

*Expert Analysis*

## Show Me the Money! Bankruptcy Claims Under Section 503(b)(9)

### *Part 2: How to Maximize Recovery by Properly Asserting Claims for Goods Sold to a Debtor in the 20 Days Before Bankruptcy*

**By Michael D. Zaverton, Esq.**

**Walter & Haverfield**

Suppliers that sell raw materials or goods to other businesses on credit often find themselves waiting years to get paid pennies on the dollar when a customer files for bankruptcy. In 2005 Congress came to their aid by enacting Section 503(b)(9) of the Bankruptcy Code. This provision grants creditors an administrative expense priority for the value of any goods sold to and received by a debtor within 20 days before the beginning of the debtor's bankruptcy case, if the goods were sold to the debtor in the ordinary course of that debtor's business.<sup>1</sup>

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. Now, the claim for the goods sold and delivered to the debtor in the 20 days before bankruptcy, called a 503(b)(9) claim, may be allowed as an administrative expense that must be paid before the claims of most other creditors.

Unless creditors are proactive, however, and correctly and timely assert their 503(b)(9) claims in the debtor's bankruptcy case, they will not receive the benefit if this change.

#### **HOW AND WHEN TO ASSERT 503(B)(9) CLAIMS**

To date, no uniform procedural rules or forms have been adopted for the assertion of claims under Section 503(b)(9), so procedures vary from court to court. In some districts, bankruptcy courts have adopted local rules governing the filing of 503(b)(9) claims.<sup>2</sup> Elsewhere, procedures and forms for filing Section 503(b)(9) claims have been established on a case-by-case basis, with the timing and extent of such procedures depending on the size and nature of the debtor's business.<sup>3</sup>

In some cases, the bankruptcy courts have directed that special “proof of claim” forms be created for the assertion of 503(b)(9) claims. The lack of procedural uniformity increases the potential for missed deadlines and creditor missteps.

### **DEBTOR EFFORTS TO MANAGE THE CLAIMS PROCESS TO THEIR ADVANTAGE**

In some Chapter 11 cases, debtors have been able to use the lack of uniform procedures for the assertion and allowance of 503(b)(9) claims to their advantage and to the detriment of their creditors.

Generally, these debtors have:

- Obtained immediate discretionary authority to pay 503(b)(9) claims.
- Sought the establishment, at the very outset of their bankruptcy case, of exclusive procedures for the assertion of 503(b)(9) claims.
- Obtained, sometime thereafter, an order setting a separate bar date (deadline) for the assertion of 503(b)(9) claims.<sup>4</sup>

Bankruptcy courts usually approve such debtor requests because they wish to avoid a deluge of “requests for payment” of administrative expenses by creditors with 503(b)(9) claims in the critical early stages of a debtor’s bankruptcy case.

#### ***Discretionary authority to pay: A carrot to dangle before creditors***

Courts routinely enter orders that give Chapter 11 debtors discretionary authority to pay 503(b)(9) claims, although such orders often restrict or cap the aggregate amount that a debtor can pay on account of such claims. Additional limitations may be imposed by the debtor’s post-petition lender, which may only allow the debtor to make partial payment of 503(b)(9) claims during the pendency of the Chapter 11 case.

Debtors then use the promise of immediate payment of all or part of a vendor’s 503(b)(9) claim, and the release of court- and lender-imposed limitations on such payments, to negotiate very advantageous critical vendor arrangements with their suppliers. This is especially true if the supplier finds itself unexpectedly unable to obtain advances under its own financing arrangements because outstanding receivables due from the debtor have been removed from the supplier’s borrowing base.

These cash-starved vendors simply lack the ability to wait until the end of the debtor’s Chapter 11 case for payment of their 503(b)(9) claims. They often find themselves forced to extend credit on the same terms that existed before the debtor’s bankruptcy and waive the unpaid balance of their 503(b)(9) claim just to get an immediate infusion of much-needed cash.

