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503(b)(9) Claimants – The New Constituent, a/k/a “the 500 Pound Gorilla,” at the Table

*Judith Greenstone Miller & Jay L. Welford**^{1,2}

I. INTRODUCTION

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“BAPCPA”)³ established a new administrative priority claim under Section 503(b)(9) of the Bankruptcy Code, Title 11, §§ 101, *et seq.* (“Code”) for those creditors that provide goods to a debtor in the ordinary course of business within 20 days prior to the commencement of the case. The legislative history surrounding this section is scant, but presumably Congress was concerned about providing a vehicle to enhance payment to creditors that shipped goods to a debtor in the ordinary course of business on the eve of bankruptcy. According to Collier’s:

The ostensible reason for according administrative priority to such obligations was to prevent debtors from acquiring goods at a time where the debtor knew that bankruptcy was imminent and that the debtor would not be able to pay for such goods.

COLLIER’S ON BANKRUPTCY ¶ 503.16[1] at 503-79 (15th ed. rev.). Colliers goes on to state that the provision, while well intentioned, provides unequal treatment to similarly situated creditors:

The addition of this provision represents a dramatic departure from bankruptcy precedent. It is also likely to lead to disparate treatment of otherwise similarly situated creditors since vendors of

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3. Pub. L. No. 109-8 (2005) (effective in cases commenced on or after Oct. 17, 2005).

goods will be treated differently than other creditors providing value to the debtor during the 20-day period preceding the filing of the case.

Id. at 503-79 and 503-80.

Apart from this dichotomy in treatment, in enacting this provision, Congress failed to take into consideration other ramifications that this section would have on the bankruptcy process.

The adoption of this provision, in essence, has created a new constituent at the bargaining table – the Section 503(b)(9) claimants. The first days of a Chapter 11 case were already difficult and complicated enough for a debtor, in terms of obtaining financing and approval to use cash collateral and maintaining the flow of goods and services. Now, that process has been further complicated and exacerbated by the creation of this new class of creditor. Issues such as (i) who is entitled to assert a 503(b)(9) claim; (ii) how and when is the claim asserted; (iii) may 503(b)(9) claimants compel immediate payment of their claims; (iv) what defenses may be asserted against payment of such claims; (v) whether an unsecured creditors' committee should align itself with the interests of the 503(b)(9) claimants; and (vi) whether the U.S. Trustee can be compelled to form a 503(b)(9) committee, are but a few of the many questions that are now being raised, addressed, and analyzed in Chapter 11 cases.

II. WHAT IS A 503(b)(9) CLAIM?

The time for making a reclamation demand under Section 546(c) of the Code has been expanded under BAPCPA from 10 days to 45 days *if* the debtor received goods from a creditor while insolvent. A written request must be made to the debtor identifying the goods subject to reclamation within 45 days after the date of receipt of such goods. Alternatively, if such time period expires after the petition is filed, then the request must be made no later than 20 days after the petition date. Notwithstanding a creditor's failure to make a written demand for reclamation, Section 546(c)(2) nonetheless entitles the creditor to seek allowance of an administrative expense claim for a portion of goods delivered to a debtor during the 20 days preceding the filing of the debtor's bankruptcy petition under Section 503(b)(9).

Section 503(b)(9) provides:

- (b) After notice and a hearing, there shall be allowed administrative expense, 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.

11 U.S.C. § 503(b)(9).

By its express terms, Section 503(b)(9) only applies to "goods" (not "services") provided to a debtor within 20 days prior to the commencement of the case. "Goods" is not defined in Section 503(b)(9) and, thus, what is ultimately determined to be "goods" may be subject to litigation. For example: is a part or tooling that has been significantly altered by a creditor a "good" or "service" when it is provided to the debtor? Courts may look to the definition of "goods" contained in Article 9 of the Uniform Commercial Code ("UCC") for purposes of defining what falls within the scope of Section 503(b)(9). COLLIER'S ON BANKRUPTCY ¶ 503.16[1] at 503-79-80 (15th rev. ed.). See also U.C.C. § 9-102(44).⁴ Query, whether the manner in which the invoice refers to what was shipped to the debtor impacts whether the item for which 503(b)(9) treatment is being sought will be accorded that classification? While the writing on the invoice may be a starting point for the analysis and evidence of the parties' intent, nevertheless, it is likely to be subject to rebuttal and contested by other parties-in-interest.

