra* note 119.

plans, and propose their own plans.[409] However, the U.S. Trustee ("Trustee") is only required to appoint an unsecured creditors' committee and the Trustee is given the exclusive authority to appoint committee members.[410] A Trustee's only appointment restrictions are that committee members must be "willing to serve," hold "the seven largest claims against the debtor," and be "representative of the different kinds of claims to be presented" against the estate.[411] Appointment of any additional committees, including secured creditor and equity committees, is within the Trustee's discretion.[412]

If a Trustee denies appointment of a committee, a party's influence is generally considerably reduced. The party is usually excluded from "meaningful" reorganization plan negotiations and is often relegated to futilely contesting the plan at the confirmation hearing.[413] However, a court can overrule the Trustee's determination if a "party in interest" can demonstrate that the additional committee is "necessary to assure adequate representation of creditors" under section 1102(a)(2).[414] Courts determine whether additional committees are necessary based on a "facts and circumstances" discretionary analysis that varies by jurisdiction.[415]

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[409] *See* 11 U.S.C. § 1102(b)(3) (establishing committee duty to provide case information to creditors); *id.* § 1103(c) (permitting committee to investigate debtor's financial condition and participate in plan formation); Sullivan & Ravert, *supra* note 222, at 499 (noting ability to investigate debtor's finances and negotiate debtor's reorganization plan are advantages of committee membership).

[410] *See* 11 U.S.C. § 1102(a)(1); *see also* Virginia A. Bell & Paul B. Jones, *Creditors' Committees and Their Roles in Chapter 11 Reorganizations*, 1993 DET. C. L. REV. 1551, 1554 (1993) (stating Trustee must appoint committee of unsecured creditors but has discretion in number, timing, and method of appointments); Kenneth N. Klee & K. John Shaffer, *Creditors' Committees Under Chapter 11 of the Bankruptcy Code*, 44 S.C. L. REV. 995, 1037 (1993) (noting removal or appointment of committee members is within limited discretion of Trustee).

[411] Miller & Welford, *supra* note 131, at 496. The Trustee typically selects committee members from the "'Top Twenty Unsecured Creditors' list filed by the debtor." Berkoff, *supra* note 119, at 405. Thus, twenty-day claimants are often selected as committee members. *See id.* at 406–07. However, if the debtor has strategically excluded certain creditors from the list, the trustee can look elsewhere for committee members. *See id.* at 405.

[412] *See* 11 U.S.C. § 1102(a)(1).

[413] *See* Berkoff, *supra* note 119, at 409; *see also* Bell & Jones, *supra* note 410, at 1559 (asserting adequate representation almost always at issue when trustee refrains from appointing committee).

[414] 11 U.S.C. § 1102(a)(2); *see also In re* Drexel Burnham Lambert Grp., Inc., 118 B.R. 209, 211 (Bankr. S.D.N.Y. 1990) (stating inadequate representation requires court to create additional committee); Klee & Shaffer, *supra* note 410, at 1039 (noting court faced with unrepresentative committee may order appointment of additional committee).

[415] *See In re* Enron Corp., 279 B.R. 671, 685 (Bankr. S.D.N.Y. 2002); Berkoff, *supra* note 119, at 406. Trustees and courts consider several factors to determine the adequacy of creditor representation, including:

> [(1)] the number of creditors in the purported class of creditors seeking to form the committee[; (2)] the complexity of the case[; (3) whether the costs of an] additional committee significantly outweigh[s] the concern for adequate representation[; and (4)] whether the ability of an existing statutory creditors' committee to function had been impaired.

Berkoff, *supra* note 119, at 406.