#### ***Controlling the claims process: Delay may make creditors forgetful***

Debtors often try to restrict a 503(b)(9) claimant’s ability to assert and prosecute its administrative expense claims.

In the Chrysler bankruptcy, for example, the automaker and its affiliated debtors obtained an interim order establishing procedures for asserting 503(b)(9) claims a mere five days after they filed for bankruptcy relief.<sup>5</sup>

The Bankruptcy Court order:

- Provided that creditors could only use the specified procedures to assert, seek determination of and/or obtain payment of Section 503(b)(9) claims.

***Bottom line: Creditors must be on the lookout for any pleading, order or notice dealing with procedures or deadlines for filing claims in the debtor’s bankruptcy case.***

- Prohibited all 503(b)(9) claimants from using any other way to address their claims unless they obtained specific permission from the court.
- Stayed any pending or future motions or other proceedings initiated by 503(b)(9) claimants to assert rights related to their claims, except proceedings initiated by Chrysler in accordance with the 503(b)(9) procedures.

Not only do such restrictions add another procedural burden for creditors, but delaying the filing of 503(b)(9) claims increases the likelihood that 503(b)(9) claimants will forget to assert their administrative expense claims.

#### ***A separate bar date: Another piece of paper creditors may overlook***

Finally, the debtor subsequently will seek an order setting a separate bar date for the filing of 503(b)(9) claims. This bar date order, *which routinely provides for the disallowance of claims that are not timely filed*, and its significance, can be easily overlooked in the cascade of pleadings creditors often receive in the early stages of major Chapter 11 cases. The tardy filing of a 503(b)(9) claim is certain to result in an objection to allowance of the claim.

#### **TAKING CONTROL OF THE 503(B)(9) CLAIMS PROCESS**

Creditors with a claim for goods sold to and received by a debtor in the 20 days before bankruptcy can best ensure that their claim for the value of those goods will be allowed as an administrative expense if they take the following steps:

##### ***Watch the mail***

Although the flow of notices and pleadings in a bankruptcy case can be overwhelming, creditors must carefully monitor the mail they receive pertaining to a debtor's bankruptcy case. Under the Bankruptcy Code, a creditor is a "party in interest" that must be given notice of matters that may affect its rights or interests.

Unfortunately, especially in large Chapter 11 cases, creditors often receive a deluge of bankruptcy-related mail, all of which will be written in legalese and much of which may be confusing. Nonetheless, creditors need to treat all such mail as an urgent communication demanding immediate attention and resist the urge to set such mail aside. They need to be especially watchful for notices, motions and orders dealing with claims procedures and bar dates in a debtor's bankruptcy case.

Creditors who miss a filing deadline may find that their otherwise valid 503(b)(9) claim will not be allowed.

Goodyear Tire & Rubber Co.'s loss of its \$1.4 million 503(b)(9) claim in the Dana Corp. bankruptcy cases should serve as a cautionary "don't miss the bar date" tale for any creditor with a claim for goods received by a debtor in the 20 days before bankruptcy.<sup>6</sup>

Dana and its affiliates, "tier-one" auto parts suppliers, filed voluntary petitions for relief under Chapter 11 of the Bankruptcy Code in early March 2006. Goodyear was one of Dana's major vendors, and when Dana's Chapter 11 case began, Dana owed the tire company more than \$3.2 million. Nearly half this debt was for goods delivered to Dana in the 20 days before its bankruptcy.

About three months after Dana's bankruptcy case began, Goodyear filed a "proof of claim" asserting its pre-petition, general unsecured claim. Goodyear did not, however, include its 503(b)(9) claim in its filing. The proof of claim also specified that

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all notices in the Dana cases should be served on Goodyear's law department at its corporate headquarters.

Subsequently, the Bankruptcy Court entered an order establishing a bar date for the filing of pre-petition claims, including 503(b)(9) claims. However, Goodyear did not file its \$1.4 million 503(b)(9) claim until more than six months after the bar date. The tire maker subsequently asked the Bankruptcy Court for authority to file its 503(b)(9) claim late, alleging it had not received the bar date notice.

