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More 'Goods' News for the Trade

Delaware Bankruptcy Court Grants Administrative Expense Priority Claim for Goods Sold and Delivered Pre-Petition and Received by Debtor Post-Petition



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In Chapter 11 bankruptcy cases, a trade creditor's unsecured claim for goods or services provided to a debtor post-petition is far more likely to be paid in full than an unsecured claim for goods or services provided pre-petition. This is because post-petition claims are generally entitled to administrative expense priority status, while pre-petition trade claims are generally treated as low priority, general unsecured claims.

The Bankruptcy Code requires the full payment of administrative expense claims in order for the debtor to confirm a Chapter 11 plan. This gives post-petition administrative expense claims a significant advantage over pre-petition general unsecured claims, which in many cases are paid only pennies on the dollar, if anything at all.

That said, pre-petition claims are entitled to administrative expense priority under certain circumstances. For example, as bankruptcy-savvy creditors are well aware, Section 503(b)(9) of the Bankruptcy Code grants administrative expense priority for claims on account of goods that are sold to and received by a debtor within the 20 days prior to the bankruptcy filing date. And, as illustrated by a July 2021 decision by the

Delaware bankruptcy court in the Chapter 11 cases of *Bluestem Brands, Inc.*, a creditor *also* may be entitled to an administrative expense priority claim under Bankruptcy Code section 503(b)(1)(A) for goods sold and delivered prior to the bankruptcy filing if the debtor ultimately received the goods *after* the bankruptcy filing.

Background Regarding Section 503(b)(9) Priority Claims, "Receipt" of Goods Thereunder, and Section 503(b)(1)(A) Administrative Expense Claims

Bankruptcy Code Section 503(b)(9) grants an administrative expense priority claim for:

"... the value of any goods received by the debtor within 20 days before the date of commencement of a case under this title in which the goods have been sold to the debtor in the ordinary course of such debtor's business."

Whether a creditor is entitled to a priority claim under Section 503(b)(9) is dependent on whether the debtor received the goods within the 20 days prior to the debtors' bankruptcy filing. In a 2017 decision in *In re World Imports, Ltd.*, the United States Court of Appeals for the Third Circuit (Third

Circuit)—the decisions of which are binding in Delaware, Pennsylvania, New Jersey and the U.S. Virgin Islands—held that a debtor had *received* goods for purposes of determining Section 503(b)(9) priority when the debtor or its agent takes physical possession of the goods, and not when the creditor delivered the goods or when title or risk of loss passes to the debtor (all of which could occur prior to physical receipt). In so doing, the Third Circuit in *World Imports* adopted the definition of receipt set forth under Article 2 of the Uniform Commercial Code (UCC): Goods are received upon taking physical possession of them. The *World Imports* court also relied in part on the Third Circuit's prior holding in *In re Marin Motor Oil*, which also used the UCC's definition of receipt while addressing a creditor's reclamation rights under Section 546(c) of the Bankruptcy Code.

Trade creditors also can assert an administrative expense priority claim under section 503(b)(1)(A) of the Bankruptcy Code for the value (usually based on invoice price) of goods sold to the debtor post-petition (i.e., after the bankruptcy filing). Section 503(b)(1)(A) grants a creditor an administrative expense priority claim for the actual, necessary costs and expenses of preserving the estate.

In light of the foregoing, what happens if a creditor had sold goods to the debtor and delivered the goods by loading them on a common carrier prior to the bankruptcy filing, but the debtor did not actually receive the goods until *after* the filing date? The creditor's claim may not be entitled to priority under Section 503(b)(9) because the goods were not received within the 20 days prior to the bankruptcy filing. However, according to the *Bluestem Brands* decision, the creditor *is* entitled to a post-petition administrative expense priority claim under Section 503(b)(1)(A), even though the goods were arguably sold and delivered prior to the bankruptcy filing.

Background Regarding the Bluestem Brands Decision

On March 9, 2020 (Petition Date), Bluestem Brands, Inc., and its affiliates (collectively, the Debtors) filed voluntary Chapter 11 bankruptcy petitions in the Delaware bankruptcy court. The court approved the

Debtors' Chapter 11 plan and appointed a plan administrator to implement and administer the confirmed plan.