Moreover, Section 503(b)(9) does not specifically provide that the goods shipped by the creditor must remain unpaid to qualify for treatment under Section 503(b)(9); to hold otherwise would create a windfall for the creditor. This Section also does not delineate how the claim is to be calculated. Presumably, the invoice price of the goods (exclusive of interest, freight or other charges) would be the applicable amount in valuing the claim, so long as it represents the price that was ordinarily used between the parties.

4. Section 9-102(44) defines "goods" as:

... all things that are movable when a security interest attaches. The term includes (i) fixtures, (ii) standing timber that is to be cut and removed under a conveyance or contract for sale, (iii) the unborn young of animals, (iv) crops grown, growing, or to be grown, even if the crops are produced on trees, vines, or bushes, and (v) manufactured homes. The term also includes a computer program embedded in goods and any supporting information provided in connection with a transaction relating to the program if (i) the program is associated with the goods in such a manner that it customarily is considered part of the goods, or (ii) by becoming the owner of the goods, a person acquires a right to use the program in connection with the goods. The term does not include a computer program embedded in goods that consists solely of the medium in which the program is embedded. The term also does not include accounts, chattel paper, commercial tort claims, deposit accounts, documents, general intangibles, instruments, investment property, letter-of-credit rights, letters of credit, money, or oil, gas, or other minerals before extraction.

III. HOW AND WHEN DOES ONE ASSERT A 503(b)(9) CLAIM?

Early in bankruptcy cases, the courts establish a bar date for the filing of unsecured claims. These notices, however, typically do not establish bar dates for the filing of administrative claims. Moreover, it is well settled that an administrative claimant, if it feels its claim is going unpaid, must file a motion with the court for allowance and payment of its claim. There is no current Code or Bankruptcy Rule that provides for the assertion of administrative claims through the proof of claim process.

Most debtors are fully aware of their traditional administrative obligations, as those obligations are incurred voluntarily by a debtor post-petition. Section 503(b)(9) claims are different, in that they are a subset of a debtor's pre-petition unsecured debt and must be asserted in order to be elevated to be accorded administrative priority. If a debtor does not know the extent and nature of such claims, it makes it very difficult for a debtor to propose a plan that satisfies the confirmation requirement that administrative claims be paid in full. *See e.g.*, Section 1129(a)(9)(A) of the Code.

To address these concerns, some courts are enacting local rules to create bar dates for the filing of Section 503(b)(9) administrative claims. *See e.g.*, Local Bankruptcy Rule 3002-1, United States Bankruptcy Court for the District of Massachusetts, that requires that creditors asserting administrative expense claims pursuant to Section 503(b)(9) must file them in writing with the Court within 60 days of the first date set for the meeting of creditors pursuant to Section 341, unless the court orders otherwise. If a creditor fails to file such a request within this specified period, the creditor will lose the right to assert administrative expense treatment for such claim. Other courts are establishing bar dates for the submission of administrative expense claims as part of the initial scheduling order in a case. *See In re Ward Prod., LLC*, Case No. 06-50527 (TJT) (Bankr. E.D. Mich. 2006) (in this scheduling order, in addition to setting a bar date, the Court clarified that the filing of a proof of claim, as opposed to a motion, would be sufficient for asserting an administrative claim). Another option is for a debtor to seek to establish a bar date by motion or, alternatively, to provide a bar date and mechanism for asserting such claims as part of a plan. Creditors having such claims must carefully read the notices they receive to ensure that they timely and properly follow the procedures for asserting 503(b)(9) claims. Otherwise they risk losing the right to assert such claims.

IV. CAN A 503(b)(9) CLAIMANT COMPEL IMMEDIATE PAYMENT?

As stated above, generally, an administrative claim is asserted by the filing of a motion seeking allowance, and sometimes immediate payment, of the claim unless the local rules or a scheduling order provide otherwise. While Section 503(b) provides that an administrative creditor may request payment of its claim, it does not provide any specific mechanism regarding when such claim must be paid. Prior to the adoption of Section 503(b)(9), the courts generally held that the timing for payment of an administrative expense claim was left to the sound discretion of the court. *In re Photo Promotion Assocs., Inc.*, 881 F.2d 6, 9 (2d Cir. 1989). However, Section 1129(a)(9)(A) of the Code sets an outside date for payment of administrative expense claims, requiring that they be paid in cash, in an amount equal to the allowed amount of such claim, on the effective date of any plan of reorganization, unless creditors agree to different treatment.

