

# Cautionary Tale for Section 503(b)(9) Claimants: Filing a Proof of Claim Might Thwart Recovery

By: Bruce S. Nathan, Esq. and David M. Banker, Esq.  
of Lowenstein Sandler

Prior to 2005, goods sellers had increased difficulty obtaining relief on their reclamation claims, and were more often than not treated as general unsecured creditors receiving little or no recovery. In 2005, Congress enacted the Bankruptcy Prevention and Consumer Protection Act of 2005 (BAPCPA), which included a new provision, Section 503(b)(9), to both incentivize and reward vendors for selling goods to distressed customers. Section 503(b)(9) grants goods sellers an administrative priority claim for the value of any goods a debtor receives within 20 days of its bankruptcy filing that were sold to the debtor in the ordinary course of such debtor's business.

One of the problems with the newly enacted Section 503(b)(9) "20 day goods" priority claim is the lack of any uniform rule for the assertion of the claim. The consequence of this lack of clarity is evident from a recent decision in *In re: Richfield Equities, LLC*, a bankruptcy case pending in the Eastern District of Michigan, where the bankruptcy court denied a Section 503(b)(9) claimant an allowed administrative priority claim because the creditor had failed to timely and properly assert its Section 503(b)(9) priority claim. The court held that the creditor should have filed a motion for allowance of its Section 503(b)(9) claim prior to the passage of the claims bar date that was set in the case. The creditor's assertion of its Section 503(b)(9) priority claim by including the claim in its proof of claim did not cut the mustard!

## The Nuts and Bolts of Section 503(b)(9)

For starters, Section 503(b)(9) states that:

(b) After *notice and a hearing*, there shall be allowed administrative expenses..., including (a) the value of any goods received by the debtor within 20 days before the 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.

Section 503(b)(9)'s "*notice and hearing*" requirement means a creditor must assert its Section 503(b)(9) priority claim by filing a motion with the bankruptcy court (which requires retaining counsel), unless the bankruptcy court permits an alternative means of asserting the claim. Therefore, unless specifically allowed by the bankruptcy court, it is improper for a creditor to assert its Section 503(b)(9) claim by filing a proof of claim.

Unfortunately, the Federal Rules of Bankruptcy Procedure (the "Federal Bankruptcy Rules") were never changed to

provide a simple procedure for asserting a Section 503(b)(9) priority claim by including the claim in a proof of claim form. Nor have the Federal Bankruptcy Rules set a deadline for the assertion of Section 503(b)(9) claims.

Some bankruptcy courts, such as the Eastern District of Michigan and the District of Massachusetts, have adopted local rules, applicable to all bankruptcy cases filed in those districts, setting a deadline for creditors to move for allowance of their Section 503(b)(9) claims. It is critically important that creditors asserting a section 503(b)(9) priority claim promptly check the local rules of the bankruptcy court where the case is pending to confirm whether the court has established a deadline and procedures for asserting section 503(b)(9) claims.

The Bankruptcy Court for the District of Massachusetts has set a deadline of 60 days after the first date set for the meeting of creditors, and the Bankruptcy Court for the Eastern District of Michigan, where the *Richfield Equities* case is pending, has set a deadline of 90 days after the first date set for the meeting of creditors, for asserting Section 503(b)(9) claims.

Some courts have approved procedures for asserting Section 503(b)(9) priority claims by filing a proof of claim. More and more frequently, especially in the larger bankruptcy cases, the courts have approved procedures requiring parties to assert Section 503(b)(9) claims via a special proof of claim form. Some of these proof of claim forms solely relate to the assertion of a creditor's Section 503(b)(9) claim (and not the balance of the creditor's remaining general unsecured claim). Other proof of claim forms resemble the official bankruptcy proof of claim form, but also include a section for asserting Section 503(b)(9) claims. This has certainly simplified the process for asserting Section 503(b)(9) claims. However, this has also caused a considerable amount of confusion for Section 503(b)(9) creditors who mistakenly believe that they can assert their Section 503(b)(9) claims by filing a proof of claim form in all cases, even where the court had not previously permitted the use of a proof of claim form for asserting Section 503(b)(9) claims.

