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Claims Chat

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Do Contingent § 503(b)(9) Claims Exist?

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Section 503(b)(9) of the Bankruptcy Code provides a trade creditor with an administrative claim for the value of unpaid goods sold to the debtor in the ordinary course of business and received within 20 days before the petition date for what otherwise would have been treated as a general unsecured claim. However, this treatment is not absolute. This article provides an overview of the impact of avoidance provisions on the applicability and interplay of §§ 503(b)(9) and 502(h), which mandates that a claim created by the avoided preference under § 547 be treated as if it had arisen pre-petition.

The History of § 503(b)(9)

Section 503(b)(9) was added to the Bankruptcy Code in 2005 with the passage of the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA). Prior to BAPCPA's passage, and aside from limited benefits provided to trade creditors by reclamation statutes, these claims were treated as lower-priority general unsecured claims. The effect of enacting § 503(b)(9) was to elevate the priority of a seller's claim for goods delivered within the 20-day period to a high-priority administrative-expense claim from a lower-priority general unsecured claim.

According to the legislative history, Congress's intent was twofold. First, it was to encourage suppliers to continue the flow of goods to a customer even if a customer's bankruptcy appeared imminent. Second, Congress recognized that the provision of goods delivered immediately before a bankruptcy preserved the value of the debtor's business just as much as goods sold to a debtor after the bankruptcy filing. As a result, the vendor's § 503(b)(9) claim is entitled to full payment to the extent that the debtor is not administratively insolvent at confirmation of the plan.

Pre-Petition Nature of the Claim

Section 503(b)(9) claims are pre-petition claims notwithstanding their elevation to administrative-claims status. In other words, they are no different than general unsecured claims.

If the bankruptcy petition is not filed, such a claim is simply a debt owed by a potential buyer to a seller and stands on equal footing with other unpaid sellers of goods. It is only the filing of the bankruptcy within 20 days of receipt of the goods that elevates this claim to administrative claim status.

Post-Petition Nature of the Claim

In the early days following BAPCPA, § 503(b)(9) claimants were required to file a motion requesting the allowance and payment of such claim on notice and with a hearing, just like other creditors holding § 503(b) administrative claims based on the post-petition sale of goods or provision of services. This process changed, and many courts now permit debtors to modify their proof-of-claim form to enable creditors to assert their § 503(b)(9) rights on that form by simply checking a box and inserting the amount of their asserted administrative claim.

Section 503(b)(9) claims are now regularly asserted on a pre-petition proof of claim that is filed with the debtor's claims and noticing agent. These are typically grouped together with other pre-petition debts that the debtor may owe to the creditor. This practice is now largely customary in chapter 11 cases and is sometimes mandated by local bankruptcy rules.

In comparison, the process for the assertion of post-petition administrative-expense claims arising under other subsections of § 503(b) is not so streamlined, and such claims must be asserted — absent prior court approval or payment — by the filing of a motion. This often imposes considerable expense and burden on the creditor.

A&P v. McKesson

The U.S. Bankruptcy Court for the Southern District of New York recently grappled with an issue of first impression addressing the effect of avoiding a preference in an action under §§ 547(b) and 550(a) on the transfer, which would — but for the payment pre-petition — constitute an administrative claim under § 503(b)(9).

In other words, the court had to determine whether the creditor — following the avoided preference — was entitled to assert a § 503(b)(9) administrative claim under § 502(h), or whether the contingent claim got stripped of its administrative status in favor of a general unsecured claim. Based on a prior holding in the case that deemed a § 503(b)(9) clam to be a post-petition claim and eligible to setoff preference exposure, the New York bankruptcy court held that a § 503(b)(9) claim forever loses its administrative-expense status once it has been paid, and the return of the payment relegates the creditor to possessing a mere general unsecured claim under § 502(h).

By way of background, the official committee of unsecured creditors in *The Great Atlantic & Pacific Tea Co*.[1] filed a complaint against McKesson Corp. seeking to avoid and recover approximately $67.7 million in payments received by McKesson from the debtor within 90 days of the petition date. After extensive discovery, but before trial, McKesson sought summary judgment on various legal grounds pertaining to the preference action and its defenses.

In the Jan. 18 decision, Hon. **Lisa G. Beckerman** addressed multiple issues raised in McKesson's summary judgment motion and arguments raised in a separate setoff request, including whether "any judgment rendered on the preference claim would be futile because the resulting section 502(h) claim for any avoided preferential transfers would not be an unsecured claim, but would be an administrative claim under section 503(b)(9) [as] ... section 502(h) requires that the transferee be put back in the same position as it would be had the preferential transfer never been made."

Writing without the benefit of a robust legislative history addressing the interplay between §§ 503(b)(9) and 502(h),[2] the court held that a § 502(h) claim is an entirely new claim devoid of the benefits provided by § 503(b)(9) that the creditor would have otherwise enjoyed had the payment not been made. In the court's view:

> [I]f a preference judgment against the Defendant were rendered in this Adversary Proceeding, the Defendant paid the amount of the preference judgment in full, and then the Defendant filed a claim for the amount of the paid preference judgment, the Defendant would not have an allowed section 503(b)(9) claim, but would have an allowed unsecured claim in the amount of the paid preference judgment.