Prior to the bankruptcy filing, the Debtors placed several orders for goods with two foreign vendors based in India—Prati Kreations (Prati) and DPI Fashions Private Limited (DPI, and together with Prati, the Foreign Vendors). The Foreign Vendors placed the goods with a carrier before the Petition Date, in February 2020. However, the Debtors received certain goods delivered under these orders after the Petition Date: \$79,211.85 of Prati's goods and \$33,657.53 of DPI's goods.

Specifically, the Debtors received \$24,527.07 of Prati's goods on March 25, 2020; \$28,676.89 on April 6, 2020; and \$26,007.89 on April 7, 2020. The Debtors received \$16,416.11 of DPI's goods on March 12, 2020, and \$17,241.42 of DPI's goods on March 26, 2020.

DPI timely filed proofs of claim asserting general unsecured claims for the amounts the Debtors owed to DPI as of the Petition Date, and Prati timely filed a proof of claim asserting an administrative expense priority claim in the amount of \$24,527.07 pursuant to Section 503(b)(9). The plan administrator moved to reclassify Prati's administrative expense priority proof of claim to a general unsecured claim in August 2020, which the court granted.

The Debtors' Chapter 11 plan set a deadline of Sept. 27, 2020, for creditors to file requests for allowance of administrative expense claims. Neither Prati nor DPI filed a request for allowance of an administrative expense claim by that deadline.

On Dec. 8, 2020, Prati filed a motion seeking allowance of an administrative expense priority claim under Bankruptcy Code Section 503(b)(1)(A) in the amount of \$79,211.85, for the goods Prati sold and delivered pre-petition but that the Debtors had received post-petition. After filing the motion, the plan administrator advised Prati of the order reclassifying Prati's prior administrative expense priority proof of claim to a low priority general unsecured claim. On Feb. 16, 2021, Prati filed a motion for reconsideration of that order.

On March 3, 2021, DPI filed a motion seeking allowance of an administrative expense claim under Section 503(b)(1)(A) of the Bankruptcy Code with respect to the \$33,657.53 of DPI's goods that the Debtors had received post-petition in connection with its pre-petition orders.

The plan administrator filed objections to the Foreign Vendors' motions for allowance of administrative expense claims and Prati's motion for reconsideration of the order reclassifying its administrative expense claim to a general unsecured claim. The plan administrator asserted that the Foreign Vendors should be precluded from asserting administrative expense claims because Prati's claim had already been reclassified as a general unsecured claim and DPI's request for allowance of an administrative expense claim was untimely.

The plan administrator also argued that the Foreign Vendors' administrative expense claims should be disallowed on the merits. The plan administrator asserted that the Foreign Vendors' claims did not arise from a transaction with the Debtors that had benefitted their post-petition estates (as is required to obtain administrative expense priority status under section 503(b)(1)(A)). The plan administrator argued that the claims arose pre-petition from contracts that had been fully performed by the Foreign Vendors when title to the goods passed to the Debtors pursuant to the UCC (via the Foreign Vendors' delivery of the goods to the carrier pre-petition), and there were no post-petition transactions with the Debtors.

The Foreign Vendors responded that Section 503(b)(1)(A) does not require a post-petition transaction to have taken place, but only that the Debtors' estates benefitted post-petition. The dispositive issue, according to the Foreign Vendors, is whether the Debtors received the goods post-petition and, based on Third Circuit precedent, the Debtors received the goods when the Debtors first got physical possession of them (not when title passed by pre-petition delivery to the carrier). Relying on *Marin Motor Oil*, the Foreign Vendors asserted that UCC Article 2 governs the rights of buyers and sellers and permits a seller to stop delivery of goods in the

carrier's possession upon discovery of a debtor's insolvency (notwithstanding passage of title and delivery pre-petition) until the debtor obtains physical possession of the goods. Therefore, the Foreign Vendors argued that goods are *received* when the debtor obtains physical possession of the goods—which in the *Bluestem Brands* case occurred post-petition.

