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Date of Physical Delivery Under the UCC Determines Priority

Vendors who sell goods to a debtor pre-petition typically hold pre-petition unsecured claims unless they qualify for administrative-expense status under § 503(b)(9) of the Bankruptcy Code, because the goods were delivered to the debtor in the 20 days preceding bankruptcy. Likewise, vendors who sell goods to a debtor after the bankruptcy has been filed would have those claims treated as administratives under § 503(b)(1)(A).

However, for international sellers, this analysis is not so simple. With shipment times up to 30 days or longer, these sellers could gain or lose administrative priority depending on whether the goods are treated as delivered when placed aboard a common carrier or when physically received by the debtor. After providing some basic background on methods of shipment, this article discusses two fairly recent cases analyzing issues unique to international sellers.



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Methods of Shipment

Under the Uniform Commercial Code (UCC), there are three main types of shipments. *Free on board* (FOB), followed by the place of *shipment*, requires the seller to place the goods on a common carrier (typically a plane or boat) and bear the expense and risk of putting them into possession of the carrier.²

Conversely, when the term “FOB” is followed by the place of destination, the seller must place the goods on a common carrier, again at its own expense, and risk the transport of the goods to that place and tender delivery at the agreed *destination*.³ In that scenario, the risk of loss is not transferred to the buyer until the buyer receives the goods. Thus, if the goods are damaged in transit, the seller will be responsible for providing the buyer with replacement goods. Finally, goods shipped *free alongside* (FAS), followed by a named port, require the seller to, at its own expense and risk, transport the goods to the common carrier at the named port.

Bankruptcy Priorities

When a chapter 11 case is filed, creditors file proofs of claim for amounts that they are owed

by the debtor. Following a claims-reconciliation process, the debtors (or agents of the debtors) will pay creditors in the order of priority. General unsecured claimants are last in priority (among creditors) and often receive only small percentage recoveries, sometimes as little as 1 or 2 percent of their allowed claim, or sometimes receive no recovery at all. Administrative claimants, on the other hand, are considered the highest priority and are in the front of the line (excluding secured creditors), getting paid first in time and often in full.

Typically, in a chapter 11 case, pre-petition sellers of goods are treated as general unsecured creditors. Section 503(b)(9)⁴ provides sellers with administrative priority status if (1) the vendor sold goods to the debtor; (2) the goods were received by the debtor within 20 days before its bankruptcy filing; and (3) the goods were sold in the ordinary course of business. Sellers of goods may also have administrative-expense priority for goods delivered to the debtor after the filing of the bankruptcy under § 503(b)(1)(A).⁵

Because international shipments can take 30 days or longer to deliver, international sellers have a greater risk of an intervening buyer bankruptcy than other sellers. As set forth in a couple of recent cases, whether these sellers have general unsecured claims or administrative claims turns on the date that the debtor takes physical possession of the goods.

What Happens to Goods Shipped More than 20 Days Before the Bankruptcy that Arrive Within the 20-Day Period?

In 2017, the Third Circuit heard a case related to § 503(b)(9) administrative priority and interpreted the meaning of “received.”⁶ In *In re World Imports*, sellers from China sold goods, in the ordinary course of business, to the debtor before the bankruptcy petition was filed. On May 26, 2013, the seller

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² U.C.C. § 2-319(1)(a).

³ U.C.C. § 2-319(1)(b).

⁴ Section 503(b)(9) provides that “[a]fter notice and a hearing, there shall be allowed administrative expenses, other than claims allowed under § 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.”

⁵ 11 U.S.C. § 503(b)(1)(A) provides that “after notice and a hearing, there shall be allowed administrative expenses, other than claims allowed under § 502(f) of this title, including ... (1)(A) the actual, necessary costs and expenses of preserving the estate.”

⁶ *In re World Imports*, 862 F.3d 338 (3d Cir. 2017).

shipped the goods to the debtor via common carrier FOB at the port of origin (the place of shipment), with the debtor obtaining physical possession of the goods on June 21, 2013.⁷ On July 3, 2013, the debtor filed for bankruptcy.⁸ The seller timely filed for an administrative expense under § 503(b)(9).