Nevertheless, in some recent cases, 503(b)(9) claimants have filed motions early in the case, and well before any plan has been filed, seeking immediate payment of their claims. *See e.g., In re Bookbinders' Rest., Inc.*, 2006 WL 3858020 (Bankr. E.D. Pa. 2006); *In re Global Homes, Inc.*, 2006 Bankr. LEXIS 3608 (Bankr. D. Del. 2006). In both of these cases, the claimants expressed concern that if they were not paid immediately, in *pari passu* with the other ordinary course post-petition expenses, there might not be sufficient funds at the end of the case to pay them in full. Claimants have also argued that immediate payment is required because: (i) the goods they provided were being used by the debtor and were necessary and essential to the debtor's ability to continue its business operations; (ii) by paying other post-petition trade creditors, the debtor was treating similar claims differently, *i.e.*, an "equal protection" argument; and (iii) the debtor had sufficient cash to pay such claims. Despite these concerns, in each of the recent cases, the courts denied requests for immediate payment of the 503(b)(9) claims because: (i) there was no statutory requirement that compelled immediate payment; and (ii) payment of such claims would interfere with the debtor's cash flow and business operations. In neither of these cases, however, did the Court make a finding of administrative insolvency.

According to Judge Frank in the *Bookbinders' Restaurant* case:

There is nothing in the language of § 503(b)(9) to support Blue Crab's suggestion that it is entitled to immediate payment of its allowed expense in derogation of the accepted principle that the timing of payment of an allowed administrative expense is within the court's discretion. Section 503(b)(9) does nothing more than define

a type of liability, previously treated as a prepetition claim, which is now accorded administrative expense status. The text of § 503(b)(9) neither states nor even implies that allowance of the expense encompasses an unqualified right to immediate payment. Nor does the text of the provision suggest that an administrative expense allowed under § 503(b)(9) is to be treated in a more favorable manner than any other allowed § 503(b) administrative expense.

In re Bookbinders' Rest., Inc., 2006 WL 3858020 at *4. Moreover, the Court indicated that it was not aware of the existence of any legislative history that supported the claimant's argument for immediate payment. *Id.* at *4 n.14. The Court did recognize, however, that "there may be circumstances in which it would be inequitable or inappropriate to permit a debtor to pay certain administrative expenses but not others." *Id.* at *5.

Moreover, while not yet fully articulated in these cases, there seems to be a difference between requiring a debtor to promptly pay for post-petition goods and services it receives post-petition and requiring immediate payment for goods provided pre-petition for which the Code has now created an administrative priority. The Court in the *Bookbinders' Restaurant* case suggests that part of the statutory basis justifying the disparate treatment accorded creditors that supply goods post-petition, versus those entitled to Section 503(b)(9) priority, is Section 363(c)(1). The Court noted that those creditors that are providing goods post-petition are being paid for such goods pursuant to Section 363(c)(1), not Section 503(b)(1), and thus, "the expenses are being paid without the formality of court allowance under § 503(b)." *Id.*

Finally, the Court in *Bookbinders' Restaurant* rejected the notion that 503(b)(9) claimants be paid immediately on the basis of landlords having such a right under Section 365(d)(3). Neither the text of the various statutory provisions nor the legislative history supported immediate payment on this basis. According to the Court: ". . . [H]ad 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 and it has not done so." *Id.* at *6. Moreover, legislative policy associated with the enactment of this provision would not trump the otherwise clear and unambiguous language on the basis of rules of statutory construction.

The Court in *In re Global Home Prods., LLC*, 2006 Bankr. LEXIS 3608 (Bankr. D. Del. 2006) was equally unpersuaded that 503(b)(9) claimants receive immediate payment of their claims. In denying the

requested relief, the Court indicated that the primary factor considered by the Court is an orderly and equal distribution among creditors and preventing a race to the debtor's assets. As such, according to the Court:

Distributions to administrative creditors are generally disallowed prior to confirmation if there is a showing that the bankruptcy estate may not be able to pay all of the administrative expenses in full. Courts will also consider the particular needs of each administrative claimant and the length and expense of the case's administration.