2. Are Twenty-Day Claimants Entitled to Official Committee Representation?

As noted above, nothing requires that twenty-day claimants be officially represented through an independent committee.[416] However, at least one court has held that section 1102(a)(2) may sometimes provide a mandatory basis for official committee representation.[417] In *In re Empire Beef Co.* ("*Empire Beef*"), the court ordered the appointment of a twenty-day claims committee over the objection of the Trustee.[418] The debtor, a meat distribution facility, had sought court approval for the immediate sale of its assets after filing chapter 11.[419] The secured lenders and the twenty-day claimants represented roughly 76% of the $29 million in unsecured debt and were the principal creditors.[420] Given the twenty-day claimants' relative stake in the unsecured debt, the claimants asked the Trustee to appoint an independent committee.[421] Yet, the Trustee declined, alleging that appointing a twenty-day claims committee was contrary to national policy.[422]

The twenty-day claimants appealed the Trustee's decision to the bankruptcy court, arguing that the general unsecured creditor's committee ran counter to their interests because they would have received more favorable treatment by the court.[423] Furthermore, they contended that, under the facts of the case, appointing a separate committee was "necessary to assure adequate representation of creditors" under section 1102(a)(2).[424] The claimants asserted that they could invoke section 1102(a)(2) because they remained "creditors" as defined under section 101(5), regardless of whether they were entitled to an administrative expense under section 503(b)(9).[425]

The Trustee and the secured lenders objected, making a laundry list of arguments. They contended that administrative priority status officially barred twenty-day claimants from official committee representation.[426] Alternatively, they alleged that the twenty-day claimants were already represented through the unsecured creditors committee, their own *ad hoc* unofficial twenty-day claims committee, and through their individual counsel.[427] Moreover, they argued that the twenty-day claimants had not established "why an additional committee was

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[416] *See* 11 U.S.C. § 1102–03 (explaining committees other than unsecured creditor committee not required); Miller & Welford, *supra* note 131, at 496.

[417] Order on Motion of National Beef Packing Company, Inc., for Appointment of an Official Committee of 503(b)(9) Creditors Pursuant to Section 1102(a)(2) of the Bankruptcy Code at 1, *In re* Empire Beef Co., (Bankr. W.D.N.Y. Nov. 1, 2007) (No. 07-22226) [hereinafter *Empire Beef* Order].

[418] *Id.*

[419] *See* Berkoff, *supra* note 119, at 410 (explaining history of *Empire Beef*).

[420] *See* Baxter, *supra* note 188, at 666.

[421] *See id.*; Berkoff, *supra* note 119, at 410.

[422] *See* Baxter, *supra* note 188, at 665; Berkoff, *supra* note 119, at 410.

[423] *See* Baxter, *supra* note 188, at 665.

[424] *Id.* at 666.

[425] *See id.*

[426] *See id.* at 667.

[427] *See id.*

necessary to ensure adequate representation of their interests."[428] Finally, they contended that adding another committee would exacerbate preexisting conflicts between the parties in the case.[429]

The court roundly rejected the Trustee and secured lenders' arguments, and, while careful to limit its decision to "the unusual and unique circumstances" of the case, approved the claimants' motion for an independent committee.[430] The court recognized the conflict of interest between the twenty-day claimants and the unsecured creditors committee, given that the size of twenty-day claims effectively put the unsecured creditors "out of the money" for a *pro rata* distribution.[431] Thus, with only the secured lenders and the twenty-day claimants "in the money," the court believed that, without a twenty-day claims committee, "there was no unified body representing the major stakeholders in the case."[432]

Although *Empire Beef* can be read as resting on the "unique facts" stated by the court, given the likelihood of multi-million dollar twenty-day claims in restaurant and retailer bankruptcies, the case potentially has much broader applicability. However, courts may ultimately decide against allowing twenty-day claimants their own committee, given that the administrative costs associated with additional committees must be borne by the estate.[433]

3. Are Official Twenty-Day Claims Committees Necessary?

Practically, the relatively few cases involving representation of twenty-day claimants, suggest that separate committees are unnecessary. First, as argued in *Empire Beef*, twenty-day claimants can always form their own unofficial committee and influence a bankruptcy.[434] Second, committee representation is probably unnecessary where twenty-day claims are being paid immediately through first day orders or where the estate is administratively insolvent. Third, twenty-day claimants also tend to hold additional and/or larger secured claims, making an additional committee unnecessary.[435]