## The *In re: Richfield Equities, LLC* Case

On September 18, 2012 (the "petition date"), *Richfield Equities* and its three affiliated entities filed Chapter 11 petitions in the United States Bankruptcy Court for the Eastern District of Michigan. *Richfield* provided waste disposal, waste management and recycling services. Dependable Wholesale, Inc. supplied tires and related

products to Richfield. On the petition date, Dependable asserted a claim in the amount of approximately \$105,000 against Richfield, which included approximately \$25,000 for goods Richfield had received within 20 days of the petition date.

According to Local Bankruptcy Rule 3003.3, adopted by the United States Bankruptcy Court for the Eastern District of Michigan,

In a Chapter 11 case, unless the court orders otherwise, the deadline for filing a required proof of claim... or a motion for allowance of a claim under § 503(b)(9) is 90 days after the first date set for the meeting of creditors.

As a result, the deadline for Dependable to file a motion for allowance of its Section 503(b)(9) priority claim was January 15, 2013, 90 days after the meeting of creditors in the case. Dependable had filed a proof of claim, using the official proof of claim form, on January 8, 2013. The proof of claim included Dependable's total claim of approximately \$105,000, of which approximately \$25,000 was asserted as a Section 503(b)(9) priority claim, with the remainder unsecured. Dependable included with its proof of claim a summary and copies of the invoices that were part of its Section 503(b)(9) claim. The smaller balance invoices were signed by an individual the court assumed was an employee of the debtor, reflecting the debtor had received the goods; the larger balance invoices were not signed. Dependable did not file a motion seeking allowance of its Section 503(b)(9) administrative priority claim by the January 15, 2013 claims bar date set by the local bankruptcy rules.

Richfield's bankruptcy case was converted to Chapter 7 (liquidation) on February 25, 2013. In May 2016, the Chapter 7 trustee appointed in the case objected to Dependable's Section 503(b)(9) priority claim. The trustee argued Dependable had improperly asserted the claim in a proof of claim form, instead of filing a motion for allowance of the claim as required by Section 503(b)(9), and had failed to timely file a motion for allowance of its Section 503(b)(9) claim by the January 15, 2013 bar date.

Dependable responded to the trustee's objection by filing a motion for allowance of its Section 503(b)(9) priority claim, nearly three and a half years after passage of the claims bar date set by the local bankruptcy rules. Dependable argued that the conversion from Chapter 11 to Chapter 7 either excused or reset the deadline to file a motion to allow its Section 503(b)(9) priority claim. Dependable also argued that its proof of claim, including the invoices attached to it, contained all the required information that it would have included in a motion for allowance of its Section 503(b)(9) claim. Dependable also asserted that cause existed to allow it to file its motion after passage of the claims bar date.

### **The Court's Ruling**

The bankruptcy court denied Dependable's motion for allowance of its Section 503(b)(9) priority claim and sustained the trustee's objection to Dependable's proof of claim to the extent it sought administrative priority status for

Dependable's Section 503(b)(9) claim. The court noted that neither the Bankruptcy Code nor the Federal Bankruptcy Rules set a deadline for a creditor to assert a Section 503(b)(9) priority claim. The local bankruptcy rule filled in the gap by setting the bar date for filing a motion for allowance of a Section 503(b)(9) claim at 90 days after the first date scheduled for the meeting of creditors. The court did not find any statutory grounds supporting Dependable's assertion that conversion of the case from Chapter 11 to Chapter 7 either excused or reset the deadline set by the local rules for Dependable to file a motion for allowance of its Section 503(b)(9) claim.

The court also noted that the earlier bar date for creditors to properly assert their Section 503(b)(9) priority claims increased the likelihood of the continued availability of evidence for creditors to prove their claims and for the trustee to challenge an improper Section 503(b)(9) claim. In the *Richfield* case, it would have been easier to confirm when the debtor had received the goods subject to Dependable's Section 503(b)(9) claim had Dependable timely filed a motion for allowance of its claim prior to the January 15, 2013 bar date set by the local rules, instead of approximately 4 years after delivery of the goods.

The court also noted that Dependable did not satisfy Section 503(b)(9)'s requirements for priority status by just filing a proof of claim that included its Section 503(b)(9) priority claim. As a general rule, creditors asserting an administrative claim must file a motion requesting allowance and payment of administrative expenses; filing a proof of claim form to assert this claim is not sufficient. This provides an early and clear means of raising issues because motions are on notice to the debtor and creditors, while proofs of claim are not.