The court denied Goodyear's request. Initially, the court noted that bar dates are an integral part of the reorganization process and are strictly enforced. The only exception is when a known creditor is not listed on the schedules and hence fails to receive notice of the bar date. The court could, however, use its equitable powers to allow a late claim to be filed if Goodyear could demonstrate "excusable neglect."<sup>7</sup>

Goodyear argued that the reason for the delay was its failure to receive the bar date notice. The record, however, showed that 21 copies of the bar date notice had been mailed to Goodyear, including one mailed to the address the company specifically designated on the proof of claim for such service. Other notices were addressed to Goodyear's general counsel and CEO.

The court found it hard to believe that none of the 21 mailed notices had been received, so it determined that Goodyear had acted "inexcusably" in filing its 503(b)(9) claim after the bar date. Thus, Goodyear's otherwise valid \$1.4 million claim for goods delivered to Dana in the 20 days before Dana's bankruptcy case was denied payment priority as an administrative expense.<sup>8</sup>

Bottom line: Creditors must be on the lookout for any pleading, order or notice dealing with procedures or deadlines for filing claims in the debtor's bankruptcy case. Failing to file their 503(b)(9) claims on or before the deadline for asserting such claims could mean that they have squandered their only real opportunity for a meaningful recovery against the debtor's bankruptcy estate.

#### ***Don't wait to file a 503(b)(9) claim***

Creditors should file their 503(b)(9) claims as soon as possible. A prompt filing will not only eliminate the possibility of missing the deadline for filing 503(b)(9) claims, but also enable a creditor to gather the data and documents supporting its claim while the matter is fresh and records related to the claim can be easily located.

If the bankruptcy court already has established procedures for the assertion of 503(b)(9) claims, creditors must comply with those procedures. On the other hand, if a procedural order dealing with this specialized type of claim has not yet been entered in the debtor's bankruptcy case, creditors can still assert their 503(b)(9) claims immediately using existing procedures for asserting administrative expense and pre-petition claims.

#### ***Engage experienced counsel***

When filing and prosecuting their 503(b)(9) claims, creditors should consult with experienced bankruptcy or creditors' rights counsel. These practitioners will be familiar with the applicable statutory provisions, case law and bankruptcy rules. They will also know if there is a local rule establishing special procedures for the assertion of 503(b)(9) claims and will be able to easily access the bankruptcy court docket to monitor the debtor's case.

Further, the statutory language of Section 503(a) specifies that a “request for payment” must be used to assert an administrative expense claim. A request for payment is a pleading that must be signed by counsel and may involve a court hearing where counsel’s presence is recommended, if not required. Counsel’s participation may also be needed to prepare the proposed order for the bankruptcy judge’s signature if the creditor’s 503(b)(9) claim is allowed.

Because Section 503(b)(9) moves pre-petition claims for the value of goods received by the debtor in the 20 days before bankruptcy to the front of the payment line, the increased likelihood of meaningful payment justifies the retention of a skilled professional to ensure that the creditor’s 503(b)(9) claim is properly asserted and prosecuted.

### **Properly file the request for payment**

Bankruptcy Code Section 503(a) specifies that creditors must file their administrative expense claims by filing a request for payment with the bankruptcy court. So, unless a court order directs creditors to file 503(b)(9) claims another way, the creditor must assert its claim in a request for payment. There is no standardized form for asserting a request for payment.

At a minimum, however, the request should include the following:

- The creditor’s name, *i.e.*, the name that is on the invoices issued to the debtor.
- The debtor’s name, *i.e.*, the name of the actual entity that the goods were sold to (this is especially important in cases involving multiple debtors).<sup>9</sup>
- A description of the goods delivered to the debtor, including copies of the invoices issued to the debtor for such goods or, if the invoices are voluminous, a summary of the invoices. (Remember, Section 503(b)(9) only covers goods sold, not services provided.)
- An assertion that the goods were received by the debtor within the 20 days before the debtor’s bankruptcy filing. Claimants should attach proof of delivery or receipt, if any, or describe how the debtor received the goods.
- A request under Section 503(b)(9) for allowance of an administrative expense claim in an amount equal to the value of the goods sold to and received by the debtor received in the 20 days before its bankruptcy, *i.e.*, the aggregate amount due under the invoices issued to the debtor for such goods.

