

First Opinions: Bankruptcy Courts' Recent Rulings on Twenty Day Claims

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As part of the 2005 revisions of the Bankruptcy Code, Congress greatly enhanced the priority of claims asserted by suppliers of goods to debtors in the 20-day period immediately prior to a debtor's bankruptcy filing by enacting new section 503(b)(9). This new provision raises several interesting issues, some of which were addressed by two recent cases examining the question of when such claims are to be paid.

The Language of Section 503(b)(9)

Section 503(b)(9) of the Bankruptcy Code provides an administrative priority for claims — so-called “Twenty Day Claims” — for goods received by a debtor in the 20-day period immediately preceding the debtor's bankruptcy filing. Specifically, this new provision provides that

After notice and a hearing, there shall be allowed administrative expenses . . . including . . . 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.

A simple reading of this section presents several questions:

What are “goods”? The term is not defined in the statute. One likely source of a definition is the Uniform Commercial Code, which includes a very broad definition of “goods” that has been utilized by bankruptcy courts in other contexts.

How is the “value of goods” determined? The agreed upon purchase price might be considered strong or even conclusive evidence of the value of the goods, but arguably should simply create an evidentiary presumption that a debtor might seek to rebut.

How is it determined when goods are “received”? Arguably, when delivery occurs should be determined under state law, but the statute offers no guidance, and creditors or debtors might argue that actual possession is necessary under the statute.

How is the “ordinary course” of the debtor’s business determined? It likely will be determined by reference to existing bankruptcy case law interpreting the phrase “ordinary course” in other contexts, but there are reasonable arguments that such interpretations are not well-suited for use in the context of section 503(b)(9) due to the different purpose of this provision.

While one can argue that these questions should be answered in the manner suggested above, even the most basic questions that arise from a simple reading of the provision have not been definitively answered, making it clear that Congress left open a number of issues in enacting this provision.

How Is a Twenty Day Claim Asserted?

In addition to the above issues that are apparent after reviewing the face of section 503(b)(9), other issues lurk below its surface. In fact, one important practical issue is how a claimant is to procedurally assert its Twenty Day Claim. In this regard, neither the statute nor case law provides a clear answer.

On the one hand, administrative claims (if not paid in the ordinary course) are asserted through the filing with the bankruptcy court of a request for allowance and payment on the main docket of the bankruptcy case, and request the court's attention to grant affirmative relief. On the other hand, pre-petition claims are normally asserted through the proof of claim process and not on the main docket. Proofs of claim do not demand the immediate attention of the court, but are deemed valid unless a party-in-interest objects. Twenty Day Claims, however, are both administrative claims and pre-petition claims. Accordingly, the process under which they are to be asserted is simply not clear.

From a legal perspective, Twenty Day Claims arguably should be filed as part of the proof of claim process because such claims — like other types of priority pre-petition claims — are subject to Federal Rules of Bankruptcy Procedure that govern the assertion of pre-petition claims and objections thereto. Practical considerations strongly support the same result. From a simple administrative standpoint, no debtor in a medium-sized or large chapter 11 case — and no bankruptcy court — will want hundreds of requests for payment flooding the main bankruptcy docket and demanding the court's and the debtor's time in the midst of other key restructuring activities. The proof of claim process is more easily administered by the debtor and more efficient for the court. Moreover, proofs of claim can be filed by the claimant itself and need not be filed by an outside attorney, which typically would be required in filing a request for payment of administrative expense on the docket.

Whatever the rule, creditors should keep a sharp eye on any procedural requirements adopted in their particular case and, where unclear, seek clarification to ensure that they do not inadvertently waive their rights to this new and valuable priority.

When Is A Twenty Day Claim to Be Paid?

Another important issue that is left open by the provision is when a Twenty Day Claim is to be paid. The only applicable statutory requirement is that Twenty Day Claims, like other administrative claims, must be paid by the effective date of the debtor's chapter 11 plan. Prior to the enactment of new section 503(b)(9), administrative claim jurisprudence left questions of timing of payment of administrative claims to the discretion of the bankruptcy court. This statutory flexibility resulted in a variety of decisions, with some courts ordering that payment of certain kinds of administrative claims be delayed until the end of a chapter 11 case, while others ordered payment of other kinds of administrative claims at earlier points in time. Whether this case law continues to apply to Twenty Day Claims is an open issue.

