



Section 503(B)(9) Four Years Later

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In 2005, Congress added Code § 503(b)(9) and created a new administrative claim which, in effect, creates a class of "critical" pre-petition creditors that debtors can pay without court authority. The creditors in this entitled class did nothing more than deliver goods to the debtor within 20 days prior to the petition date. Interestingly, the section provides no similar relief to providers of services or any class of lender.

Section 503(b)(9) provides:

After notice and a hearing, there shall be allowed administrative expenses, other than claims allowed under section 502(f) of this title, including —

* * *

(9) 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.

If you see the relationship to reclamation rights, you are on the right track. Apparently, § 503(b)(9) was intended to provide additional, and certainly more reliable, protections to creditors with reclamation rights under Code § 546 (c). In fact, the legislative history of § 503(b)(9) makes clear that the provision was intended to provide relief to sellers of goods who failed to provide the required reclamation notice under § 546(c). BAPCPA of 2005, Pub. L. No. 109-8 (2005) at § 1227.

Surprisingly, in the almost four years since the enactment of § 503(b)(9) there is a dearth of reported decisions interpreting § 503(b)(9). Below, we analyze a few of the issues raised by § 503(b)(9) and consider how courts have, and might, decide those issues.

The Meaning of 'Value'

The bankruptcy bar is abuzz about the meaning of the word "value" in § 503(b)(9). Again, the statute accords an administrative expense priority to "the value of any goods" received by the debtor in the allotted time. Some speculate as to whether "value" means the full retail price, a value based upon liquidation or something else entirely. This speculation suggests that because Congress did not ascribe a specific meaning to the term in the Code, courts will have to formulate a new judicial definition of the word "value" in connection with § 503(b)(9) claims.

Not so, for the answer is fairly self-evident, both in judicial precedent and related statutes. Admittedly, "value" is not defined in § 503, or anywhere else in the Code. Unfortunately, the Uniform Commercial Code is not much help; its definition of "value" is something given by a person "for rights if he acquires them." U.C.C. § 1-201(44).

But, we can get to the meaning of value by looking at the general definitional provisions of the U.C.C., which state that a "contract" is "the total legal obligation which results from the parties' agreement." U.C.C. § 1-201(11). It follows that, because a § 503(b)(9) claim only could arise under a contract governed by the U.C.C. or other body

of commercial law, the value of goods under § 503(b)(9) is measured by the underlying agreement, *i.e.*, the full contract price.

The U.C.C. offers further guidance. Section 503(b)(9) could be considered the offspring of the traditional reclamation claim found at § 546 and, therefore, we can look at the latter proviso's first cousin, U.C.C. § 2-702 for direction. Alas, the statutory language there and the cases decided under it don't add to the discussion. But, look a little further within the U.C.C.: Section 2-709, entitled "Action for the Price," deals with the situation when the buyer fails to pay the price after it becomes due, and what the seller may recover. U.C.C. § 2-709(1). The analogy to § 503(b)(9) is most compelling; after all, the vendor is seeking to recover for goods sold but yet unpaid for.

U.C.C. § 2-709 is clear cut: The seller may recover, together with incidental damages, the price of the goods as accepted or identified to the contract of sale. U.C.C. § 2-709(1)(a) and (b). See *Shokai Far East Ltd. v. Energy Conservation Systems, Inc.*, 628 F.Supp. 1462 (S.D.N.Y. 1986); *Hidden Brook Air, Inc. v. Thabet Aviation Intern. Inc.*, 241 F.Supp.2d 246 (S.D.N.Y. 2002) (seller entitled to contract price of goods sold but not paid for).

In sum, there is ample statutory authority and precedent to conclude that "value" means the full contract price for purposes of § 503(b)(9). Given that the new proviso sprouts from the reclamation branch of the mighty oak we call the U.C.C., our reliance is well-founded. But there is more.

