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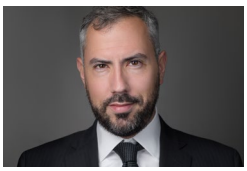
UNSECURED TRADE CREDITORS' RIGHTS JOURNAL

A Bi-Annual Report on the Legal Developments Affecting Unsecured Trade Creditors in Bankruptcy



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Creditor Not Listed on Creditor Matrix May File A Late Proof of Claim

In re Vanderpol, 606 B.R. 425 (Bankr. D. Colo. 2019)

The debtor, Jonathan A. Vanderpool, filed for bankruptcy under Chapter 13 on January 7, 2019. The debtor timely filed his schedules and creditor matrix as required by Fed. R. Bankr. P. 1007(a)(1). However, the debtor inadvertently omitted American Express National Bank ("American Express") from both. American Express learned of the debtor's bankruptcy one month after the claims bar date expired. American Express filed a motion to file a late proof of claim. The Chapter 13 trustee opposed the motion arguing that none of the limited circumstances under which a court may exercise its discretion to allow a late-filed claim under Bankruptcy Rule 3002(c) existed.

The trustee argued that the plain language of Bankruptcy Rule 3002(c)(6)(A) permitted an extension of the bar date only if the court found that "the notice was insufficient under the circumstances to give the creditor a reasonable time to file a proof of claim because the debtor failed to timely file the list of creditors' names and addresses required by Rule 1007(a)." The trustee pointed out that the plain language of the rule did not permit a late claim if the list of creditors was timely filed but the affected creditor was omitted. American Express argued that due process requires that a creditor receive proper notice of the bar date and the burden of establishing that a creditor received appropriate notice rests with the debtor.

The court sided with American Express. The court reasoned that if the only time a creditor is allowed to file a late claim is when the debtor failed to file the full creditor matrix, as implied by Rule 1007, there would be a conflict between the bankruptcy code and the bankruptcy rules. Under 11 U.S.C. § 521(i)(2), if the debtor fails to file the creditor matrix or other necessary schedules and statements "within 45 days after the date of the filing of the petition, the case shall be automatically dismissed effective on the 46th day the date of the filing of the petition." Under Fed. R. Bankr. P. 3002(c), however, the deadline for filing of a proof of claim in chapter 7, 12, or 13 case is seventy days after the filing of a voluntary petition. Thus, the Court concluded that Bankruptcy Rule 3002(c)(6)(A) must be referring to the allowance of a late filed claim even where the debtor timely filed its creditor matrix under rule 1007, otherwise Rule 3002(c)(6)(A) would be moot as the case would have already been automatically dismissed.

COMMENTARY

The Vanderpol decision underscores that the omission of a creditor from the creditor matrix, even inadvertently, may give rise to the allowance of late-filed claims. Debtors should be careful to provide proper notice to all creditors because the failure to do so may give rise to complications later on in the proceeding.

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Bankruptcy Court Defers to Debtors' Business Judgement To Pay Critical Vendors

In re Windstream Holdings Inc.,
614 B.R. 441 (S.D.N.Y. 2020)

Windstream Holdings, Inc. ("Windstream"), a broadband service provider, filed for bankruptcy under Chapter 11 of the bankruptcy Code on February 25, 2019. Immediately after filing the bankruptcy petition, the debtor filed a critical vendor motion ("Critical Vendor Motion") seeking to pay certain critical vendors up to $2 million. The Critical Vendor Motion did not identify any vendors that might potentially qualify as critical vendors. GLM DFW, Inc. ("GLM"), an unsecured creditor, objected to the motion on the following bases: (1) the court cannot delegate its judicial function to Windstream to determine who is a critical vendor; (2) Windstream should not be allowed to keep the list of critical vendors confidential as it does not qualify as "trade secret or confidential research, development, or commercial information" under 11 U.S.C. § 107, and (3) Windstream failed to apply the correct legal standard, namely, that the vendor in question would cease doing business with the debtor and that the debtor could not find a viable replacement. The bankruptcy court ruled in favor of Windstream and GLM appealed.

The District Court for the Southern District of New York affirmed the Bankruptcy Court. First, the court pointed out that bankruptcy courts routinely rely on debtors' representations and business judgment in allowing critical vendor payments. The court also noted that the bankruptcy court's supervision of each individual critical vendor designation is impractical and unnecessary given the oversight of the U.S. Trustee and the creditors' committee. Second, the court noted that Section 107 provides that "a paper filed in a case under this title and the docket of a bankruptcy court are public records." Since Windstream never filed the list of critical vendors, Section 107 did not apply. Moreover, the court pointed out that even if Windstream was required to file the list of critical vendors, the redaction of the names of critical vendors would have been a proper application of the "commercial information" exception of Section 107 of the Bankruptcy Code. Finally, the court noted that a bankruptcy court may authorize payment of prepetition claims postpetition pursuant to 11 U.S.C. § 363(b) and 105(a) and that the "doctrine of necessity" does not require a critical vendor's formal refusal to provide services prior to payment to such critical vendor.

COMMENTARY

Windstream serves as a reminder that even though debtors have to obtain the bankruptcy court's permission to pay critical vendors, the bankruptcy court relies on debtors to ultimately decide which creditors get paid under the critical vendor order. Creditors' challenges to such motions face an uphill battle.