Id. at *11 (citing *In re HQ Global Holdings, Inc.*, 282 B.R. 169 (Bankr. D. Del. 2002) (citations omitted)). Moreover, the Court indicated that absent demonstrating a necessity to pay, as opposed to the ability of the debtor to pay, an administrative claimant is not entitled to the exceptional remedy of immediate payment. *Id.* (citing *In re Cont'l Airlines, Inc.*, 146 B.R. 520, 531 (Bankr. D. Del. 1992), *In re Ionosphere Clubs, Inc.*, 98 B.R., 174, 179 (Bankr. S.D.N.Y. 1989); Alan N. Resnick, *The Future of Chapter 11: A Symposium Cosponsored by the American College of Bankruptcy: The Future of the Doctrine of Necessity and Critical Vendor Payments in Chapter 11 Cases*, 47 B.C.L. Rev. 183, 205 (2005) ("Section 503(b)(9) 'is a rule of priority, rather than payment.' The new section does not specify when payment will be made. 'Arguably, prepetition vendor claims are never payable in the ordinary course of business because of the intervening bankruptcy and the automatic stay, even if afforded administrative expense priority.'")).

Ultimately, in denying immediate payment to the 503(b)(9) claimant, the *Global Home Products* Court relied on the 3-prong test articulated in *In re Garden Ridge Corp.*, 323 B.R. 136, 143 (Bankr. D. Del. 2005), to wit: (i) the prejudice to the debtors; (ii) hardship to the claimant; and (iii) potential detriment to other creditors. In applying each of these factors, Judge Gross denied the relief sought. First, the claimant had not submitted any evidence of hardship other than its self-serving conclusory statements. Moreover, according to the debtors, there was no evidence that failure to pay this claim would put the claimant out of business — thus, in essence, attempting to analogize the 503(b)(9) claimant to a critical vendor. Second, the debtors presented testimony that they would suffer substantial hardship in their reorganization effort if immediate payment was required. In balancing the relative hardships to the parties, the Court had little difficulty in finding that the balance tipped in favor of the debtors. Clearly, the bar for 503(b)(9) claimants establishing a right to immediate payment has been set very high.

While Section 503(b)(9) appears to enhance the position of the creditor that has provided goods to the debtor within the 20 days prior to the commencement of the case, the actual benefit to be derived by the creditor may be illusory, at best. If the creditor is unable to compel immediate payment of its 503(b)(9) claim and the case is subsequently rendered administratively insolvent, it is unlikely that the creditor will receive payment on its claim. Moreover, there is no requirement that the lender fund the payment of such claims. If the administrative claimants are unwilling to accept less than full payment on their claims at confirmation, the debtor will not be able to propose and confirm a plan.

When faced with an administratively insolvent case, 503(b)(9) claimants may have as their only viable option to trigger payment of their administrative claims the filing of a motion to dismiss or convert the case under Section 1112 of the Code. Nevertheless, obtaining dismissal or conversion is not likely to result in payment of such claims *unless* there is some benefit to be achieved by liquidating the case through Chapter 11. If such circumstances exist, then dismissal or conversion may provide 503(b)(9) claimants with the ability to leverage their position to compel payment of their claims in the early stages of the case.

V. IS THE RETURN OF ALL PREFERENTIAL PAYMENTS A PREREQUISITE TO ALLOWANCE AND PAYMENT OF A 503(b)(9) CLAIM?

Questions have been raised whether allowance and payment of an administrative expense claim asserted under Section 503(b)(9) of the Code may be defeated based on the creditor having received and failed to return preferential payments made by a debtor within the 90 days prior to the filing of the petition. Section 502(d) of the Code generally requires the return of all preferential transfers as a prerequisite to claim allowance. It provides:

(d) Notwithstanding subsections (a) and (b) of this section, the court shall disallow any claim of an entity from which property is recoverable under Section 542, 543, 550, or 553 of this title or that is a transferee of a transfer avoidable under Section 522(f), 522(h), 544, 545, 547, 548, 549 or 724(a) of this title, unless such entity or transferee has paid the amount, or turned over any such property, for which such entity, or transferee is liable under Section 522(i), 542, 543, 550 or 553 of this title.

11 U.S.C. § 502(d).

According to Collier's:

Section 502(d) of the Bankruptcy Code requires disallowance of a claim of a transferee of a voidable transfer *in toto* if the transferee has not paid the amount or turned over the property received as required under the sections under which the transferee's liability arises. . . . Once the liability of the transferee has been determined, the claim interposed by the transferee will be disallowed unless such transferee gives effect to the judgment flowing from the exercise of the powers described above.

