

## **Bench View: A Further Examination of § 503(b)(9)**

**Hon. Randolph Baxter, Northern District of Ohio**

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“BAPCPA”) provided significant changes to bankruptcy law. One major change was the addition of 11 U.S.C. § 503(b)(9) (“503(b)(9)”) which allows administrative expenses for sellers of goods to insolvent companies. Section 503(b)(9) gives sellers who fail to provide notice under 11 U.S.C. § 546(c) the right to claim the value of those goods as an administrative expense, so long as those goods are received by the debtor within 20 days prior to the filing of the case and sold to the debtor in the ordinary course of his business. This administrative expense status gives the seller priority over general unsecured creditors.

While there has been little written about 503(b)(9) due to its relative newness, in the past few years, the courts have fleshed out various parts of this section. *In re Bookbinders’ Restaurant, Inc.*, 2006 WL 3858020 (E.D. Pa 2006) addressed the timing of payment of 503(b)(9) claims while *In re Global Home Products*, 2006 WL 3791955 (Del. 2006) went a step further by setting out factors relevant to determining the payment time of 503(b)(9) claims. Additionally, *In re WETCO Restaurant Group, LLC*, 2008 WL 1848779 (W.D. La. 2008) dealt with the applicability of the statute and its effect on the right of setoff, and both *In re Barbaran*, 365 B.R. 333 (D.C. 2007) and *In re Pridgen*, 2008 WL 1836950 (E.D.N.C. 2008) spoke to the language of 503(b)(9).

Two new cases add to the growing literature of 503(b)(9). *In re Brown & Cole Stores* (375 B.R. 873, 2007) and *In re Empire Beef Co. Inc.*<sup>1</sup>. resolved two specific

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<sup>1</sup> This was a bench ruling by the Honorable John C. Ninfo sitting in the United States Bankruptcy Court Western District of New York.

questions: 1) whether a secured creditor is entitled to file a priority administrative claim pursuant to 503(b)(9); and 2) whether 503(b)(9) claimants are entitled to an appointment of an official 503(b)(9) creditor's committee. These cases present issues of first impression and have expounded on our understanding of 503(b)(9).

*In re Brown & Cole Stores v. American Associated Grocers*

In *Brown & Cole Stores v. American Associated Grocers*, 375 B.R. 873 (9<sup>th</sup> Cir. BAP, 2007), the U.S. Ninth Circuit Bankruptcy Appellate Panel ("BAP") affirmed a Western District of Washington Bankruptcy Court ("Bankruptcy Court") ruling that secured claims for goods receive by a debtor within 20 days of its bankruptcy filing, in addition to unsecured claims, are entitled to administrative priority status under section 503(b)(9) of the Bankruptcy Code.<sup>2</sup> Additionally, the Ninth Circuit BAP reversed the Bankruptcy Court in ruling that administrative priority claims brought under section 503(b)(9) are claims that arise before the commencement of a debtors case and thus, under section 553(a) of the Bankruptcy Code, are subject to setoff against pre-petition claims of the debtor.

Debtor Brown & Cole Stores ("B&C") was a large privately held grocery store chain in Washington state whose principal supplier was Creditor American Associated Grocers ("Associated"). The value of all goods supplied to B&C on credit by Associated were secured by a first priority security interest of Associated in B&C's holdings in

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<sup>2</sup> 11 U.S.C. § 503(b) and (b)(9) provide:

(b) After notice and a hearing, there shall be allowed administrative expenses, other than claims allowed under section 503(f) of this title, including -

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(9) The value of any goods receive by 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.

Associated stock. During the 20 days before B&C's Chapter 11 bankruptcy filing on November 7, 2006, B&C received approximately six million dollars in goods for which Associated was seeking recovery under 503(b)(9) ("20 Day Goods Claim") despite Associated's first priority security interest for all indebtedness of B&C to Associated.

