

# 503(b)(9) Claims from the Trenches: Debtor and Creditor Perspectives

Webinar

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# Presenter: Mark E. Felger



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**Mark E. Felger** is co-chair of the Bankruptcy, Insolvency and Reorganization group at Cozen O'Connor and the managing partner of its Wilmington, DE office. He has represented all constituencies in business reorganizations and liquidations over the past 25 years, including debtors, creditors' committees and trustees. He is certified in business bankruptcy law by the American Board of Certification, and is a certified panel mediator for the Bankruptcy Court in Delaware. Mr. Felger is AV Peer Review-rated by Martindale-Hubbell. Mark has been recognized by *Law and Politics* as both a Delaware and Pennsylvania "Super Lawyer," named one of the leading bankruptcy lawyers in Delaware by *Chambers USA*, and listed in *The Best Lawyers in America* in the area of Bankruptcy and Creditors' Rights. He is admitted to practice in Pennsylvania, New Jersey, Delaware and New York.

# Presenter: Jill B. Bienstock



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**Jill B. Bienstock** focuses her practice on a variety of areas including creditors' rights, avoidance actions and reorganizations for both individuals and corporate entities. She has represented Fortune 500 companies, various debtors, secured and unsecured creditors, landlords, equipment lessors, restaurants, hedge funds and banks, creditors' committees and liquidating trustees, both in and out of bankruptcy court. Jill's work has been recognized most recently in her selection as a "Rising Star" by New Jersey Super Lawyers and New York Metro Area Super Lawyers for 2015 and 2016.

Prior to joining Cole Schotz, Jill was a judicial intern for the Hon. Ronald J. Hedges, a magistrate judge in the U.S. District Court for the District of New Jersey and a summer associate for the firm.



# Presenter: Lucian (Luke) Murley



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**Lucian (Luke) Murley** represents debtors, official committees, and other estate-fiduciaries in major bankruptcy and restructuring cases in Delaware. In addition, Luke regularly advises financially healthy businesses that find themselves creditors in Chapter 11 cases or defendants in bankruptcy-related litigation. Luke has been recognized for his work in the insolvency community, including being listed as a “Rising Star” in Delaware Super Lawyers for two years running. He also holds an “AV” Preeminent Peer Rating, Martindale-Hubbell's highest rating for ethical standards and legal ability, and is co-chair of the American Bankruptcy Institute’s Bankruptcy Litigation Committee.

# Best Practices: Debtor's Perspective



- ❑ Consider 503(b)(9) procedures:
    - ❑ Informal claim resolution procedures (meet and confer, exchange of documents)
    - ❑ Use tailored proof of claim form vs. formal motion
    - ❑ Procedures to address disputes, discovery, and reconciliation
    - ❑ Authority to settle on modified notice and/or without full FRBP 9019 motion
  - ❑ Work with client to identify critical vendors with 503(b)(9) exposure
  - ❑ Balancing expedited procedures vs. creditor rights
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# Best Practices: Creditor's Perspective

- ❑ Work with client to identify 20-day goods; carefully review to parse out
- ❑ Carefully analyze what Debtor's procedures require
- ❑ Monitor payments to other creditors and ensure your client's claim is on par with similarly situated creditors
- ❑ Monitor case to ensure administrative solvency and manage client expectations
- ❑ Ensure you are aware of client goals and developments in the case
  - ❑ Is this a customer your client wants to continue doing business with?
  - ❑ Does Debtor plan to reorganize or sell assets? Potential suitors – are they going to take on the responsibility for 503(b)(9) claim?

# What Legal Issues Are Still Being Litigated?



- ❑ What is a “good”?
  - ❑ What does “received by the debtor” mean?
  - ❑ Can a debtor apply pre-20-day credits to reduce/offset 503(b)(9) claims?
  - ❑ When do 503(b)(9) claims get paid?
  - ❑ Does the “freight of the case” argument work?
  - ❑ How do 503(b)(9) claims (and payment thereon) impact avoidance actions?
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# Disputed Legal Issue: “Goods ”