The court arrived at this conclusion by first analyzing the congressional intent behind § 503(b)(9)'s enactment. Some believe that § 503(b)(9) was added to the Bankruptcy Code to provide relief to sellers of goods who do not comply with the reclamation procedures provided by § 546(c). Meanwhile, others believe that § 503(b)(9) was intended to encourage sellers of goods to continue selling products to a distressed purchaser, which could potentially preserve the value of the purchaser's business and enhance its reorganization potential.

The court's analysis ultimately turned on the applicability of its previous holding in the case that McKesson's § 503(b)(9) claim constituted a post-petition claim, while § 502(h) provides that a claim created by an avoided preference would be treated as if it had arisen pre-petition. By adhering to the law of the case doctrine, the court felt constrained by its prior holding in the case by the predecessor judge who extended the *Quantum*[3] decision, and held that McKesson has a right to set off its allowed § 503(b)(9) administrative claim against any judgment entered against it on account of a preferential transfer action.

The prior decision in the case, and other decisions relied on by the predecessor judge, concluded that McKesson's § 503(b)(9) administrative claim is a post-petition claim, like claims arising from other subsections of § 503(b), even though the underlying debt arose from unpaid goods delivered to a buyer who later filed for bankruptcy. Due to these previous holdings, the court reasoned that McKesson was seeking a § 503(b)(9) post-petition claim on account of the avoided transfers, something for which § 502(h) did not provide.[4]

Potential Solutions

Avoidance of preference payments made on account of debt subject to § 503(b)(9) is not a frequent occurrence in bankruptcy cases. This is largely because most sale transactions involve payment terms of more than 20 days, and financially strapped purchasers usually delay vendor payments leading up to the bankruptcy filing. Thus, the more common scenario is that obligations subject to § 503(b)(9) remain unpaid as of the petition date, not that they are paid and subject to avoidance as potential preferences. Despite the rather infrequent occurrence of the issue raised in the *A&P* case, the current statutory framework seems contradictory and difficult to reconcile, and may not serve the likely congressional intent behind the addition of § 503(b)(9).

Congress can clarify these murky waters in various ways. It could amend § 502(h) to provide that claims resulting from avoided and recovered transfers retain the status of the debt on account of which the payments were made. In that case, an avoided preferential transfer that was made on account of debt subject to § 503(b)(9) status would result in a claim subject to the same status.

Congress could also amend § 547 to provide that payments made on account of debt that would give rise to an administrative claim are not subject to avoidance. The logic

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1 *Official Comm. of Unsecured Creditors v. McKesson Corp. (In re Great Atl. & Pac. Tea Co.)*, 2024 Bankr. LEXIS 209 (Bankr. S.D.N.Y. Jan. 18, 2024).

2 Section 502(h) of the Bankruptcy Code provides that "[a] claim arising from the recovery of property under section 522, 550, or 553 ... shall be determined, and shall be allowed under subsection (a), (b), or (c) of this section ... the same as if such claim had arisen before the date of the filing of the petition."

3 *Official Comm. of Unsecured Creditors of Quantum Foods LLC v. Tyson Foods Inc. (In re Quantum Foods LLC)*, 554 B.R. 729, 733 (Bankr. D. Del. 2016) (permitting setoff of allowed post-petition administrative-expense claim against preference).

4 The court also rejected the defendant's citation to *Fleet Nat'l Bank v. Gray (In re Bankvest Capital Corp.)*, 375 F.3d 51 (1st Cir. 2004), and *In re Falcon Prods. Inc.*, 2008 WL 363045 (E.D. Mo. Feb. 8, 2008), both of which found a preference to be futile where avoidance of the transfer would result in the creditor filing a claim that would be fully paid due to the claim being a priority or secured claim. In distinguishing those cases, Judge Beckerman held that they did not conflict with § 502(h) because they concerned pre-petition claims, not a post-petition § 503(b)(9) claim that was being asserted here.

would be that since administrative expense claims are generally paid in full as a condition of confirmation, such creditors would unlikely have recovered more than similarly situated post-petition administrative-expense creditors whose payments are not subject to avoidance under § 547.

Another potential solution is instead of providing the 20-day claimants with administrative-expense status under § 503(b), which is generally reserved for the post-petition costs and expenses of "preserving the estate," Congress could afford them the same priority by expressly adding those claims to § 507(a)(2). Lastly, courts could provide preference defendants with a *Kiwi*-type defense[5] and hold that the hypothetical chapter 7 element (§ 547(b)(5)) cannot be met if the hypothetical claim would have been a § 503(b)(9) administrative claim that will be paid in full. abi

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5 *Kimmelman v. Port Auth. of N.Y. & N.J. (In re Kiwi Int'l Airlines Inc.)*, 344 F.3d 311, 314 (3d Cir. 2003) ("[T]he assumption of a contract under 11 U.S.C. § 365 bars a preference claim by a trustee.").