The request for payment must be filed with the bankruptcy court in which the debtor’s case is pending and also with any claims noticing agent \ appointed in the case.<sup>10</sup> Copies of the request for payment must be mailed to the debtor, debtor’s counsel and counsel for the unsecured creditors committee, if any, appointed in the debtor’s bankruptcy case.

Typically, creditors can find these names and addresses on the notices and pleadings they have received in the case or, in some cases, on websites established by the debtor or the creditors committee. The U.S. trustee and all other parties who have officially asked to receive notices in the debtor’s case will receive electronic notice that a creditor has filed a request for payment via the bankruptcy court’s electronic filing system.

***The increased likelihood of meaningful payment justifies the retention of a skilled professional to ensure that the creditor’s 503(b)(9) claim is properly asserted and prosecuted.***

***Creditors should file their proof of claim as soon as possible after the debtor's bankruptcy case begins to avoid the risk of missing any subsequent deadlines for filing claims the bankruptcy court may set.***

As an added precaution, creditors should promptly file a proof of claim that includes their 503(b)(9) claims as a component of their pre-petition claim against the debtor. Although it is granted the same payment priority as claims arising after the filing of a debtor's petition for bankruptcy relief, a 503(b)(9) claim — a claim for goods delivered to the debtor before the debtor's bankruptcy case began — is in actuality a pre-petition claim.

By including their 503(b)(9) claims in their proof of claim, creditors will have put the debtor on notice that they are asserting that a portion of their claim is entitled to administrative expense priority. Thus, creditors that file their proof of claim as soon as possible after the debtor's bankruptcy case begins — while events are fresh in their mind and records are easily accessible — will avoid the risk of missing any subsequent deadlines for filing claims the bankruptcy court may set.

File the claim using a proof-of-claim form easily obtainable on the Internet or on the bankruptcy court's website. Bankruptcy Form 10, the standardized proof-of-claim form, was recently revised, so creditors should make sure they are using the most recent version.

#### ***Properly fill out the proof-of-claim form***

In the revised form, creditors can indicate that all or a portion of their claim is entitled to priority under Section 507(a) of the Bankruptcy Code in a column located on the right side of the form. Administrative expense claims arising under Section 503(b) are expressly listed as priority claims in Section 507(a)(2).<sup>11</sup>

Thus, if a creditor is asserting a 503(b)(9) claim against the debtor's bankruptcy estate as a component of its pre-petition claim, it should:

- Correctly identify on the proof-of-claim form the debtor that owes the money, *i.e.*, the name of the entity that the creditor sold the goods to. Be sure to file the claim in the bankruptcy case filed by that debtor. This is especially important in cases involving more than one debtor entity.
- Specify in Item No. 1 ("Amount of Claim as of Date Case Filed") the entire amount of the pre-petition claim against the debtor, including the amount owed for goods received by the debtor in the 20 days prior to the debtor's bankruptcy.
- Complete Item 5 by checking off "Other" in the box provided and indicating that entitlement to a priority claim is based on Section 507(a)(2).
- Complete Item 2 on the proof-of-claim form by specifying the basis for the claim, *e.g.*, goods sold, money loaned, services provided, *etc.*
- Attach a supplemental page to the proof of claim indicating that a portion of the pre-petition claim is for goods sold to and received by the debtor in the 20 days before the debtor's bankruptcy case began, that that portion of the claim is entitled to administrative expense priority under Section 503(b)(9), and the value of such goods, *i.e.*, the amount of the 503(b)(9) claim.
- Comply with Item 7 of the proof-of-claim form by attaching copies of documentation supporting the pre-petition claim. Attach copies of contracts, purchase orders and invoices (or a summary of such documents if they are too voluminous). Also attach copies of documents identifying the goods received by the debtor in the 20 days before the its bankruptcy and evidencing the receipt of such goods by the debtor to support the 503(b)(9) portion of the claim.