Finally, twenty-day claimants are often selected to serve on unsecured committees[436] through which they can push their agenda. For example, in *In re*

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[428] *Id.* at 666.
[429] *See* Berkoff, *supra* note 119, at 410.
[430] Baxter, *supra* note 188, at 665.
[431] Berkoff, *supra* note 119, at 410.
[432] *Id.*
[433] *See In re* George Worthington Co., 921 F.2d 626, 629 (6th Cir. 1992).
[434] *See Empire Beef* Order, *supra* note 417 (ordering appointment of 503(b)(9) creditor committee).
[435] *See* Berkoff, *supra* note 119, at 406–07 (characterizing inclusion of section 503(b)(9) claimholders on unsecured committee as unnecessary); Miller & Welford, *supra* note 131, at 496 (explaining 503(b)(9) claimholders hold additional claims); *see also In re* Benchmark Homes, Inc., No. BK06-802430TJM, 2008 WL 4844122, at *1 (Bankr. D. Neb. Oct. 30, 2008) (involving case where creditor had secured, unsecured, and twenty-day claims).
[436] *See* Berkoff, *supra* note 119, at 406–07 (conceding "some, if not all" twenty-day claimants are likely on debtor's top twenty unsecured creditors list at filing date).

Metaldyne Corp. ("*Metaldyne*"),[437] the debtor sought court approval for a DIP agreement that would give liens on all remaining unencumbered assets as adequate protection for the debtor's use of the secured lenders' cash collateral.[438] Even though the proposal could have jeopardized the general unsecured creditors' future prospects for a recovery, the unsecured creditors committee did not object to it.[439] Instead, the committee made a motion requesting carve-out from the DIP financing agreement, which would ensure that the $5–7 million in twenty-day claims would be paid.[440] However, the court denied the committee's motion, characterizing the request as "saber-rattling" done purely "to force a better deal," especially when the twenty-day claims were already adequately funded.[441]

Similarly, the case of *In re Nutritional Sourcing Corp*. ("*Nutritional Sourcing*")[442] demonstrates how twenty-day claimants may actively conspire against other general unsecured creditors. In *Nutritional Sourcing*, a committee composed of nine parties, including three probable twenty-day claimants, several secured creditors, and the debtor, negotiated a settlement agreement that narrowly defined the term "trade creditor" to exclude creditors that rendered services to the debtor.[443] Under the negotiated definition, vendors of goods would be fully repaid under a reorganization plan, whereas the remaining unsecured creditors would only receive 13.2% on their claims.[444]

Unsurprisingly, the court refused to approve the settlement and the resulting plan. Six of the nine parties that negotiated the term "trade creditor" stood to benefit from the narrow definition, and none of the negotiators "were in a position to adequately represent and protect the interests of 'non-goods' trade creditors."[445] Moreover, a non-goods trade creditor had specifically requested to be on the committee after realizing that the only trade creditors represented in the negotiations were those holding potential twenty-day claimants.[446] The court noted that this request "should have been sufficient to prompt Debtors to evaluate the composition of the Committee and adjust to make it more balanced."[447] In any event, the court held that the debtor had an obligation to evaluate the committee composition prior to settlement negotiations, not after a party requested to participate.[448]

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[437] No. 09-13412 MG, 2009 WL 2883045 (Bankr. S.D.N.Y. June 23, 2009).
[438] *Id.* at *1.
[439] *Id.* at *4.
[440] *Id.*
[441] *Id.* (noting twenty-day claims would be paid with funds collected from avoidance actions and section 363 sales).
[442] 398 B.R. 816 (Bankr. D. Del. 2008).
[443] *See id.* at 835.
[444] *Id.* at 822.
[445] *Id.* at 835.
[446] *Id.* at 836 n.15.
[447] *Id.*
[448] *Id.*