B&C opposed Associated's claim on grounds that:

1. Associated's claim was not entitled to administrative priority under section 503(b)(9) because it was a secured claim;
2. Allowing payment of Associated's 20 Day Goods Claim that is secured would be inequitable to other creditors;
3. B&C was entitled to a setoff of Associated's 20 Day Goods Claim for certain damage claims brought by B&C based on Associated's alleged pre-petition breach of the pricing provisions of "Master Supply Agreement" between Associated and B&C.

In determining that 20 Day Goods Claims brought under 503(b)(9) were entitled to administrative expense priority regardless of whether such claims are secured or unsecured, the BAP determined that the language of 503(b)(9) is plain and unambiguous and by its terms only limits a vendor's right to assert an administrative claim in three ways:

1. The vendor must have provided goods;
2. The debtor must have received the goods within 20 days of the commencement of debtor's bankruptcy;
3. The goods at issue must have been sold to the debtor "in the ordinary course" of the debtors.

Addressing B&C's contention that giving administrative priority to a secured creditor may be inequitable to other creditor's, the BAP explained that it is not up to the court to determine which creditors should have the leverage accompanying a claim's administrative priority status. Associated's status as a secured lender does not effect their ability to have a qualified priority administrative claim under the adopted plain meaning of 503(b)(9). If Associated is undersecured as to the value of its 20 Day Goods claim,

then to deny administrative priority to this claim would be to relegate a claim clearly falling within the plain meaning of 503(b)(9) to the level of general unsecured.

Furthermore, even if Associated's 20 Day Goods Claim is fully secured, priority payment of its claim under 503(b)(9) would not truly be inequitable to other creditors because such payment would "free the value of the security for that claim for the benefit of other creditors."

In *Brown & Cole*, the BAP further articulated the nature of claims brought under 503(b)(9) in supporting its holding that the Bankruptcy Court's refusal to setoff Associated's 20 Day Goods Claim with G&E's unsecured claim against Associated for pre-petition breach of contract was improper. The BAP found that the mutuality of debts required under 553(a) of the Bankruptcy Code<sup>32</sup> for setoff to be appropriate was satisfied as between an administrative priority expense claim and a general unsecured claim because, while all subsections of 503 besides 503(b)(9) relate to the allowance of certain post-petition debts as administrative expenses, 503(b)(9) claims are by the statute's plain terms pre-petition debts just as B&G's unsecured claim against Associated is for a pre-petition debt. Although 20 Day Goods Claims are deemed to be "administrative" claims under 503(b)(9) that receive priority in the distribution of dividends, 20 Day Goods Claims are essentially no different than any other claim that arises pre-petition besides the fact that Congress has "moved [them] up higher on the priority ladder" when they enacted BAPCPA.

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<sup>3</sup> 11 U.S.C. § 553(a) states in pertinent part:

Dissenting from the majority's decision that a fully secured creditor can also have rights under 503(b)(9) (but concurring on the issue of setoff), Judge Jaroslovsky objected to the majority's "simple 'plain meaning' analysis" and further asserts that the conclusion reached by the majority results in the violation of a fundamental "bankruptcy policy dictate" that a secured creditor can be forced to accept a plan that pays its secured claim over time. Judge Jaroslovsky's asserts that by leaving out wording that would make 503(b)(9) explicitly applicable to both secured and unsecured claims and yet including such explicit wording in 503(b)(1)(B)(i) regarding the entitlement of tax claims to administrative priority, Congress never intended to indicate that all administrative expenses have priority regardless of their secured status. Moreover Judge Jaroslovsky suggests that granting fully secured creditors administrative priority with regards to certain claims (i.e. 20 Day Goods Claims), the court would allow a fully secured creditor to circumvent a bankruptcy court's power to force them, under section 1129(a)(8), to accept payment of its secured claim over time in order to preserve the possibility of a successful Chapter 11 reorganization plan.