- File the proof of claim with the bankruptcy court or with the claims agent, if one has been appointed in the debtor's bankruptcy case. Include an extra copy of the proof-of-claim form and a pre-addressed, postage-paid envelope so a time-stamped copy of the proof of claim can be returned to the creditor for its records.

If the 503(b)(9) claim is paid during the course of the debtor's bankruptcy case, the creditor should amend the proof of claim to reflect the amount of such payment.

### Payment of allowed 503(b)(9) claims

As a matter of bankruptcy law, administrative expense claims are subject to bankruptcy court review and are not allowed without notifying the debtor and other interested parties and, if necessary, conducting a hearing on any objections to their allowance. Even when a creditor's 503(b)(9) claim is allowed, payment will in most instances be deferred until later in the debtor's bankruptcy case.

For one thing, Section 503(b)(9) does not specify when such pre-bankruptcy administrative expense claims must be paid. Additionally, because other provisions of the Bankruptcy Code give a Chapter 11 debtor until the effective date of its reorganization plan to pay allowed administrative expense claims, courts have uniformly determined that payment of allowed 503(b)(9) claims can be deferred to the effective date of the debtor's reorganization plan.<sup>12</sup>

While some courts have concluded that a bankruptcy court may order immediate payment of a creditor's 503(b)(9) claim if non-payment would create a hardship for the creditor and if payment would not be prejudicial to the debtor or potentially detrimental to other creditors, creditors should anticipate, for financial planning purposes, that any payment on their allowed 503(b)(9) claim is likely to be deferred.<sup>13</sup>

### NOTES

- <sup>1</sup> 11 U.S.C. § 503(b)(9). Although also applicable in Chapters 7 and 13 of the Bankruptcy Code, because allowed administrative expense claims must be paid in full on or shortly after the effective date of a Chapter 11 plan, be it a plan of reorganization or a plan of liquidation, Section 503(b)(9) is of particular relevance in Chapter 11 cases.
- <sup>2</sup> At present, it appears that only two bankruptcy courts have adopted local rules addressing the assertion of 503(b)(9) claims: the U.S. Bankruptcy Court for the District of Massachusetts and U.S. Bankruptcy Court for the Eastern District of Michigan.
- <sup>3</sup> For example, in *In re Lyondell Chemical Co.*, No. 09-10023 (Bankr. S.D.N.Y.), 503(b)(9) claimants were required to use a specially designed proof-of-claim form and to file their 503(b)(9) claims with the debtor's claims noticing agent on or before the general bar date for filing claims. In *In re Pilgrim's Pride Corp.*, No. 08-45664 (Bankr. N.D. Tex.), holders of 503(b)(9) claims were required to submit a written request for allowance of their claim to the debtor, its counsel and the claims noticing agent on or before the separate deadline set by the court. The request had to include specific information and documents substantiating the 503(b)(9) claim. In *In re Semcrude LP*, No. 08-11525 (Bankr. D. Del.), the court established detailed procedures for the administration of 503(b)(9) claims. Among other things, these procedures required the debtors to include in their bankruptcy schedules a listing, based on their books and records, of the estimated amounts owed to vendors that delivered goods to the debtors within the 20 days before the start of their bankruptcy case; provided for the establishment of a separate bar date for the filing of proofs of claim asserting 503(b)(9) claims; gave any interested party 30 days in which to object to the 503(b)(9) claims scheduled by the debtors; gave the debtors 45 days after the bar date for filing 503(b)(9) claims to file a notice with the court disputing the amounts asserted in such claims; and gave interested parties 20 calendar days to respond to the debtors' notice disputing the asserted 503(b)(9) claims.
- <sup>4</sup> This approach is patterned, in large part, on debtor strategies for dealing with reclamation claims that were used even before the Bankruptcy Abuse Prevention and Consumer Protection Act was enacted in 2005.
- <sup>5</sup> A slightly modified version of these procedures was approved by the court in a final order granting Chrysler's motion May 20, 2009.

