2017 BURR Alert

Shipped Goods Deemed "Received" Upon Physical Possession for Allowed Claims for Administrative Expenses in Bankruptcy

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Signed, sealed, delivered, but am I yours? Apparently not, according to the United States Court of Appeals for the Third Circuit, at least in the context of allowed administrative expense claims under Section 503(b)(9) of the Bankruptcy Code.[1] The Third Circuit recently considered and ruled in a case as to when goods are deemed "received" for the purposes of determining whether a creditor may recover the value of the goods as an allowed administrative expense claim under the Bankruptcy Code. By the Court's own admission, this decision "has important ramifications for a creditor that sells goods to a debtor soon before the debtor files a Chapter 11 bankruptcy petition."[2]

What were the circumstances underlying this case?

Two Chinese companies, Haining Wansheng Sofa Company and Fujian Zhangzhou Foreign Trade Company, sold furniture and other similar items to the debtor, World Imports, in the ordinary course of business for the parties.[3] Both companies shipped the goods via common carrier "free on board," which means that the risk of loss of the goods or damage to the goods transferred from the companies to World Imports once they were delivered to the common carrier.[4] In both circumstances, the goods were delivered to the carrier more than 20 days before World Imports filed a Chapter 11 petition, but World Imports did not take physical possession of the goods until fewer than 20 days before filing its petition.[5]

After the petition was filed, the companies filed motions with the bankruptcy court seeking allowance and payment of claims as administrative expenses based on the value of the shipped goods under Section 503(b)(9) of the Bankruptcy Code.[6] Section 503(b)(9) allows a creditor to recover, as an administrative expense given "the highest priority," the value of goods sold in the ordinary course of business and received by a debtor within 20 days before the bankruptcy filing.[7] The companies argued that the goods were received at the time World Imports took physical possession of them.[8] Nevertheless, both the Bankruptcy Court and the District Court in this case agreed with World

[1] 11 U.S.C. § 503(b)(9).
[2] *In re World Imports, Ltd.*, No. 16-1357, 2017 WL 2925429, at *1 (3d Cir. July 10, 2017).
[3] *Id.*
[4] *Id.*
[5] *Id.*
[6] *Id.*
[7] *Id.*; 11 U.S.C. § 503(b)(9).
[8] *World Imports, 2017 WL 2925429 at *1.*

Imports, that the goods at issue were "constructively received" when shipped from China, which occurred more than 20 days before the bankruptcy filing, and denied the companies' motions.[9]

The key issue raised on appeal for the Third Circuit is when the goods were deemed "received" by World Imports for the purposes of determining when the 20-day period is deemed to begin for administrative expense claims under Section 503(b)(9).[10]

What did the Court decide?

The Third Circuit ultimately sided with the companies' position on appeal, and held that the goods were received when World Imports took physical possession of them, which occurred within 20 days of their bankruptcy filing.

The Court found that legal and English dictionaries, and the Uniform Commercial Code, as applied to goods, all pointed towards defining "receive" in this case to mean "take physical possession."[11] The Third Circuit had also ruled in a much earlier decision[12] that the word "receive" meant "taking physical possession" in the context of Section 546(c), a related provision of the Bankruptcy Code that allows a shipper to *reclaim* goods sold to a debtor within 45 days of the debtor's receipt of the goods.[13] Section 503(b)(9), the pertinent statute in this case, was enacted in part as an *exemption* from the conditions for reclaiming goods from a debtor as set forth in Section 546(c).[14]

The Court also clarified the distinction between *free-on-board delivery* and *receipt* in this context. Under free-on-board delivery, the risk of loss or damage passes from the seller to the buyer, but goods are in possession of the common carrier and the seller can still stop physical delivery.[15] When the goods are received by the buyer, the buyer assumes title in the goods and the seller is no longer able to stop delivery.[16] After physical receipt by the buyer and the buyer's bankruptcy filing, the seller's remedies are seeking reclamation of the goods from the buyer or recovery of their value as an administrative expense within the requisite time frame.[17]

What are the implications for shippers and sellers?

The key takeaway for sellers and suppliers from this case is the importance of keeping a detailed record of (1) the date goods are shipped, (2) the nature of their shipping agreement, particularly

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[9] *Id.*
[10] *Id.* at *2.
[11] *Id.*
[12] *In re Marin Motor Oil*, 740 F.2d 220, 224-25 (3d Cir. 1984).
[13] 11 U.S.C. § 546(c); *World Imports*, 2017 WL 2925429 at *3.
[14] *World Imports*, 2017 WL 2925429 at *3.
[15] *Id.* at *4.
[16] *Id.* at *5.
[17] *Id.* at *4.

whether they are delivered "free on board," and (3) the date goods are physically received by the buyer.[18]

Regardless of when they were sold or delivered, goods that are physically received by the buyer within 20 days of the buyer filing for bankruptcy relief will likely be protected and given priority as allowed claims for administrative expenses. On the other hand, goods that were physically received more than 20 days before a buyer's bankruptcy filing will not be allowed as an administrative expense, and the seller should then determine if the 45-day window for reclaiming goods is still an available option.

Keeping a thorough record of these dates could be particularly beneficial for intercontinental sellers and suppliers, where there may be a longer period of time between delivery to a common carrier and receipt by a buyer. In any case, good record-keeping of the shipping dates, the nature of the delivery agreements, and the dates a buyer receives goods can help sellers and suppliers determine their options should a buyer file a bankruptcy petition before the seller or supplier has been paid for goods shipped and received.

To discuss this further, please contact:

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[18] While not the subject of this article, keeping a record of these dates would be equally important should the seller decide to seek reclamation of the goods themselves under Section 546(c) rather than recovering the value as an administrative expense under Section 503(b)(9).