*In re: Empire Beef Company*

Empire Beef Company filed Chapter 11 in the United States Bankruptcy Court for the Western District of New York. The U.S. Trustee appointed an official unsecured creditors' committee that included several creditors asserting 503(b)(9) priority claims. The 503(b)(9) claimants felt that the official unsecured creditors' committee was not adequately representing their interests and requested that the U.S. Trustee appoint an official 503(b)(9) creditors' committee. The U.S. Trustee declined to create a 503(b)(9) committee because the U.S. Trustee's national policy is to not appoint such committees.

In the end, the court found persuasive the reasons necessitating the formation of a 503(b)(9) committee thus becoming the first court to approve the appointment of an official 503(b)(9) committee to represent the interests of all 503(b)(9) claimants.

It is important to note however, the unique and unusual circumstance of this case. Empire Beef's secured lenders and 503(b)(9) claimants were the only principal stakeholders in the case as a result of the likely administrative insolvency of Empire Beef's bankruptcy estate. Moreover, Empire Beef's 503(b)(9) creditors also represented the vast majority, approximately \$22 million, of the total unsecured creditor pool totaling approximately \$29 million.

The 503(b)(9) priority creditors asserted that the creation of an official 503(b)(9) creditors' committee was necessary for the adequate representation of the interests of all 503(b)(9) creditors. This stemmed from the argument that their interests were not being adequately represented by the official unsecured creditors' committee because it was representing the interests of general unsecured creditors, which ran counter to the interests of the 503(b)(9) claimants to the extent the latter were entitled to more favorable treatment.

The 503(b)(9) creditors relied upon 1102(a)(2) of the Bankruptcy Code, which states that "[o]n request of a party in interest, the court may order the appointment of additional committees of creditors... if necessary to assure adequate representation of creditors ... The United States Trustee shall appoint any such committee."

The U.S. Trustee, supported by Empire Beef and its secured lender, opposed the appointment of an official 503(b)(9) creditors' committee arguing that the Bankruptcy Code does not authorize the appointment of a committee of administrative expense

claimants. Since the claims of 503(b)(9) creditors are entitled to administrative priority status, they are not eligible for appointment to a separate creditors' committee.

Additionally, they argued that within the existing committee of unsecured creditors, 503(b)(9) creditors were adequately represented since many of them were already actively participating in the case. Moreover, they argued that the creation of an "official" 503(b)(9) creditors' committee would be redundant since these creditors had essentially formed an effective *ad hoc* committee to represent the interests of all 503(b)(9) claimants.

Finally, the U.S. Trustee and Empire Beef asserted that the 503(b)(9) claimants failed to establish that the additional committee is necessary to ensure adequate representation of their interests. Courts exploring the meaning of adequate representation under 1102(a) have employed a variety of factors in their evaluations, including the nature of the case, the tasks that the proposed committee is to perform, the ability to participate in the case without an official committee and the timing of the request. *See In re Enron Corp.*, 279 B.R. 671, 685 (Bankr. S.D.N.Y. 2002).

The 509(b)(9) claimants responded by stating that 1102(a)(2) authorizes the appointment of "additional committees of creditors" and rejected the U.S. Trustee's argument that 503(b)(9) claimants are not "creditors" eligible to serve on an official committees' pre-petition claim against the debtor. A 503(b)(9) claim is a new and different kind of pre-petition claim in that it is based on the debtor's pre-petition purchase of the goods, but is, nevertheless, entitled to administrative priority status. Since the 503(b)(9) creditors hold pre-petition claims, they should be eligible for appointment to an official 503(b)(9) creditors' committee.

The Court ultimately rejected the U.S. Trustee's arguments and approved the appointment of an official 503(b)(9) creditors' committee. What is important to note is that in its order, the court used language to limit the precedential effect of its ruling, indicating that the appointment of the 503(b)(9) committee was due to "the unusual and unique circumstances of this case." While *In re Empire Beef Co.* establishes the creation of 503(b)(9) creditors' committees, it remains to be seen whether the special circumstances of this case warrant a very limited application.