COLLIER'S ON BANKRUPTCY ¶ 502.05[1] at 502-56 and 502-57 (15th rev. ed.).

Moreover, “[t]he legislative history and policy behind Section 502(d) illustrates that the section is intended to have the coercive effect of ensuring compliance with judicial orders.” *In re Davis*, 889 F.2d 658, 661 (5th Cir. 1989), *cert. denied*, 495 U.S. 933 (1990). Thus, creditors who have received a voidable transfer, irrespective of whether they have filed a proof of claim, will not be able to participate in a distribution from the estate until the improperly transferred property is surrendered to the estate. COLLIER'S ON BANKRUPTCY ¶ 502.05[2] at 502-57.

However, there is a split of authority in the cases over whether an administrative claim (as opposed to an unsecured claim) is subject to Section 502(d). No court, however, has considered the issue to date in the context of a § 503(b)(9) claim. *See In re Triple Star Welding, Inc.*, 324 B.R. 778 (B.A.P. 9th Cir. 2005) (Section 502(d) applies to administrative expense claims); *MicroAge, Inc. v. Viewsonic Corp.* (*In re MicroAge, Inc.*), 291 B.R. 503, 508 (B.A.P. 9th Cir. 2002) (Section 502(d)) may be raised in response to the allowance of an administrative expense claim; the definition of a “claim” in Section 101(5) is broad enough to include administrative expenses and Section 502(d) does not include any language to qualify such definition; policy behind Section 502(d), to encourage transferees to return avoidable transfers to estate, supports result); *In re Georgia Steel, Inc.*, 38 B.R. 829, 839-40 (Bankr. M.D. Ga. 1984) (holding that Section 502(d) applies to prevent payment of any part of administrative expenses due a creditor until preferential property transferred is recovered). *Contra In re Lids Corp.*, 260 B.R. 680, 683 (Bankr. D. Del. 2001) (“administrative expense claims are accorded special treatment under the Bankruptcy Code and thus, are not subject to Section 502(d)”); *Camelot Music, Inc. v. MHW Advertising & Public Relations, Inc.* (*In re CM Holdings, Inc.*), 264 B.R. 141, 158 (Bankr. D. Del. 2000) (because administrative claim did not arise prepetition, it is not a claim under §101(10), and thus, Section 502(d) does not apply).

Moreover, in some cases it has been argued that if a creditor is granted and paid an allowed administrative expense claim, the amount paid should not be able to be used as “new value” in defending a subsequent preference action. To allow otherwise would, in essence, be giving the creditor a windfall. *Contra Boyd v. The Water Doctor (In re Check Reporting Servs.), Inc.*, 140 B.R. 425 (Bankr. W.D. Mich. 1992) (transfer does not have to remain unpaid to qualify for new value).

VI. DOES THE COMMITTEE REPRESENT THE INTERESTS OF 503(b)(9) CLAIMANTS AS PART OF ITS CONSTITUENCY AND FIDUCIARY OBLIGATIONS?

Prior to the enactment of BAPCPA, a committee was generally homogeneous and was comprised only of creditors holding unsecured claims. As such, their goal of maximizing the value of the assets and securing the greatest return for the unsecured creditors as a whole was relatively easy to address and achieve among the members of the committee. However, now with the adoption of Section 503(b)(9), a committee is often comprised of two types of creditors – those solely with unsecured claims and those with both unsecured and Section 503(b)(9) claims. Moreover, often times, the 503(b)(9) claimants constitute a significant majority of the committee. As a result, the goals of the various members are not necessarily consistent and aligned and, have often prompted questions regarding who the committee represents and what responsibilities and actions the committee must take to fulfill and satisfy its fiduciary duties. For example, should a committee actively seek to limit the amount of 503(b)(9) claims, as it would with any type of administrative claim, to maximize the possible return to unsecured creditors? The issue becomes particularly focused when, as often is the case, there are insufficient assets to pay both groups of creditors in full.

Section 1102(b)(1) of the Code directs the U.S. Trustee to appoint a committee of creditors consisting of persons willing to serve, holding the seven largest claims against the debtor, and are representative of the different kinds of claims to be presented. The duties of the committee are set forth in Section 1103 of the Code and include, among other things, consulting with the debtor about the administration of the case, investigating the acts, conduct, assets, liabilities and financial condition of the debtor and its operations, and the desirability of continuing such business and participating in the formulation of a plan. 11 U.S.C. § 1103(c). Overlaying these specific statutory duties is the

general duty of the committee to maximize the value of the assets for the benefit of the unsecured creditors of the estate.