Instead of simply applying traditional tests to the question of when section 503(b)(9) claims should be paid, a bankruptcy court could rule in a number of ways, including by authorizing: (a) payment in the ordinary course at the start of the bankruptcy case; (b) payment as soon as the claim is allowed; (c) payment at the end of the case, upon plan confirmation; or (d) payment at the discretion of the debtors.

This timing of payment issue is the subject of two recent decisions of bankruptcy courts located within the Third Circuit: *In re Bookbinders' Restaurant, Inc.* out of the Eastern District of Pennsylvania and *In re Global Home Products, LLC* out of the District of Delaware.

Bookbinders

In *Bookbinders*, the debtor and various holders of Twenty Day Claims resolved such claims, which were liquidated and allowed in agreed-upon amounts. One of the creditors thereafter asserted that it was entitled to immediate payment of its allowed Twenty Day Claim. The court rejected the supplier's argument that Twenty Day Claims must be paid immediately as a matter of law, but reserved the question of whether it would order the claim paid in an exercise of the court's discretion.

In reaching this holding, the court relied on three primary facts. First, it noted that nothing in the text of section 503(b) (including subsection (9)) requires immediate payment of such claims. Second, the court noted that the normal rationale for paying post-petition administrative claims is that such claims arise from ordinary course transactions with the post-petition debtor in possession and thus may be payable under section 363(c) of the Bankruptcy Code. By contrast, the court explained, Twenty Day Claims do not arise from transactions with the debtor in possession but instead arise from transactions with the pre-petition debtor, making section 363(c) completely inapplicable. Finally, the court noted that, in other provisions of the Bankruptcy Code, Congress made it clear when claims were to be paid as a matter of law, and concluded that "had Congress intended to provide §503(b)(9) claimants with some type of enhanced right to payment after allowance of the expense, I am convinced that it would have made its intent express in the statute."

While the reasoning of the court suggested that it would not be inclined to order immediate payment of Twenty Day Claims, the court ultimately held that it was within its discretion to

order such claims paid, and the court scheduled an evidentiary hearing on that question. The creditor, however, realizing that it was unlikely to prevail, withdrew the motion prior to hearing.

Global Home Products

In *Global Home Products*, shortly after the debtor's bankruptcy filing, a supplier to the debtor filed a motion seeking immediate allowance and payment of its Twenty Day Claim. Unlike in *Bookbinders*, however, the debtor did not argue that all Twenty Day Claims should be paid at the end of the case as a matter of law, and the creditor did not argue that all such claims should be paid immediately as a matter of law. Instead, both the debtor and the creditor agreed that the normal standards applicable to payment of post-petition administrative claims would apply.

The court then applied the extant standard tests for determining the timing of payment of administrative claims in the District of Delaware, including consideration of prejudice to the debtor and hardship to the claimant. In this regard, the debtor produced evidence that it did not have sufficient cash to pay all of its Twenty Day Claims and that a court order requiring it to pay such claims could violate its post-petition financing facility's terms and would cause its reorganization efforts to collapse. Because the creditor could afford to wait for payment and was not itself in financial distress, the bankruptcy court ultimately concluded that the balance of equities favored the debtor. Thus, immediate payment was not required.

Ultimately, the results in *Bookbinders* and *Global Home Products* are somewhat unsatisfying, as both courts applied (or ruled that they would apply) the traditional test for whether administrative claims should be paid and did not address the special nature of Twenty Day Claims or clearly articulate a rationale justifying application of the old tests in this new context. That said, the fact

that the court ruled in favor of the debtor in both cases suggests that, whatever the logic applied, creditors may have a difficult time obtaining rulings from bankruptcy courts ordering immediate payment of such claims.

Conclusion

While a seemingly minor revision to the Bankruptcy Code, the enactment of section 503(b)(9) has greatly shifted the dynamic between debtors and their suppliers in a number of interesting, untested and unexpected ways. The decisions of the courts in *Bookbinders* and *Global Home Products* represent bankruptcy courts' initial efforts at interpreting some of the many interesting facets of this new Code section, which will likely be the subject of substantial litigation and dispute for years to come.

In re Bookbinders' Restaurant, Inc., 2006 WL 3858020 (Bankr. E.D. Pa. Dec. 28, 2006).

In re Global Home Products, LLC, 2006 WL 3791955 (Bankr. D. Del. Dec. 21, 2006).