The court suggested that it might have ruled differently and considered Dependable's proof of claim if Dependable had included adequate proof that Dependable had satisfied Section 503(b)(9)'s requirements for priority status. Specifically, Dependable could not prove when the debtor had received the goods subject to its Section 503(b)(9) claim based on the documents included as part of its proof of claim.

Finally, Dependable did not prove that cause existed to justify its late filing of a motion for allowance of its Section 503(b)(9) priority claim. The court found that the prejudice to the debtor and other administrative claimants that Dependable had caused when it had delayed in filing its motion and then filed its motion late outweighed the prejudice to Dependable from denial of its motion. The debtor and its creditors had every reason to rely on the earlier January 15, 2013 claims bar date to confirm the universe of priority creditors. The trustee was also prejudiced by Dependable's delay in filing its motion for allowance of its Section 503(b)(9) claim approximately 4 years after the delivery of the goods subject to Dependable's claim by making it far more difficult to determine when the debtor had received the goods. Dependable also could not justify its delay, or the cause for its delay, in filing its motion. Dependable was aware of

its potential administrative expense claim under Section 503(b)(9) prior to the claims bar date, but had chosen not to timely file the appropriate separate motion, instead opting to improperly assert its Section 503(b)(9) claim via proof of claim form, and only later filing a motion three and a half years after passage of the bar date. Dependable's dilatory actions severely impacted the trustee's ability to confirm when the debtor had received the goods subject to Dependable's claim.

## Conclusion

The American Bankruptcy Institute (ABI) had created a Commission to Study the Reform of Chapter 11. The Commission had engaged in a three year, in-depth study of the Bankruptcy Code to provide recommendations for reform of the Chapter 11 process. The Commission proposed a modification to Section 503(b)(9), and the Federal Bankruptcy Rules and the Official Proof of Claim Form, to allow Section 503(b)(9) creditors to assert their claims by filing a proof of claim on or before the general claims bar date set in the case or a specific section 503(b)(9) claim bar date established by the bankruptcy court. This change, if enacted by Congress, would greatly simplify the process for Section 503(b)(9) claimants to assert their claims.

However, without the enactment of these changes, creditors should understand that filing a motion for allowance of their Section 503(b)(9) priority claims is the proper way to assert these claims, unless the bankruptcy court allows for the assertion of Section 503(b)(9) claims by filing a proof of claim. That does not mean creditors should "jump the gun" and file a motion for allowance of their Section 503(b)(9) priority claims at the beginning of the case. The prudent course of action is to monitor the docket of the bankruptcy case for a court order setting a claims bar date and allowing the assertion of a Section 503(b)(9) claim by filing a proof of claim, and then following the procedures and timely filing the claim. In the absence of a court order, creditors should

consult with counsel on the manner in which to assert their Section 503(b)(9) claims. Creditors should review the local bankruptcy rules adopted by the court in which the bankruptcy case is pending, as well as court orders in the case to confirm the deadline and correct way to assert their Section 503(b)(9) claims, and then make sure they timely and properly assert these claims. Anything less poses a risk of losing what might otherwise be a valuable claim.



### About the authors:

**Bruce S. Nathan**, Partner in Lowenstein Sandler's Bankruptcy, Financial Reorganization & Creditors' Rights Department, has more than 30 years experience in the bankruptcy and insolvency field, and is a recognized national expert on trade creditor rights

and the representation of trade creditors in bankruptcy and other legal matters. Bruce has represented trade and other unsecured creditors, unsecured creditors' committees, secured creditors, and other interested parties in many of the larger Chapter 11 cases that have been filed, and is currently representing the liquidating trust and previously represented the creditors' committee in the Borders Group Inc. Chapter 11 case. Bruce also negotiates and prepares letters of credit, guarantees, security, consignment, bailment, tolling, and other agreements for the credit departments of institutional clients.

**David Banker** is a Partner in Lowenstein Sandler's Bankruptcy, Financial Reorganization & Creditors' Rights Department. David's practice focuses on creditors' rights in the context of complex bankruptcies, including representing trade creditors, creditors' committees, plan trustees, secured lenders and lessors.