If twenty-day claimants are largely successful in manipulating unsecured creditors committees, general unsecured creditors are at risk.[449] A committee owes a fiduciary duty to maximize assets for the entire general unsecured creditor class, "not for particular segments of that class."[450] *Metaldyne* and *Nutritional Sourcing* demonstrate that inherent conflict of interests can arise where twenty-day claimants negotiate agreements allegedly on behalf of all general unsecured creditors.[451] Moreover, even if the committees in those cases had instead been negotiating for the benefit of general unsecured creditors, an inherent conflict would still arise because every dollar paid to the general unsecured creditor class could have gone directly to a twenty-day claimant.[452]

Finally, because section 503(b)(9) effectively reduces certain vendors' general unsecured claim exposure in bankruptcy, they might be less inclined to participate in developing a successful reorganization plan.[453] Thus, section 503(b)(9)'s effect on committee representation may suggest a systemic problem that cannot be tackled merely with amendments to the section.

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[449] *See* Miller & Welford, *supra* note 131, at 497 (noting committee members are removed when they seek to individually benefit, which could thereby decrease unsecured creditor class distribution); *In re* Metaldyne Corp., No. 09-13412 MG, 2009 WL 2883045, at *5 (Bankr. S.D.N.Y. June 23, 2009) (dismissing committee's motion to obtain twenty-day claimant carve-out).

[450] Miller & Welford, *supra* note 131, at 498 ("[T]he argument that a committee's duties extend to its unsecured constituents only . . . . [means] any support for allowance or payment of higher priority administrative claims would be in direct conflict with the committee's fiduciary duties, even if a subset of its constituents may benefit."); Berkoff, *supra* note 119, at 407 (criticizing statutory unsecured creditors' committees as "[in]appropriate vehicle for representation of § 503(b)(9) claimholders"); *In re* Johns-Manville Corp., 26 B.R. 919, 925 (Bankr. S.D.N.Y. 1983) (stating committee members should work to avoid conflicts of interests with creditors).

[451] *See* Miller & Welford, *supra* note 131, at 498 ("The analysis is similar to a committee's stance on allowance and payment of reclamation claims that would diminish the overall return to unsecured creditors.").

[452] *See* Berkoff, *supra* note 119, at 407 (noting diametrically opposed interests of general creditor body and section 503(b)(9) creditors); Dennis J. Connolly, *BAPCPA to Change Committee Make-up and Practice*, AM. BANKR. INST. J., July/Aug. 2005, at 54–55 (suggesting conflict of interest between trade vendor administrative claims and general unsecured creditors); Miller & Welford, *supra* note 131, at 498 (stating twenty-day claimants should consider recusing themselves where unsecured creditors committees are negotiating carve-outs for benefit of general unsecured creditors).

[453] *See Circuit City Unplugged*, *supra* note 8, at 52 (prepared statement of Todd J. Zywicki, Professor, George Mason School of Law).

> [A]dministrative priority claim status may have the unintended consequence of encouraging liquidation in another way: vendors are a constituency in bankruptcy that tends to favor reorganization because this maintains a market for their products. By reducing the value of their unsecured claims in bankruptcy, however, this may reduce their voice and clout in the reorganization process. Thus, while this increased priority helps them in the short run it ironically might create offsetting harm in the long-run by increasing the probability of liquidation.

Id.

IV. REFORM PROPOSALS

Without definitively knowing exactly why section 503(b)(9) was passed or what it was trying to accomplish, suggesting reform proposals is highly speculative. Most proposals turn on preconceived notions of what, if anything, the section sought to accomplish. They also inevitably alter the leverage of secured creditors, unsecured creditors, the debtor, and those vendors of goods currently afforded administrative expense treatment. Furthermore, proposals addressing the issues raised by setoff, preference liability, and committee representation would require additional amendments to several Code provisions. Recognizing that there are a limitless number of potential proposals, this section restricts its focus to reforming sections 503(b)(9) and 546(c).

