

## **‘Would You Like Fries With That?’**

### ***Goods vs Services Under § 503(b)(9) of the Bankruptcy Code***

**By Steve Krause and Irina Boulyjenkova**

In 2005, § 503(b)(9) was added to the Bankruptcy Code to provide an administrative priority claim for the “value of any goods received by the debtor within 20 days before the date of commencement of a case ... in which the goods have been sold to the debtor in the ordinary course of such debtor’s business.” Recent court decisions addressing the classification of “goods” versus “services” have shed some light on the proper definition of “goods” in the context of whether a particular claim is for “goods” under § 503(b)(9). However, these decisions have left open some key questions. For instance, while court decisions have considered whether certain types of claims constitute “goods,” many fact patterns remain to be addressed. Further, courts disagree on whether mixed contracts for goods and services should be bifurcated into “goods” and “services,” or whether the entire contract should be treated as a contract for goods or for services. Finally, there is a lack of clarity on whether a single “federal” definition of “goods” should be used, or whether courts will look to applicable state law for this definition.

#### **RELEVANCE OF THE DEFINITION OF ‘GOODS’**

Because § 503(b)(9) refers specifically to “goods,” courts have consistently held that claims for administrative expenses under § 503(b)(9) can only be for goods sold rather than services provided. Thus, courts have been called on to distinguish “goods” from “services” and, unfortunately, the distinction is not always clear. The term “goods” is not defined in the Bankruptcy Code, *see* 4 COLLIER ON BANKRUPTCY, p. 503.16[1] (Alan N. Resnick & Henry J. Sommer eds, 16th ed.). However, the definition of “goods” used in the Uniform Commercial Code (“UCC”) has been adopted by most courts that have considered § 503(b)(9).

#### **WHAT CONSTITUTES ‘GOODS’**

Most recent courts that have considered what constitutes “goods” have done so in the context of utilities claims, and the results have been mixed. Some courts have found that utility claims give rise to administrative priority claims under § 503(b)(9). For example, one court found that a provider of natural gas was entitled to an administrative priority claim. *In re Plastech Engineered Products*, 397 B.R. 828 (Bankr. E.D. Mich. 2008). Another court found that natural gas providers were entitled to administrative priority claims for the value of gas delivered to the debtor, but not for the debtor’s use of the utilities’ infrastructure. *In re Pilgrim’s Pride Corp.*, 421 B.R. 231 (Bankr. N.D. Tex. 2009). The *Pilgrim’s Pride* court also held that a water supplier’s claim was limited to the value of water supplied. Similarly, another court recently agreed that the sale of electricity gave rise to a § 503(b)(9) claim. *In re Erving Indus., Inc.*, No. 09-30623, 2010 Bankr. LEXIS 1069 (Bankr. W.D. Mass. Apr. 7, 2010).

However, courts have not accorded administrative priority status to all utility claims. Unlike its approach to the claims of gas and water providers, the *Pilgrim’s Pride* court held that sewage and garbage removal were services in the context of § 503(b)(9). The court also held that the delivery of electricity was a service. The court explained that there are “many things that are distributed commercially for use or consumption that would not qualify as ‘goods’ under the UCC.” *Pilgrim’s Pride*, 421 B.R. at 239. As an example, the court noted that a television show, although intellectual property, would not fall within the meaning of “goods” under the UCC.

This reasoning is consistent with a Mississippi Bankruptcy Court holding that advertising purchased under a contract does not constitute “goods” under the UCC. *In re Deer*, No. 06-02460, 2007 Bankr. LEXIS 4676 (Bankr. S.D. Miss. June 14, 2007).

The *Plastech* court also considered several other claims seeking priority under § 503(b)(9), including those of a vendor engaged in snow removal. Relying on invoices that separated charges for snow removal and for application of de-icing materials, the court held that de-icer was within the definition of “goods” and only that portion of the vendor’s claim should be entitled to administrative priority status. Another vendor made electric motors for Plastech, in the process obtaining “such parts as were necessary to make these motors work.” 397 B.R. at 834. The vendor’s bill was broken out into “labor” and “materials.” The court held that parts and materials were “goods” within the UCC definition, but the “labor” portion of the claim was not.

Other types of claims include one for steel processing, which was found to be a service, *In re Modern Metal Products Co.*, No. 08-73908, 2009 Bankr. LEXIS 2881 (Bankr. N.D. Ill. Sept. 16, 2009), and one for a trucking company’s freight services, which was also found to constitute a service. *Pilgrim’s Pride*, 421 B.R. at 237-8.

Notably, courts have generally rejected arguments that the term “goods” as used in § 503(b)(9) should be limited to “goods” that would otherwise be subject to reclamation under § 546(c) but for the creditor’s inability to meet the § 546(c) noticing standards. Consequently, courts generally agree that there is no requirement that goods be reclaimable in order to qualify for administrative priority treatment under § 503(b)(9).

Courts have emphasized that it is “goods sold,” and not merely goods shipped or received, that entitle a claimant to administrative priority under § 503(b)(9). In a case in which a vendor asserted a claim for sorting and repackaging garments that the debtor bought from another vendor, the court emphasized that “section 503(b)(9) does not provide for the allowance of an administrative claim for goods shipped,” but rather for “goods sold.” *In re Goody’s Family Clothing, Inc.*, 401 B.R. 131, 136 (Bankr. D. Del. 2009). The court in *Modern Metal* reached a similar result.