A. To Whom Does a Committee Owe a Fiduciary Duty?

Generally, the case law requires a committee to act in the best interest of its constituency – *i.e.*, the unsecured creditors – and pursue that fiduciary duty. The clearest statement of the rule is:

In general, the purpose of such committees is to represent the interests of unsecured creditors and to strive to maximize the bankruptcy dividend paid to the class of creditors. *See, e.g., In re Haskell-Dawes, Inc.*, 188 B.R. 515, 519 (Bankr. E.D. Pa. 1995).

In re Nationwide Sports Distribs., Inc., 227 B.R. 455, 463 (Bankr. E.D. Pa. 1998).

The duty is to maximize the return to the entire class, not for particular segments of that class. According to the Court in *In re Tucker Freight Lines, Inc.*, 62 B.R. 213, 216 (Bankr. W.D. Mich. 1986):

The Bankruptcy Code contemplates a significant and central role for committees in the scheme of a business reorganization. *In re Penn-Dixie Indus., Inc.*, 9 B.R. 941, 944 (S.D.N.Y. 1981). Official committees appointed under § 1102 are empowered under § 1003(c)(3) to participate in the formulation of a plan, [and] advise those represented by such committee of such committee's determinations as to any plan formulated. . . . While there is "implied in this grant of authority . . . a fiduciary duty" to committee constituents, there is at the same time "an implicit grant of limited immunity."

In re Tucker Freight Lines, Inc., 62 B.R. at 216.

The duty extends to the class as a whole, not to individual members. As the Court indicated:

Counsel for the . . . committee do not represent any individual creditor's interest in [a] case; they were retained to represent the entire . . . class. Therefore, counsel for the creditors' committee do not owe a duty to [one creditor] to maximize its interest at the expense of the remaining creditors in the represented class.

In re Drexel Burnham Lambert Group, Inc., 138 B.R. 717 (Bankr. S.D.N.Y. 1992); *see also, In re Levy*, 54 B.R. 805, 807 (Bankr. S.D.N.Y. 1985).

The principle that a committee owes a duty to all and only all of the general unsecured creditors is implicitly recognized in varying contexts. Thus, a committee member will be removed if his efforts to establish his own individual rights may result in a lesser distribution to the unsecured creditor class as a whole.

Members of the Committee also have another duty – a fiduciary duty to all creditors represented by the committee If [the committee member] is successful in the trust fund litigation it would

have a substantial negative impact on the prospects of a distribution to unsecured creditors in these bankruptcy cases. . . . [Its] aggressive efforts to establish its secured status could seriously undermine the Committee's effort on behalf of the unsecured creditors. . . .

In re Fas Mart Convenience Stores, Inc., 265 B.R. 427, 432 (Bankr. E.D. Va. 2001).

Moreover, the courts assume that the committee's duty is to maximize the recovery for the class as a whole and not to any individual members, or group of members of the class.

In the case of reorganization committees, these fiduciary duties are crucial because of the importance of committees. Reorganization committees are the primary negotiating bodies for the plan of reorganization. They represent those classes of creditors from which they are selected. They also provide supervision of the debtor and execute an oversight function in protecting their constituent's interests. *See* H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 401 (1977), U.S. Code Cong. & Admin. News, p. 5787.

In re Johns-Manville Corp., 26 B.R. 919, 925 (Bankr. S.D.N.Y. 1983).

Based on the foregoing, one can certainly make the argument that a committee's duties extend to its unsecured constituents only. Thus, any support for allowance or payment of higher priority administrative claims would be in direct conflict with the committee's fiduciary duties, even if a subset of its constituents may benefit from such claim allowance and payment. The analysis is similar to a committee's stance on allowance and payment of reclamation claims that would diminish the overall return to unsecured creditors.

B. If Section 503(b)(9) Claimants' Interests are not Represented by the Unsecured Creditors' Committee, Do the Section 503(b)(9) Claimants Have the Right to Form Their Own Committee?