A. Codify Critical Vendor Orders

If Congress intended section 503(b)(9) to address when critical vendor orders should be granted, then Congress should amend the section to *explicitly* tackle that issue.[454] First, Congress would need to expand section 503(b)(9) to govern to all critical vendors, including vendors of services. Then, Congress would codify an evidentiary standard for granting critical vendor motions. For example, if Congress could agree that the *K-Mart* decision established an appropriate burden of proof (a big if), section 503(b)(9) as amended would provide an administrative expense for:

> . . . the value of any goods *or services* received by the debtor within 20 days before the date of commencement of a case under this title in which the goods *or services* have been sold to the debtor in the ordinary course of such debtor's business, *provided that the debtor prove*:
> *(1) but for immediate full payment, vendor of goods or services would cease doing business with the debtor and*
> *(2) the benefit to the debtor from continued business with the vendor will not leave the remaining creditors worse off.*

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[454] Professor Resnick advocated for this Congressional clarification shortly after section 503(b)(9) was adopted:

> The Code should be amended to clarify the extent to which the doctrine of necessity applies in Chapter 11 cases. The legislation would avoid further uncertainty, as well as expensive and time-consuming litigation, over the propriety of allowing payment of prebankruptcy debts. It also would result in more national uniformity (and less forum shopping) regarding payment of prebankruptcy claims outside of a plan. The legislation should recognize different standards to be applied depending on the type of debt sought to be paid.

Resnick, *supra* note 13, at 213.

This proposal creates a potential breeding ground for litigation, particularly over terms like "immediate" and "worse off," but here debtors—not vendors—will control where that litigation starts and ends. Debtors decide who is critical, who has satisfied the elements of section 503(b)(9), and how far they will appeal a court's determination on those issues.

B. Add a Scienter Element to Section 503(b)(9)

Alternatively, if section 503(b)(9) is Congress's attempt to dissuade debtors from intentionally stockpiling goods, then Congress should amend the section to include a scienter element. This would help limit the section's application to debtors that just happened to order goods immediately before bankruptcy. Additionally, because there is nothing stopping debtors from intentionally increasing service-related orders pre-petition, the section should be expanded in part to protect vendors of services. The amended section 503(b)(9) would read:

> . . . the value of any goods *or services* received by the debtor, *in anticipation of filing bankruptcy*, within 20 days before the date of commencement of a case under this title in which the goods *or services* have been sold to the debtor in the ordinary course of such debtor's business

This proposal raises significant evidentiary obstacles if the burden of proof remains on the claimant. However, the section might be further amended to create a rebuttable presumption that the debtor ordered goods and services in anticipation of filing bankruptcy. Yet this will transfer litigation costs to the estate. It is also unclear how the debtor would be able to rebut the presumption without having its employees testify and implicate corporate privilege issues.

C. Change the Rules Governing Reclamation

If, however, Congress wanted section 503(b)(9) to fortify a vendor's right of reclamation, then Congress should *strengthen reclamation rights directly* or make them a prerequisite to filing a twenty-day claim. Putting aside the likelihood that the BAPCPA amendments to section 546(c) suggest that Congress did not want to enhance the position of unsecured creditors at the expense of secured creditors, two proposals come to mind.[455]

Under the first proposal, Congress could amend section 546(c) to make a secured creditor's floating lien explicitly subject to a vendor's right of reclamation. In relevant part, section 546(c)(1) would read:

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[455] One commentator has suggested extending the prior lien defense to section 503(b)(9), but this would render the section equally useless for vendors of goods as is section 546(c). Glasgow, *supra* note 14, at 313.

> Except as provided in subsection (d) of this section and in section 507(c), ~~and subject to~~ the prior rights of a holder of a security interest in such goods or the proceeds thereof~~,~~ *and* the rights and powers of the trustee under sections 544(a), 545, 547, and 549 are subject to the right of a seller of goods that has sold goods to the debtor, in the ordinary course of such seller's business, to reclaim such goods . . . .