- ❑ “the value of any goods received by the debtor. . .”
  - ❑ Is electricity a “good”?..... Depends on your court!
    - ❑ In re Great Atlantic & Pacific Tea Co., Inc., 538 B.R. 666 (S.D.N.Y. 2015) (electricity is not a good because it is not moveable at the time of metering because already used); In re NE Opco, Inc., 501 B.R. 233 (Bankr. D. Del. 2013) (same); compare In re Erving Indus., Inc., 432 B.R. 354, 370 (Bankr. D. Mass. 2010) (reasoning that electricity is a good because it is moveable at the time of contract for sale and identifiable at the time of metering).
  - ❑ Services vs. Goods – Plastech and Goody’s
    - ❑ “The word *received* modifies the word *goods* in § 503(b)(9). It is the *goods* and not the *value* that must be received by the debtor to trigger § 503(b)(9).” In re Goody’s Family Clothing Inc., 401 B.R. 131, 136 (Bankr. D. Del. 2009) (quoting In re Plastech Engineered Prods. Inc., 2008 WL 5233014, at \*2 (Bankr. E.D. Mich. Oct. 7, 2008)).
- ❑ Where creditor supplies both goods and services, only goods are 503(b)(9).  
Remainder is relegated to general unsecured claim. In re Plastech Engineered Prods., Inc., 397 B.R. 828, 837-38 (Bankr. E.D. Mich. 2009) (finding where the value of services vs. goods could be ascertained, allowing 503(b)(9) for goods).

# Disputed Legal Issue: “Goods ”

- Non-good costs likely not includable:

Freight, shipping, labor, interest, taxes, late fees are not part of the value of “goods”. See, e.g., In re Pilgrim’s Pride Corp., 421 B.R. 231, 237 (Bankr. N.D. Tex. 2009) (sustaining objection to 503(b)(9) claim for freight services); In re Plastech Engineered Prods., Inc., 397 B.R. 828, 839 (Bankr. E.D. Mich. 2008) (sustaining objection to a 503(b)(9) claim for the portion designated “labor”).

# Disputed Legal Issue: Receipt

- ❑ Received-by-the-debtor element: “the value of any goods received by the debtor . . . in which the goods have been sold to the debtor . . .”
  - ❑ Older Cases
    - ❑ In re Plastech Engineered Products, Inc., No. 08-42417, 2008 WL 5233014, at \*1 (Bankr. E.D. Mich. Oct. 7, 2008) (sustaining debtors’ objection to 503(b)(9) claim for goods that were delivered to a debtor’s customer)
    - ❑ Ningbo Chenglu Paper Products Manufacturing Co., Ltd. v. Momenta, Inc. (In re Momenta, Inc.), No. 11-cv-479-SM, 2014 WL 3765171, at \*7 (D.N.H. Aug. 29, 2012) (affirming bankruptcy court’s denial of 503(b)(9) claim for goods that were shipped directly to the debtor’s customers)
    - ❑ In re World Imports, 516 B.R. 296 (Bankr. E.D. Pa. 2014) (holding goods shipped directly to the debtor’s customers were not “received” by the debtor for purposes of section 503(b)(9))
  - ❑ Newer Cases
    - ❑ In re SRC Liquidation Co., Case No. 15-10541 (BLS) (Bankr. D. Del. Oct. 15, 2015) (transcript of bench ruling) (“[W]hile it may be a business relationship developed of long practice and, frankly, for the benefit and at the direction of the Debtor, nevertheless, the circumstances of that business relationship and the way product was moved from one party to another is such that it takes it outside of the scope of Section 503(b)(9).”)
    - ❑ In re ADI Liquidation, Inc. (f/k/a AWI Delaware, Inc.), No. 14-12092 (KJC) (Bankr. D. Del.)
- ❑ Stay tuned!

# Disputed Legal Issue: Credits

## □ Application of Credits to 503(b)(9) Claims

- Hypothetical: Debtor-buyer earns marketing allowance (i.e., credits) on all purchases from creditor-vendor, and marketing allowances are regularly applied to amount owed creditor-vendor. Debtor files chapter 11. Creditor has \$100k prepetition claim, of which \$50k is 503(b)(9), the remainder is GUC. As of the petition date, debtor is holding \$30k in unapplied credits, only \$10k of which relates to the 503(b)(9) goods, the remainder of which arose prior to the 503(b)(9) period.
- Disputed Issue: Does debtor get to apply the credits preferentially against the 503(b)(9) claim (leaving creditor with a \$20k 503(b)(9) claim) or may debtor be relegated to only applying credits relating to the 503(b)(9) period to the 503(b)(9) claim (leaving creditor with a \$40k 503(b)(9) claim)?