As previously described, under the UCC, when the seller shipped the goods via common carrier — FOB followed by the place of shipment — the risk of loss passed from the seller to the debtor. The debtor objected to the administrative claim on the grounds that the goods were “constructively” received by the debtor when the seller put the goods onto a common carrier and the risk of loss had passed from the seller to the debtor, which occurred on May 26, 2013.⁹ Under this argument, the debtor would have “received” the goods outside of the 20-day window, thus the claim would only be entitled to treatment as a general unsecured claim.

On the other hand, the sellers argued that the relevant date for determining when the goods were “received” was when the debtor took *physical* possession of the goods, which occurred on June 21, 2013.¹⁰ Under this argument, the debtor “received” the goods within the 20-day administrative-priority window offered by § 503(b)(9), and the seller would receive priority treatment as an administrative expense holder.

The Third Circuit began with the text and context of § 503(b)(9) and noted that the Bankruptcy Code does not define the word “received.”¹¹ Absent an express statutory definition, courts normally use the phrase “ordinary or natural meaning.”¹² The Third Circuit looked to multiple dictionaries and found that although not identical, all definitions of “received” include the requirement of physical possession.¹³

In addition, the Third Circuit looked to UCC § 2-103(c),¹⁴ which defines “receipt” of goods as “taking physical possession of them.”¹⁵ Therefore, the Third Circuit inferred that when Congress drafted § 503(b)(9), it meant to adopt this well-known meaning of the term “receipt.”¹⁶ Under the UCC, “receipt” of goods also does not occur until the seller is no longer able to stop the delivery, which is when the buyer has physical possession of the goods regardless of the date of the risk of transfer. The Third Circuit also noted that although it is true that a buyer is deemed to have received goods when an agent of the buyer takes physical possession of them, a common carrier is not an agent of the debtor, and constructive receipt does not include FOB delivery to a common carrier.¹⁷

The Third Circuit continued its analysis by looking at other Bankruptcy Code provisions, and determined that §§ 546(c) and 503(b)(9) were the only two sections under the heading “Reclamation” in § 1227 of the Bankruptcy

Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA).¹⁸ That section amended § 546(c) to clarify the conditions placed on trustees and sellers that sought to reclaim goods sold to a debtor, and it created § 503(b)(9) to add an administrative expense as an exemption from § 546(c)’s reclamation conditions. The Third Circuit found that “it is a fundamental canon of statutory construction that the words of a statute must be read in their context and with a view to their place in the overall statutory scheme.”¹⁹ Given the interrelationship between the two provisions,²⁰ and a previous holding from the Third Circuit that Congress meant for terms used in § 546(c) to bear the definition used in the UCC at the time of BAPCPA’s enactment,²¹ the Third Circuit held that the UCC definitions must also apply to § 503(b)(9).²²

The Third Circuit held that the mere fact that the risk of loss had passed from the sellers to the debtor more than 20 days before the debtor filed for bankruptcy, when goods that the debtor purchased pre-petition were delivered FOB to a common carrier, did not alter the fact that the debtor received the goods within 20 days of the petition date. Accordingly, the seller satisfied the requirements for a priority claim under § 503(b)(9).

What About Goods Shipped Pre-Petition, but Received Post-Petition?

In a relatively recent decision from the U.S. Bankruptcy Court for the District of Delaware, Hon. **Mary F. Walrath** addressed a related issue involving an administrative expense where goods were sold by sellers from India to the debtors pre-petition, placed on a common carrier pre-petition, but arrived after the debtors had already filed for bankruptcy.²³ In *Bluestem Brands*, the seller filed a proof of claim alleging a § 503(b)(9) administrative expense.²⁴ The plan administrator objected to the seller’s administrative expense because it was not delivered within the 20-day window pre-petition and was therefore ineligible for the administrative priority pathway offered by § 503(b)(9).²⁵ The seller filed a response, and after Judge Walrath heard oral argument, the seller filed a letter to Judge Walrath addressing new authority, including a § 503(b)(1)(A) administrative expense.²⁶

The debtors argued that to have a § 503(b)(1)(A) administrative expense, there must be a post-petition transaction between the claimant and the estate, and those expenses must have yielded a benefit to the estate.²⁷ The plan administrator, on behalf of the debtors, argued that the sellers could not have a § 503(b)(1)(A) administrative expense because there was no post-petition transaction.²⁸ The

7 *Id.* at 340.