Cases in Point

It is axiomatic that the statutory language of the Code must be interpreted in accordance with its plain meaning. The cases are legion whereby the Supreme Court had admonished the lower courts to do precisely that. *Lamie v. U.S. Trustee*, 540 U.S. 526, 534 (2004); *Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 6 (2000). Therefore, in seeking out (as we must) the plain meaning of the "value" of goods, the most logical and sensible definition is the contract price, as that is indeed what the relevant parties ascribed by mutual agreement as the value of their original transaction. Linguistic gymnastics are wholly unnecessary in this endeavor.

The better reasoned bankruptcy cases would agree. The landmark of *Brown & Cole Stores, LLC v. Associated Grocers, Inc. (In re Brown & Cole Stores, LLC)*, 375 B.R. 873 (B.A.P. 9th Cir. 2007) ("Brown & Cole"), strongly advocated reliance on the plain meaning of § 503(b)(9), declaring that "when the law's language is plain, the sole function of a court is to enforce that proviso according to its own terms." Sabino, "The Death of Reclamation: How Congress and the Courts Have Eviscerated Reclamation Rights, and What Can Be Done About It." Norton Annual Survey of Bankruptcy Law 2008 31, 55, analyzing *Brown & Cole*, *supra* at 877. To be sure, Bankruptcy Judge Montali's erudite decision did not deal directly with the "value" question, but can there be any doubt that the court would have applied a plain meaning rubric to that word, just as it did to the rest of the proviso?

Similarly, Bankruptcy Judge Sontchi in *Goody's Family Clothing*, 401 B.R. 131 (Bankr. D. Del. 2009), employed the same tact, making plain meaning paramount in deciding if services equate with goods (they do not, *see infra*). *Id.* at 134. Additionally, in denying § 503(b)(9) status for services (even services in preparing goods for sale), *Goody's* inextricably intertwined "value" with the goods sold to the debtor. *Id.* at 136. Once again, common sense and traditional legal principles drive us inexorably to measure value in this context from the most sensible and reliable source, the underlying contract.

Notably, *Goody's* was in large part predicated upon Bankruptcy Judge Shefferly's conclusion in *In re Plastech Engineered Products, Inc.*, 2008 WL 5233014, at 2 (No. 08-42417 Bankr. E.D. Mich. 2008), that "[i]t is the goods and not the value that must be received by the debtor to trigger § 503(b)(9)." *Id.* Indeed, the *Plastech* court explicitly rejected the vendor's assertion that its 503(b)(9) claim be measured by some amorphous value received by the debtor. Rather, Judge Shefferly was most emphatic in grounding entitlement to § 503(b)(9) rights upon the actual receipt of goods. Again, logic tells us to measure value by the goods themselves, *i.e.*, the contract price.

Taking *Goody's* and *Plastech* in their proper light, these bankruptcy judges rightly tied the entirety of § 503(b)(9) status to the actual sale of goods from the claimant to the debtor. This also ties in neatly with the UCC concepts discussed above that a vendor's right to recover for unpaid goods is predicated upon the contract and the price set therein.

Thus, we are again inescapably drawn to conclude that, for purposes of this statute, "value" is the full contract price, as that is the worth the parties accorded their transaction by prior agreement. Accord Resnick, "The Future

of the Doctrine of Necessity and Critical-Vendor Payments in Chapter 11 Cases." 47 *Boston College Law Review* 183, 205 ("It can be expected that value will be the same as the purchase price in most cases, especially if any arguable difference in the two amounts is not so material as to warrant litigation over that issue.").

It's 'Ordinary Course,' Again!

Section 503(b)(9) also provides that the goods must be sold in the "ordinary course" of the debtor's business. Like the term "value," the term "ordinary course" is not defined in the Code. But, unlike "value," the term "ordinary course" exists in other areas of the Code: § 547(c)(2) (preference defenses), § 363(c) (asset sales) and § 303(f) and § 502(f) (involuntary cases).