# Disputed Legal Issue: Credits

## ❑ Application of Credits to 503(b)(9) Claims

- ❑ In re Circuit City Stores, Inc., No. 08-35653, 2009 WL 4755253 (Bankr. E.D. Va., July 12, 2015)
  - ❑ Electronics retailer
  - ❑ Omnibus claim objection
  - ❑ 503(b)(9) claimants owed debtor receivables

# Disputed Legal Issue: Credits

## ❑ Application of Credits to 503(b)(9) Claims

- ❑ In re ADI Liquidation, Inc. (f/k/a AWI Delaware, Inc.), No. 14-12092 (KJC), 2015 WL 4638605 (Bankr. D. Del. May 5, 2015)
  - ❑ Cooperative food distributor
  - ❑ Facing 25 503(b)(9) motions, debtors and committee filed a joint motion regarding credits and overpayments
  - ❑ 503(b)(9) claimants owed the debtor credits and return overpayments
    - ❑ overpayments = COD payments for which debtor did not receive goods
    - ❑ “credits” = promotional allowances, volume discounts, warehouse allowances, rebates
  - ❑ Debtors cited § 558 and Circuit City



# Disputed Legal Issue: Credits

## ❑ “Creditor Objections”

- ❑ An omnibus motion or objection violates due process (i.e., each creditor has a right to be heard as to individual claims)
- ❑ An omnibus motion or objection is an improper advisory opinion
- ❑ Debtor’s approach undermines legislative history/ intent
- ❑ § 558 cannot be used offensively
- ❑ § 553 does not allow debtor to setoff pre-petition obligation
- ❑ Debtor’s approach infringes on creditor’s setoff right/adequate protection
- ❑ Debtor waived the right to offset credit
- ❑ Double-dipping scenario in § 363/Sale situation

# Disputed Legal Issue: Credits

- How did Circuit City and AWI courts rule on creditor objections?

	Circuit City	AWI
<b>Violative Due Process</b>	Overruled!	Overruled!
<b>Premature/ Improper Advisory Opinion</b>	Overruled!	Overruled!
<b>Inconsistent with Legislative History/ Intent</b>	Overruled!	Overruled!
<b>558 Is Not a Sword</b>	Overruled!	Overruled!
<b>Setoff Improper under 553</b>	Overruled!	Overruled!
<b>Adequate Protection</b>	Overruled!	Overruled!
<b>Right of Setoff Waived</b>	Not Discussed	Ruling: Rebuttable Presumption of No Waiver

# Disputed Legal Issue: Timing of Payment

- ❑ In re Global Home Products, No. 06-10340 (KG), 2006 WL 3791955 (Bankr. D. Del. Dec. 21, 2006)
  - ❑ “To qualify for exceptional immediate payment, a creditor must show that there is a necessity to pay and not merely that the Debtor has the ability to pay.” Id. at \*3 (citations and internal quotation marks omitted).
  - ❑ Section 503(b)(9) is a “rule of priority, rather than payment.” Id. at \*3 (citations and internal quotation marks omitted).
  - ❑ The Court in Global Home considered the following three factors in determining an entitlement to immediate payment: (1) the prejudice to the debtors, (2) hardship to claimant, and (3) potential detriment to other creditors. Id. at \*4.

# Disputed Legal Issue: Administrative Solvency

- ❑ **“Freight of the Case” Argument**

- ❑ A typical creditor’s argument: “This sale can’t be done on the back of 503(b)(9) claimants!”

- ❑ Notable recent case: In re Family Christian, LLC, 533 B.R. 600 (Bankr. W.D. Mich. 2015)

- ❑ Court denied approval of sale for reasons unrelated to payment of admins, **but explicitly disqualified one bid for failure to guarantee payment of admins**

- ❑ Entered order providing that any qualifying bid must provide for payment in full of all admins

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# Disputed Legal Issue: Avoidance Actions

- ❑ **Are 503(b)(9) payments “double-dipping” when the same 20-day goods are used as new value?**
  - ❑ Friedman’s Liq. Trust v. Roth Staffing Cos. LP (In re Friedman’s Inc.), 738 F.3d 547 (3d Cir. 2013): Third Circuit held in an issue of first impression that post-petition payment to creditor under Wage Order could not reduce the creditor’s new value defense. Notably, payments were made under a wage order for what were services (and not a 503(b)(9) order), but the court’s analysis is keenly focused on when to determine what is the actual new value and the Third Circuit held it was at the time of the petition date, and thus post-petition payments under the Wage Order (or arguably under a 503(b)(9) order in other matters), cannot be used to discount a new value argument by creditor in response to preference claims.
  - ❑ But see Siegel v. Sony Electronics, Inc. (In re Circuit City Stores, Inc.), 515 B.R. 302 (Bankr. E.D. Va. 2014): Bankruptcy Court held that payment on account of 503(b)(9) is an *otherwise unavoidable transfer* such that the new value attributable to the 20-day period prior to the filing is negated. Court reasoned that *Friedman’s* holding is very limited – only relating to wage orders and not 503(b)(9) payments.

# Key Takeaways?