#### **BIFURCATING BETWEEN GOODS AND SERVICES**

For a claim that includes the provision of both goods and services, complications arise in determining whether only a portion of the claim or the entire claim should be entitled to administrative priority. The answer may mean the difference between payment in full and cents on the dollar for a vendor’s entire claim.

Where a transaction involves a mixture of goods and services, some courts apply the “predominant purpose” test. *See, e.g., In re Circuit City Stores, Inc.*, 416 B.R. 531 (Bankr. E.D. Va. 2009). If a contract is for a mixture of goods and services and the predominant purpose is found to be the delivery of goods, then the entire claim may be allowed under § 503(b)(9). If the predominant purpose is found to be the delivery of services, the claim would be treated as a general unsecured claim.

However, some courts have refused to apply the predominant purpose test to determine how to treat a § 503(b)(9) claim based on a mix of goods and services. For instance, the *Plastech* court held that the only relevant determination under § 503(b)(9) was the value of the goods that were sold, irrespective of whether the contract also involved the delivery of services. The *Plastech* court noted that the predominant purpose test was developed “for various non-bankruptcy purposes,” including for tax law and products liability law, and called it an “all or nothing approach” that leads to a “winner take all” situation. 397 B.R. at 834, 836. The court emphasized that “there [was] nothing in section 503(b)(9) that require[d] the approach for the purposes of that section of the Bankruptcy Code.” *Id.* at 837. While it might be true that the adoption of this test would reduce or eliminate evidentiary hearings, the *Plastech* court reasoned that such efficiency considerations should not trump

the plain language of the statute which, in that court's view, required a valuation of the goods provided and provision of an administrative priority claim for that amount. Citing to *Plastech*, the court in *Erving* agreed with the courts that rejected the application of the predominant purpose test to the § 503(b)(9) claims. 2010 Bankr. LEXIS 1069, at \*50.

### **UCC: MODEL VS STATE**

While courts seem to agree on using the UCC definition of “goods” under § 503(b)(9), there is disagreement as to which version of the UCC should be used. The proper definition could be the one found in the version of the UCC adopted by the state with the most significant relationship to a claim or, in light of the argument that the definition of “goods” used in the federal Bankruptcy Code should remain consistent from state to state, it could be the Model UCC definition. Whether courts decide to look to the Model UCC, use state law to interpret provisions of the Model UCC, or refer to the UCC of the state with the most significant relationship to a claim will determine if the definition of “goods” will be uniform across jurisdictions, thereby allowing parties to look to decisions of bankruptcy courts across the country to determine whether a particular type of claim constitutes a claim for “goods.”

Some courts have chosen to look to the Model UCC when applying the definition of “goods” in the context of § 503(b)(9). For instance, the court in *Pilgrim's Pride* rejected the arguments of various § 503(b)(9) claimants that it must look to the definition of “goods” found within a state-specific version of the UCC and instead relied on the version in the Model UCC. The court explained that “[f]ederal law governs the interpretation of federal statutes” and a court must take into account the need for uniform interpretation of the Bankruptcy Code. 421 B.R. at 236. The court noted that “[s]ection 503(b)(9) is not like those provisions of the Code ... that specifically reference state law,” and that variations among laws of different states should not result in different meanings of “goods” from state to state. *Id.* at 236, n.5. The *Pilgrim's Pride* court further added that applying “differing state laws to determine entitlement to priority treatment under § 503(b)(9) would run contrary to the constitutional mandate for uniformity.” *Id.* at 236. The Delaware bankruptcy court has held similarly, explaining that “[i]nterpretation of the Bankruptcy Code is a federal matter, and not controlled by state law.” *Goody's*, 401 B.R. at 134. The court in *Erving* also stated that “federal bankruptcy courts should be reluctant” to give variances in local enactments of the UCC or the variances in interpretation by the courts of various states effect under federal law and that the definition of goods is a “matter of federal, and not state, interpretation.” 2010 Bankr. LEXIS 1069, at \*28.

Not all courts are slavish followers of the Model UCC. For instance, although the bankruptcy court in Circuit City looked to the Model UCC for its definition of “goods,” it indicated that it would “look to state law generally for any well known meaning of the term in constructing this definition” and borrow from state law to create an applicable “federal common law rule.” 416 B.R. at 535. This approach diverges from the approach of the *Pilgrim's Pride* court that simply looked to the Model UCC for the definition of “goods” without taking into account state law. For its part, the court in *Plastech* looked to the Michigan version of the UCC (the Michigan Commercial Code) for its definition of “goods.”

### **CONCLUSION**

Five years have passed since § 503(b)(9) was added to the Bankruptcy Code, creating a new category of administrative priority claims and a new set of rules for determining whether claims are entitled to receive that priority. In this time, courts have gone a long way in defining the parameters of the section's coverage and applying the legal framework to facts for how to distinguish between goods and services and how to treat mixed

goods and services transactions. Courts have provided useful guidance to parties trying to determine whether a claim is entitled to administrative priority status, particularly in the context of utilities claims. Despite the helpful guidance to date, questions remain. Court decisions on this topic have not yet addressed many types of claims common in bankruptcy. Moreover, while some courts have applied the “predominant purpose” test, others have bifurcated claims into goods and services, thus granting administrative priority treatment for at least a certain portion of the claim. Additionally, there is no general consensus whether courts should use a single, uniform definition of “goods” or whether courts should look to state law for guidance in interpreting the term. Future court decisions may provide additional guidance on these open issues.

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