We have not found any written decisions that discuss the meaning of "ordinary course" for purposes of § 503(b)(9), but we think courts will look at other areas of the Code in order to understand it. We know in the preference context that "ordinary course" means customary terms and conditions used by other parties in the same industry facing the same or similar problems. *Lawson v. Ford Motor Co. (In re Roblin Industries, Inc.)*, 78 F.3d 40, 41, (2d Cir. 1996); *In re Tolona Pizza Products Corp.*, 3 F.3d 1029 (7th Cir. 1993).

In the asset sale context, the standard involves a two-part test (vertical and horizontal) under which courts: 1) view the transaction from the vantage point of hypothetical lien creditor and ask whether the transaction subjects the creditor to economic risks of a different nature than those accepted when it entered into the transaction with the debtor (the "creditor's expectation" or vertical test); and 2) view the transaction from an industry-wide perspective to decide whether the transaction is the type in which other businesses similar to the debtor's would engage as ordinary business (the "industry-wide" or horizontal test). See *In re Nelson Nutraceutical, Inc.*, 369 B.R. 787, 797-98 (Bankr. D. Del. 2007); *In re G.S. Distribution, Inc.*, 331 B.R. 552, 559 (S.D.N.Y. 2005).

But, since 2005, the preference defense landscape has changed. It is unclear how courts will deal with the issue of subjective versus objective ordinary course standards brought to the fore by the 2005 Amendments to § 547(c)(2). That section now provides that a creditor can prevail on an ordinary course defense by proving either that the transaction was within the ordinary course of business between the parties, or that the transaction was within the ordinary business terms in the industry. See 11 U.S.C. § 547(c)(2); *In re Ameri P.O.S. Inc.*, 355 B.R. 876 (Bankr. S.D. Fla. 2006). We will have to wait to see if the same dual standard will hold true for purposes of 503(b)(9) ordinary course analysis.

You Said 'Goods,' Did You Mean 'Services?'

Another area of possible controversy is the meaning of the term "goods" in § 503(b)(9). Lawyers have argued that "goods" can include services performed for the debtor within the 20-day period. Using the same analysis discussed above with respect to the meaning of "value," the plain meaning of the term "goods" should carry the day to defeat such arguments.

In the *Goody's* case, the court held that inspection, ticketing and repackaging services provided to a clothing retailer did not qualify as "goods" under § 503(b)(9). Judge Sontchi reached that conclusion relying on the plain meaning of the term and the U.C.C. definition of goods. U.C.C. § 2-105(1); *Goody's Family Clothing*, 401 B.R. at 134-35.

But the distinction between goods and services can get murky. For example, is the supplying of natural gas to a debtor providing a service or the delivery of goods? The court in another decision in the *Plastech* case held that the provision of natural gas was a mixture of goods and services and the court must determine what portion of the claim constitutes goods. *In re Plastech Engineered Products, Inc.*, 397 B.R. 828 (Bankr. E.D. Mich. 2008).

In *Plastech*, the court looked at the definition of goods under Michigan's version of the U.C.C. and rejected the view of the Michigan state courts that applied a predominate purpose test under which if the predominate purpose of the goods/services supplied was the provision of services, and then the claim would be considered a claim for services. Such an all or nothing test makes sense when trying to determine whether a particular contract is governed by the U.C.C., but it is an overly rigid test for determining what portion of a claim is administrative under § 503(b)(9). The *Plastech* court took a more flexible approach and appropriately reasoned that it could examine the underlying basis for the claim and determine what portion of the claim related to the delivery of goods. The remaining portion of the claim for services would be an unsecured claim. *Plastech*, 397 B.R. at 838-39.

The *Plastech* court then did the same thing with the § 503(b)(9) claim filed by the provider of snow removal services finding that the goods supplied were the chemicals applied as part of the snow removal process. *Plastech*, 397 B.R. at 837-39.

Conclusion

Although § 503(b)(9) is nearly four years old, it is still in a nascent stage. Rival creditors, to say nothing of debtors in possession and bankruptcy trustees, will continue to push its evolution over some of the issues discussed here. Until we have the benefit of more judicial decisions, and, one would hope, guidance from the appellate courts, 503 (b)(9) will remain controversial and hotly contested.

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