Recognizing that 503(b)(9) claimants are required to generally act individually and not as part of an organized group in seeking allowance and payment of their claims: should 503(b)(9) claimants be entitled to their own committee to pursue payment of their claims on a collective basis? In some instances, 503(b)(9) claimants are attempting to formally organize, requesting the U.S. Trustee to appoint a 503(b)(9) committee. *See, e.g., In re Pine River Plastics, Inc.*, Case No. 07-42010-PJS (Bankr. E.D. Mich. 2007) (503(b)(9) claimants resigned from the Committee and were unsuccessful in their unofficial attempt to cause the U.S. Trustee to appoint a 503(b)(9) committee).

While 503(b)(9) committees are not specifically provided for under the Code, the U.S. Trustee has discretion to appoint such a committee. Section 1102(a)(1) of the Code permits appointment of "such addi-

tional committees of creditors . . . as the United States trustee deems appropriate.” *Id.* Having a formal committee of 503(b)(9) claimants may make it easier to negotiate and resolve the allowance and immediate payment claims of such creditors. On the other hand, authorizing such a committee will increase the administrative fees and costs of a Chapter 11 – a committee formed under the auspices of Section 1102 has the right to hire counsel and other professionals whose fees are paid by the estate. Absent formation of a committee, the costs and expenses for pursuing payment of such claims would fall on each of the individual 503(b)(9) claimants. Resources available to debtors to fund such expenses are scarce at best, in most cases. Moreover, lenders are reluctant or unwilling to carve out additional funds for payment of another layer of professional fees. Furthermore, these claimants are more likely to be able to protect themselves without the necessity of a committee. Thus, it is unlikely that the U.S. Trustee will appoint a committee solely for 503(b)(9) claimants.

C. Does a Committee Violate its Fiduciary Duties by Negotiating for a Carve-Out for Payment of General Unsecured Claims, or Does it Have a Duty to Ensure that the Bankruptcy Code’s “Waterfall Priority Scheme” is Fully Respected?

It is becoming more common for committees to seek to carve-out from the secured creditors’ collateral an assigned dividend for the benefit of unsecured creditors. By utilizing the carve-out mechanism, a committee is necessarily seeking to bypass other higher priority creditor classes who would otherwise take first from a debtor’s assets under the waterfall priority scheme set forth in the Code. Because 503(b)(9) claimants are usually present on a committee in their dual creditor status role, such creditors are privy to discussions by a committee regarding carve-out strategies. Whether such committee members must recuse themselves or be excused from such discussions is certainly not well settled, let alone addressed in the case law.

The 503(b)(9) claimants often suggest that the committee is required to get the best deal that it can for the creditors as a whole. On the other hand, each dollar that goes to pay a 503(b)(9) allowed claim takes funds away from the general unsecured creditor pool. Is the committee required to negotiate a carve-out for the benefit of the estate as a whole (at least inclusive of 503(b)(9) claims), or merely for the payment of unsecured claims? Put another way, is the committee required to ensure that the Chapter 11 process is being used for the purposes consistent with the Code?

First, it would appear that a committee would not be deemed to have violated its fiduciary duties if it adopts a position supportive of the Code's requirements generally. In *In re Cent. Med. Ctr., Inc.*, 122 B.R. 568 (Bankr. E.D. Mo. 1990), the Committee objected to certain provisions of a plan and an opposing party argued that since the objection did not run directly to the benefit of the unsecured creditors, but instead addressed other plan terms that violated the Bankruptcy Code, the Committee should be deemed to have overstepped its bounds and its objection should be ignored. The Court disagreed and permitted the Committee to pursue its objections, stating:

Finally, this Court believes that as part of upholding its fiduciary responsibilities to its constituents, a committee has both a duty and an obligation to raise objections to any provision of a plan it deems violative of Section 1129(a) [of the Code]. For example, an individual class constituent may ratify the economic treatment it receives under a given plan of reorganization. However, the plan may violate one of the subsections of Section 1129(a). This Court believes that in such a case, a committee has a duty to object to the Plan. Thus, for these three reasons this Court concludes that the Committee has standing to raise its objections to Proponents' Plan pursuant to Section 1129(a).

Id. at 571.