Additionally, Congress would repeal subsection (c)(2) and section 503(b)(9) because a vendor's right of reclamation, if properly exercised, would now truly have teeth. The "prior lien defense" would no longer apply, but vendors would still need to fulfill the timely written demand requirements and could not compel reclamation where the goods were sold to third parties. However, this proposal might undermine the stability of the secured credit market as lenders might never know where and when their liens will definitively attach.

Alternatively, Congress could amend section 546(c)(2) to require vendors to exercise their right of reclamation as a prerequisite for qualification under section 503(b)(9). Here, section 546(c)(2) as amended would provide:

> (2) If a seller of goods ~~fails to provide~~ *provides* notice in the manner described in paragraph (1), *but could not reclaim the goods because of a prior security interest or other bona fide purchaser, then* the seller still may assert the rights contained in section 503(b)(9).

This proposal limits the number of valid twenty-day claims because vendors must now pass section 546(c)'s stringent procedural requirements before filing a twenty-day claim. Moreover, the proposal would probably work to narrow the scope of section 503(b)(9) because cases like *Erving* would no longer apply if the alleged "good" could not be reclaimed.

D. Limit Section 503(b)(9)'s Application to Vendors Conferring an Actual Benefit to the Estate

Recently, two commentators have advocated amending section 503(b)(9) to more closely parallel "one of the principal tenants underlying the Code: namely, that claims accorded administrative-expense priority should be narrowly limited to those that provide a benefit to the bankruptcy estate."[456] Under their proposal, a

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[456] Wilson & Long, *supra* note 9, at 21. Under Mr. Wilson and Mr. Long's proposal, amended section 503(b)(9) would read as follows:

> (b) After notice and a hearing, there shall be allowed administrative expenses, other than claims allowed under section 502(f) of this title, including–

twenty-day claim would arise only when the debtor was still in possession of the goods delivered twenty-days pre-petition.[457] Any party objecting to a twenty-day claim would have the burden of proof "regarding which goods, if any, were in the possession of the debtor" on the petition date.[458] The claimant would have the burden of proof on all other issues, including whether the delivery actually benefitted the debtor post-petition.[459] This proposal would also limit section 503(b)(9)'s scope, but it is unclear why the section still remains necessary. Section 503(b)(1)(A) already provides an administrative expense for the "actual, necessary costs and expenses of preserving the estate."[460]

E. Make Twenty-Day Claims Simple Priority Claims

Another practitioner suggests that Congress amend section 503(b)(9) to confer merely a priority claim rather than an administrative expense priority claim.[461] Because priority claims need not be paid in full upon the effective date of the plan, twenty-day claims could then be modified and crammed down under a reorganization plan and paid over time.[462] This would address the problems noted by Judge Jaroslovsky in his dissent in *Brown*. Moreover, Congress would have to move section 503(b)(9) to a different place under the Code because twenty-day claims would no longer constitute administrative expenses. This proposal would not only eliminate the administrative expense impediment to implementing a

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. . .

> (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 (A) the goods have been sold to the debtor in the ordinary course of such debtor's business, *and (B) the goods were in the possession of the debtor on the date of commencement of a case under this title. In any hearing regarding an asserted administrative expense under this subsection (b)(9), the party opposing the allowance of an administrative expense shall have the burden of proof regarding which goods, if any, were in the possession of the debtor on the date of commencement of a case under this title and the party asserting the administrative expense shall have the burden of proof on everything else.*

Id.

[457] *Id.*

[458] *Id.*

[459] *Id.*

[460] 11 U.S.C. § 503(b)(1)(A) (2006); *accord In re* Phila. Newspapers, LLC, 433 B.R. 164, 169 (Bankr. E.D. Pa. 2010) (interpreting "actual and necessary costs" and "preserving the estate"); *In re* Plastech Engineered Prods., Inc. ("*Plastech III*"), 394 B.R. 147, 161 (Bankr. E.D. Mich. 2008) (explaining when administrative expenses are allowed).

