

The \$382,901 Check Really is in the Mail

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David H. Conaway
Partner

Chair, Bankruptcy, Insolvency and Creditors' Rights Group

Co-Chair, Marketing Committee

We recently delivered a \$382,901 check to a client in payment of a Bankruptcy Section 503(b)(9) claim, known as a “20-day administrative” claim. The claim arose from the client’s pre-petition sale of goods to its customer. General unsecured creditors received nothing.

Since 2005, when Section 503(b)(9) was added to the Bankruptcy Code, sellers of goods can assert an administrative priority claim for the pre-petition sale of goods, if the goods were “received” by the debtor within 20 days prior to the Chapter 11 filing. When are goods “received” in an FOB mill sales contract? The answer is below.

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The Bankruptcy Code provides a payment priority scheme for claims in this order: secured claims, administrative claims, certain priority claims, and lastly general unsecured claims, which by definition arise from the pre-petition sale of goods. Normally general unsecured claims receive little or no value or dividend in a Chapter 11 case. Given the high priority of administrative claims and since the Bankruptcy Code requires payment of administrative claims as a condition of confirmation of any plan of reorganization, absent administrative insolvency, these claims are normally paid in full.

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Essential Points for Sellers’ 20-Day Administrative Claims

1. A 20-day administrative claim requires the seller to file a motion and to obtain a court order approving the claim.

In larger Chapter 11 cases, to avoid a potential flood of motions by sellers, Debtors often obtain an “omnibus”

court order establishing uniform procedures for filing 20-day administrative claims.

2. The amount of a seller’s 20-day administrative claim is the value of the goods received by the Debtor, usually determined by the invoice price.

3. Goods are received when the Debtor has physical possession of the goods, which is usually established by bills of lading correlating to the invoices in question.

In cases where goods were shipped outside the 20 days, but physically received within the 20 days, some debtors have argued that in an FOB mill sales contract, goods are constructively received when the seller places the goods with a shipper. However, most cases, including the Circuit City case, have ruled that the provisions of Article 2 of the Uniform Commercial Code (Sales of Goods) regarding delivery control. Article 2 favors actual physical possession. As long as a seller’s right of stoppage of goods in transit exists, the buyer has not received the goods. The buyer’s actual physical possession is when the right to the stoppage of goods in transit terminates. Thus, the more reasoned view is goods are received when the buyer has actual physical possession.

4. In Chapter 11 cases ending in a confirmed plan of reorganization, 20-day administrative claims are normally paid in full, since payment of administrative claims is a condition of plan confirmation.

5. In Chapter 11 cases where the main event is a quick Section 363 sale of all the debtor’s assets, payment in full of 20-day administrative claims is at risk.

If the Section 363 sale is for an amount equal to or less than the amount of secured debt, there may not be any value to pay administrative claims, including 20-day administrative claims.

However, many Bankruptcy Courts frown on secured creditors using Chapter 11 as a vehicle to liquidate

their collateral without providing some value to other creditors. The so-called “pay to play” rule usually results in secured creditors sharing some of the proceeds of the Section 363 sale to pay all or a portion of administrative claims. For example, in the Vertis Holdings Chapter 11 case pending in Delaware, after a Section 363 sale, a lender set aside \$12 million dollars from sales proceeds to pay 20-day administrative claims, which are estimated to be about \$25 million. Vertis’ unsecured creditors will receive nothing.

In the Malden Mills (Polartec licensee) Chapter 11 case, the Debtor filed a Section 363 sale motion for all its assets for \$45 million, the same amount as the secured debt. The lender agreed to pay the Debtor’s counsel fees as a sale transaction cost, but no other administrative claims would be paid. The Debtor also proposed to pay from the sale proceeds a \$1 million bonus to management if the Section 363 sale closed quickly. On behalf of two material vendors owed about \$1 million, Shumaker objected to the sale and the proposed bonus. The court ruled that the vendors’ 20-day administrative claims had to be paid at closing. Early intervention and objection to the debtor’s first day motion was necessary to preserve the 20-day administrative claim.

The Takeaway

Sellers of goods should always explore their potential 20-day administrative claim. It can be easy money and result in payment of all or a significant portion of the seller’s general unsecured claim.

We hope you have found this article informative and useful. Please let us know if you have any comments or questions

slk-law.com

dconaway@slk-law.com