Alternatively, at least one court has held that a committee would not be deemed to have violated its fiduciary duties if it negotiates for a carve-out solely for the benefit of the general unsecured creditors. The question of carve outs and "gifting" by a secured creditor was addressed by the Court in *Official Unsecured Creditors' Committee v. Stern (In re SPM Mfg. Corp.)*, 984 F.2d 1305 (1st Cir. 1993). In that case, the Court held generally that an under-secured lender with a conclusively determined and uncontested "perfected, first security interest" in all of a debtor's assets may through a settlement, "share" or "gift" some of those proceeds to junior, general unsecured creditors, even though priority unsecured creditors (i.e. taxing authorities) will go unpaid. In response to the argument by certain priority unsecured creditors that the committee breached its fiduciary duties by carving out a distribution only for the general unsecured creditors, the Court stated:

. . . The Code expressly authorizes a committee to "perform such other services as are in the interest of those represented." 11 U.S.C. § 1103(c)(5). Appellees also concede that the Committee's appointment, pursuant to 11 U.S.C. § 1102(a) charged it only with representation of the general, unsecured creditors (not with representation of the I.R.S. or other priority creditors). Nevertheless, they contend, any agreement negotiated by the Committee should have

been negotiated to benefit the estate as a whole and thus any contractual right to receive payment from Citizens rightfully belongs to them. . . .

We do not accept this contention, as it seems based on the erroneous assumption that the Official Unsecured Creditors' Committee is a fiduciary for the estate as a whole. While a creditors' committee and its members must act in accordance with the provisions of the Bankruptcy Code and with proper regard for the bankruptcy court; the committee is a fiduciary for those whom it represents, not for the debtor or the estate generally. *In re Microboard Processing, Inc.*, 95 B.R. 283, 285 (Bankr. D.Conn. 1989). Thus the committee's fiduciary duty, as such, runs to the parties or class it represents. *Markey v. Orr*, 1990 WL 483808 at *4 (W.D. Mich. 1990). *It is charged with pursuing whatever lawful course best serves the interests of the class of creditors represented. In this case, the Committee reasonably determined that entering into the Agreement with Citizens was in the best interests of the class it represented.*

In re SPM Mfg. Corp., 984 F.2d at 1316 (emphasis added). *See also In re World Health Alternatives, Inc.*, 344 B.R. 291 (Bankr. D.Del. 2006) (court approved settlement of committee's objections to sale and financing motions that provided, among other things, for a carve-out of the lender's collateral to the unsecured creditors under which priority unsecured creditors would not be paid as not violating the absolute priority rule; because the proposed settlement was being made outside the context of a plan, the absolute priority rule was not applicable); *contra*, *Motorola, Inc. v. Official Committee of Unsecured Creditors, et. al (In re Armstrong World Indus., Inc.)*, 432 F.3d 507 (3rd Cir. 2005) (court refused to confirm a plan that provided for issuance and distribution of warrants to equity over the objection of the unsecured creditors where the plan provided that the subject warrants would be transferred by class 7 creditors to equity if class 6 creditors objected to the plan as violating the absolute priority rule because equity would be receiving or retaining property when all senior classes were not being paid in full under the plan); *In re Iridium, Operating L.L.C.*, 478 F.3d 452 (2d Cir. 2007) (court refused to approve settlement whereby secured creditor proposed to "gift" proceeds of its claim to unsecured creditors because it violated the absolute priority rule that requires administrative and priority creditors to be paid in full before unsecured creditors are paid on their claims and suggested that (i) the committee owes a duty to all the creditors of the estate, and (ii) the absolute priority rule and its application needs to be considered even in the context of a Rule 9019 settlement being proffered outside confirmation of a plan).

The *SPM* decision, while known for its groundbreaking approval of “gifting” by secured creditors to lower class creditors, is equally groundbreaking in its approval of a committee’s actions which were expressly detrimental to an assumed subset of its constituency, priority unsecured creditors, in favor of another subset of its constituency, general unsecured creditors. While the *SPM* decision appears to be one of the few decisions, to date, to ratify this departure from a general fiduciary duty concept, the holding in *SPM* seems equally applicable to a committee’s efforts to extract a benefit for general unsecured creditors to the detriment of 503(b)(9) claimants. Whether that analogy will hold true in other courts has yet to be seen.

VII. CONCLUSION

It is unlikely that Congress envisioned that all of these ancillary issues would arise from the creation of a new administrative class of creditors. Unfortunately, because BAPCPA is relatively new, there is little case law to provide guidance on how to deal with these issues. Hopefully, over time, as more of these issues reach the courts, creditors will be provided with more guidance and better benchmarks for addressing and dealing with the 503(b)(9) claimants – the new constituent, a/k/a the “500 Pound Gorilla,” at the table.