The plan administrator countered that Third Circuit precedent, such as *Marin Motor Oil* and *World Imports*, are inapplicable here because they did not deal with administrative expense priority status under Section 503(b)(1)(A). Rather, those cases dealt with priority claims involving reclamation rights under Section 546(c) and goods the debtor had received within 20 days of the bankruptcy filing under Section 503(b)(9), and both of those sections explicitly base priority status on when the debtors had *received* goods (whereas section 503(b)(1)(A) does not). The plan administrator also argued that while receipt may be relevant to allowance under sections 546(c) and 503(b)(9), it is not relevant to allowance of a post-petition administrative expense claim under Section 503(b)(1)(A).

The Bankruptcy Court's Decision

The Bankruptcy Court ruled in favor of the Foreign Vendors and granted each of their motions for allowance of their respective administrative expense priority claims under Section 503(b)(1)(A).

As an initial matter, the Court granted Prati's motion to reconsider the reclassification of its proof of claim and rejected the plan administrator's opposition to DPI's request for allowance of its administrative expense claim as untimely. The Court held that cause existed to recharacterize the Foreign Vendors' prior, timely filed proofs of claim as administrative expense claims because their failure to timely move for allowance of their administrative expense claims (and Prati's failure to respond to the objection to its proof of claim) were the result of "excusable neglect." The Court concluded (i) the Debtors were not prejudiced by the late requests for allowance of the Foreign Vendors' administrative expense claims because the prior timely filed proofs of claim gave notice of the relevant facts, (ii) the length of the Foreign Vendors' delay

in asserting their administrative claims did not weigh in favor of denying the Foreign Vendors' requests because the claims reconciliation process remained ongoing and no distributions to creditors had yet been made, (iii) the Foreign Vendors had valid reason for the delay because they are Indian companies that would not readily appreciate the nuances of American bankruptcy law regarding administrative expense claims, general unsecured claims, and their respective and distinct bar dates, and (iv) the Foreign Vendors had made a good faith effort to assert their claims in a timely fashion.

The Court then addressed the merits of—and ultimately granted—the Foreign Vendors' requests for allowance of administrative expense priority claims. According to Section 503(b)(1)(A), the Foreign Vendors were entitled to an administrative expense priority claim for "the actual, necessary costs and expenses of preserving the estate ... after the commencement of the [bankruptcy] case." The Court concluded that the standard for allowance of an administrative expense claim under Section 503(b)(1)(A) is whether the Foreign Vendors' provision of goods the Debtors had received post-petition actually benefitted or preserved the Debtors' estate. Section 503(b)(1)(A) does not require a post-petition contract or transaction as a condition for granting the Foreign Vendors an allowed administrative expense claim.

The Court held that the Foreign Vendors had satisfied Section 503(b)(1)(A)'s requirement that the goods they had sold to the Debtors benefitted and preserved the Debtors' estate. It was undisputed that the Debtors had physically received the Foreign Vendors' goods after the Petition Date. The Debtors then resold the goods and used the proceeds after the Petition Date all benefitting the Debtors' business. Relying on the Third Circuit's decisions in *Marin Motor Oil* and *World Imports*, the Court concluded that goods are *received* when the debtor obtains physical possession of the goods and not upon the delivery of the goods to the carrier.

The Court also acknowledged that Section 503(b)(1)(A) does not use the word *received*, but found that distinction to be

irrelevant. Section 503(b)(1)(A) is broader than sections 546(c) and 503(b)(9) because Section 503(b)(1)(A) affords priority status to many types of claims—including claims unrelated to the sale of goods. And, ultimately, the Court found "no good reason" to grant lower priority status to a claim for goods a debtor physically receives on or after the bankruptcy filing date than to a claim for goods a debtor receives prior to the bankruptcy filing date (such as a claim for goods the debtor had received within the 20 days period before the filing pursuant to Section 503(b)(9)).

Conclusion

The *Bluestem Brands* decision is a huge win for trade creditors, particularly because it came from one of—if not the—most active districts for large commercial Chapter 11 filings, the District of Delaware. Trade creditors that sold and delivered goods to a Chapter 11 debtor in the days or weeks leading up to a debtor's bankruptcy filing should pay close attention to when the debtor had actually received the goods and then assert the appropriate priority. And don't risk losing your potential claim by failing to timely assert the claim; always make sure to timely file or assert your claims against the debtor!

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