8 *Id.* at 340-41.

9 *Id.* at 340.

10 *Id.*

11 *Id.* at 341.

12 *Id.* at 338 (citing *Smith v. United States*, 508 U.S. 223, 228 (1993)).

13 *Id.* at 342.

14 The UCC does not define the word “received,” but does define the term “receipt.”

15 Official Comment No. 2 to U.C.C. § 2-103 provides that “‘receipt’ must be distinguished from delivery particularly in regard to the problems arising out of shipment of goods, whether or not the contract calls for making delivery by way of documents of title, since the seller may frequently fulfill his obligations to deliver even though the buyer may never ‘receive’ the goods.”

16 *In re World Imports*, 862 F.3d, at 342.

17 *Id.* at 344.

18 *Id.* at 343-44.

19 *Id.* at 343 (quoting *FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120 (2000)).

20 11 U.S.C. § 546(c)(2) provides that “[i]f a seller of goods fails to provide notice ... the seller still may assert the rights contained in section 503(b)(9).”

21 See *In re Marin Motor Oil*, 740 F.2d 220, 224-25 (3d Cir. 1984) (holding that term “receipt” used in § 546(c) has the same meaning as UCC’s definition, which is “taking physical possession”).

22 *Id.* at 343-44.

23 See *In re Bluestem Brands Inc.*, No. 20-10566 (MFW), 2021 WL 3174911 (Bankr. D. Del. July 27, 2021).

24 *Id.* at *1.

25 *Id.*

26 *Id.*

27 *Id.* at 4 (citing *In re Energy Future Holdings Corp.*, 990 F.3d 728, 741-42 (3d Cir. 2021)).

28 *Id.* at 4.

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plan administrator pointed to the UCC, noting that the risk of loss had been transferred to the debtor when the goods were placed on the common carrier.²⁹ The sellers, on the other hand, argued that the transaction ended post-petition because the debtors did not receive the goods until post-petition — citing the UCC’s definition of “receipt” — and that the seller retains the right to stop delivery under UCC § 2-705 until the goods are physically received by the debtor.³⁰

Judge Walrath noted that the language of § 503(b)(1)(A) provides for an administrative expense for “the actual, necessary costs and expenses of preserving the estate ... *after the commencement of the case*.”³¹ Therefore, the correct standard in determining whether a claim is entitled to administrative status under this section is whether the seller provided a benefit to the estate post-petition, and there is no requirement that there be a post-petition contract.³²

Judge Walrath surmised that there was no valid reason for a difference of treatment between goods arriving to the debtors 20 days prior to the bankruptcy filing date that

receive the special administrative status (§ 503(b)(9)) and goods delivered after the petition date.³³ No one disputed that the seller’s goods were physically received by the debtors after the commencement of the bankruptcy case. The goods were beneficial and necessary to preserving the estate because the debtors resold the goods and used the proceeds of the sale.³⁴ Therefore, the seller satisfied the test of § 503(b)(1)(A) and was entitled to an administrative claim for the goods physically received by the debtors post-petition.

Conclusion

Although international shipments can create unique scenarios when analyzing administrative-claim priority in bankruptcy, recent opinions from within the Third Circuit have reiterated that the date of physical delivery of such goods will be determined under the UCC. By applying the UCC definition of “receipt,” these courts have ensured the uniform treatment of these claims in bankruptcy, regardless of when they were shipped. **abi**

²⁹ *Id.* at 5.

³⁰ *Id.*

³¹ *Id.* (quoting 11 U.S.C. § 503(b)(1)(A)) (emphasis added).

³² *Id.* at 5.

³³ *Id.* at 6.

³⁴ *Id.*

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