- <sup>6</sup> *In re Dana Corp.*, No. 06-10354, 2007 WL 1577763 (Bankr. S.D.N.Y. May 30, 2007).
- <sup>7</sup> The court's opinion suggests that Goodyear only sought relief under Bankruptcy Rule 9006(b)(1), which grants the court discretionary authority, for cause shown, to allow an act to be done if the failure to act within the allowed time was the result of excusable neglect. Section 503(a) of the Bankruptcy Code also specifies that the court can, for cause, permit an administrative expense claimant to tardily file a request for payment of an administrative expense.
- <sup>8</sup> Not only was Goodyear denied administrative expense priority for its \$1.4 million claim, it was effectively denied any right to recovery on the claim because it had not been included as a component of Goodyear's previously filed pre-petition claim and because the date for filing pre-petition claims had passed.
- <sup>9</sup> As a general rule, a creditor can only look to the assets of the specific debtor entity legally obligated to pay its claim for payment on its claim. When related businesses file for bankruptcy, however, bankruptcy courts sometimes enter orders directing that the cases be jointly administered and that all pleadings in such cases be filed under the name of a designated debtor and under the designated debtor's bankruptcy case number. In such circumstances, a creditor requesting payment of an administrative expense claim under Section 503(b)(9) must comply with the court's administrative order and file its request under the name and case number designated by the court. If the goods were sold to a different debtor entity, however, the claimant should specify the name of the debtor entity to which the goods were sold as well as the bankruptcy case number for that debtor in its request.
- <sup>10</sup> Most bankruptcy courts now require that pleadings, such as a "request for payment," be filed electronically and have put strict limits on when paper filings will be accepted. Bankruptcy or creditors rights attorneys will have access to the court's electronic filing system, yet another reason for creditors to seek the assistance of counsel when prosecuting their 503(b)(9) claim.
- <sup>11</sup> The official proof-of-claim form states: "This form should not be used to make a claim for an administrative expense arising after the commencement of the case. A 'request' for payment of an administrative expense may be filed pursuant to 11 U.S.C. § 503." As claims for the value of goods received by and sold to the debtor in the 20 days before bankruptcy, however, 503(b)(9) claims clearly arise before the commencement of the debtor's bankruptcy case. Accordingly, a creditor may use a proof-of-claim form to assert a 503(b)(9) claim. Section 503(a) of the Bankruptcy Code, however, expressly provides that administrative expense claims are to be asserted by way of a request for payment. Accordingly, unless the bankruptcy court has ordered otherwise, creditors should assert their 503(b)(9) claims through a "request for payment" and use the proof-of-claim form only as a supplemental means of ensuring that the debtor has been placed on notice that their 503(b)(9) claim exists.
- <sup>12</sup> See, e.g., *In re Global Home Prods.*, No. 06-10340, 2006 WL 3791955 (Bankr. D. Del. Dec. 21, 2006); *In re Bookbinders Rest.*, No. 06-12302, 2006 WL 3858020 (Bankr. E.D. Pa. Dec. 28, 2006); *In re Arts Dairy*, No. 09-32386, 414 B.R. 219 (Bankr. N.D. Ohio 2009).
- <sup>13</sup> *In re Global Home*, 2006 WL 3791955, \*4.



**Michael D. Zaverton** is an associate at **Walter & Haverfield** in Cleveland. He has more than 20 years' experience in commercial litigation, creditors' rights and bankruptcy matters. For more information, visit his bio online at [http://walterhav.com/attorneys/michael\\_d\\_zaverton.htm](http://walterhav.com/attorneys/michael_d_zaverton.htm) or contact him at (216) 781-1212 or [mzaverton@walterhav.com](mailto:mzaverton@walterhav.com).

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