[461] *See Is Chapter 11 Bankruptcy Working?*, *supra* note 9, at 71 (response to post-hearing questions from Lawrence C. Gottlieb, Esq., Cooley Godward Kronish LLP, New York, NY) (explaining priority claim need not be paid in full at time of confirmation).

[462] *Id*. To further reduce the overall scope of section 503(b)(9), Mr. Gottlieb also advocates reducing the twenty-day pre-petition period to a fifteen or ten day period. *Id*.

confirmation plan, but it might also help reduce the reluctance among lenders to extend DIP financing.

F. Repeal Section 503(b)(9) and the BAPCPA Amendments to Section 546(c)

Finally, the most sensible proposal might be to pass House Representative Jerrold Nadler's bill repealing section 503(b)(9) and the BAPCPA amendments to section 546(c) while reinstating former section 546(c)(2).[463] Vendors of goods would once again only be entitled to administrative expense claims as a remedial measure where courts deny their ability to exercise their reclamation right.[464] The status quo would be reinstated, and the aforementioned twenty-day claims litigation would be a valuable drafting lesson of the past. Time would tell whether we would see a national rise in critical vendor orders to compensate for the loss of section 503(b)(9).

CONCLUSION

Without any legislative history to help resolve the many statutory ambiguities raised by section 503(b)(9), courts will continue rendering divergent decisions without any confidence in whether they are reaching results intended by Congress. Fundamental differences over how a claim is asserted, who can assert a claim, and what is covered by a claim all result in *ad hoc* approaches to a far-reaching section that should have clear parameters. The uncertainty surrounding twenty-day claims litigation only stands to increase litigation costs, drain estate funds, and, ultimately, lower the distribution to creditors.

Moreover, this Note only touches on the current issues raised by section 503(b)(9) with still larger questions looming on the horizon. For example, the case law has only alluded to the fact that twenty-day claims may be regularly bought and sold (so-called "claims trading") by parties.[465] How will claims trading affect the

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[463] See the proposed bill of Representative Jerrold Nadler (D-NY), Business Reorganization and Job Protection Act of 2009, H.R. 1942, 111th Cong. (1st Sess. 2009). Representative Nadler stated that the Bill would "remove some of obstacles now hindering struggling businesses and . . . give retailers, which are often the job providers of our communities, the means to reorganize and stay in business." *House Seeks to Help Retailers Reorganize*, ANDREWS BANKR. LITIG. REP., Apr. 17, 2009, at 2. Although the House Subcommittee on Commercial and Administrative Law reviewed the bill, it has not been enacted. *See* Borukhovich, *supra* note 10, at 470.

[464] *See* 11 U.S.C. § 546(c)(2) (2000); *see also* Griffin Retreading Co. v. Oliver Rubber Co. (*In re* Griffin Retreading Co.), 795 F.2d 676, 679 (8th Cir. 1986) (discussing court's options if reclamation is denied); Conoco v. Braniff, Inc., 113 B.R. 745, 757–58 (Bankr. M.D. Fla. 1990) (noting court's discretion in choosing remedies).

[465] *See In re* Dana Corp., No. 06-10354 (BRL), 2007 WL 1577763, at *5 (Bankr. S.D.N.Y. May 30, 2007) ("Although it was well aware of its 503(b)(9) Claim, Goodyear admits that '[b]ecause the market for Section 503(b)(9) Claims was not sufficiently attractive, Goodyear held those claims . . . .' Clearly Goodyear is a highly sophisticated creditor who initially chose not to file its 503(b)(9) Claim for business reasons."); Routh, *supra* note 5, at 79 (discussing how section 503(b)(9) creates new market for claims traders); *see also In re* Universal Bldg. Prods., No. 10-12453 (MFW), 2010 WL 4642046, at *3 (Bankr. D. Del. Nov. 4, 2010)

section 503(b)(9) issues already litigated is anyone's guess. Until then, courts must continue to use speculation and assumption to guide their decisions. Surely Congress can do better.

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(recalling how professional was "rewarded" with proxies after advising certain creditors how making twenty-day claim would improve their repayment prospects).

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