Reclamation Claim is Subordinate to a DIP Lender's Lien

In re hhgregg, Inc.,
949 F.3d 1039 (7th Cir. 2020)

On March 6, 2017, hhgregg, Inc. ("hhgregg"), an appliance retailer, filed for bankruptcy under Chapter 11 of the Bankruptcy Code. As of the petition date, hhgregg owed Wells Fargo Bank, National Association ("Wells Fargo") at least $66 million under the prepetition credit facility, which gave Wells Fargo a first-priority, floating lien on nearly all of hhgregg's assets, including existing and after-acquired inventory and its proceeds. After the petition date hhgregg entered into an agreement with Wells Fargo to obtain debtor-in-possession ("DIP") financing which was similar in form and function to the prepetition credit facility and also gave Wells Fargo a first-priority security interest on substantially all of hhgregg's assets, including existing and after-acquired inventory and its proceeds. Three days after the court entered an interim order approving the DIP financing, Whirlpool Corporation ("Whirlpool") sent hhgregg a reclamation demand seeking the return of $16.3 million of unpaid inventory delivered to hhgregg in the 45-day period before the petition date. Wells Fargo opposed the return of the goods in question, arguing that it had a first priority lien on the goods under the interim DIP financing order. The bankruptcy judge ruled in favor of Wells Fargo, which the district court affirmed. Whirlpool appealed to the Seventh Circuit.

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Whirlpool claimed that its reclamation right existed as of the petition date, prior to the entry of the interim DIP financing order, even though it did not formally issue the reclamation demand to hhgregg until after the court entered the interim DIP financing order. Therefore, Whirlpool argued that its reclamation right superseded Wells Fargo's DIP financing lien. Wells Fargo argued that reclamation demands were not self-executing and had to be made in writing under 11 U.S.C. § 546(c). Wells Fargo also argued that there was never a point in time that it did not have a first lien on the goods in question because the creation of their post-petition liens under the interim DIP financing order occurred simultaneous to the extinction of its prepetition liens.

The Seventh Circuit affirmed the lower court's decision for the two reasons cited by Wells Fargo. First, the court noted that a reclamation right is not a security interest and it is not self-executing either within or outside bankruptcy. Thus, absent a timely written demand, the seller has no reclamation right under § 546(c)(1). The court held that Whirlpool's reclamation demand came after the interim DIP financing order and was not "in effect" on the petition date. Second, assuming that the reclamation right was in existence before the written demand, the Seventh Circuit held that Whirlpool's reclamation claim did not spring into first position when Wells' Fargo's prepetition lien was extinguished in the final roll-up because there was no gap in the Wells Fargo lien chain; Whirlpool's goods were continuously encumbered by Wells Fargo's liens.

COMMENTARY

In re hhgregg emphasizes that a reclamation right arises only upon delivery of a reclamation demand. Thus, although Bankruptcy Code section 546(c) provides 20 days to file a reclamation demand, creditors would be wise to file such demand right away. While reclamation rights will usually be subordinate to the lender's liens, as was the case in hhgregg, there are circumstances where the reclamation demand becomes a valuable negotiating tool. But in order to have such leverage, the demand must be timely and properly made.

Critical Vendors Are Not Insulated From Preference Actions

In re Maxus Energy Corp., et al., 615 B.R. 62 (Bankr. D. Del. 2020)

Tierra Solutions, Inc. ("Tierra"), an environmental remediation company, along with its affiliates filed for bankruptcy under Chapter 11 of the Bankruptcy Code. The court appointed Joseph J. Farnan Jr. as the liquidating trustee. The trustee filed a complaint against Vista Analytical Laboratory, Inc. ("Vista"), an environmental laboratory operator, to avoid and recover $217,410 paid to Vista within ninety days prior to the petition date. Vista filed for summary judgment arguing that the trustee could not avoid the transfers because it was a critical vendor, and if it were not paid the $217,410 in the preference period, the debtor would have paid that amount under the critical vendor order. Thus, Vista argued that it did not receive "more than such creditor would receive if … the transfer had not been made" as required by § 547(b)(5) of the Bankruptcy Code. The trustee argued that the critical vendor order did not shield Vista from avoidance actions as it was questionable whether Vista's pre-petition general unsecured claim would have been paid in full under the critical vendor order.

The court sided with the trustee and denied the summary judgment motion stating that there was a genuine issue of material fact whether Vista would have actually been paid the $217,410 under the critical vendor order. The court noted that Vista and Tierra never entered into a separate trade agreement pursuant to the critical vendor order to legally bind Tierra to pay Vista its pre-petition claim in exchange for Vista's post-petition services. The court also noted that the authority granted to the debtors under the critical vendor order was discretionary and the debtors were not required to pay Vista. It was therefore entirely plausible that, in fact, Tierra would not have paid Vista the additional $217,410 received during the preference period.

COMMENTARY

In re Maxus Energy emphasizes that a critical vendor who received a payment under a critical vendor order is not absolutely shielded from a preference action. Critical vendors who wish to be shielded from preference actions should enter into a separate trade agreement to legally bind debtors to pay all of the vendors' pre-petition claims and specifically seek a preference waiver as part of such agreement.