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1.

The Uniform Commercial Code ("UCC") § 2-702 (2) states:

- (2) Where the seller discovers that the buyer has received goods on credit while insolvent he may reclaim the goods upon demand made within ten days after the receipt, but if misrepresentation of solvency has been made to the particular seller within three months before delivery the ten day limitation does not apply. Except as provided in this subsection the seller may not base a right to reclaim goods on the buyer's fraudulent or innocent misrepresentation of solvency or of intent to pay.

However, the application of section 2-702(2) is greatly limited by UCC § 2-702(3), which states:

- (3) The seller's right to reclaim under subsection (2) is subject to the rights of a buyer in ordinary course or other good faith purchaser under this Article [2] (section 2-403). Successful reclamation of goods excludes all other remedies with respect to them



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## Reclamation

### Section 546(c)(1)

Except as provided in subsection (d) of this section and in section 507(c), and subject to the prior rights of a holder of a security interest in such goods or the proceeds thereof, the rights and powers of the trustee under sections 544(a), 545, 547, and 549 are subject to the right of a seller of goods that has sold goods to the debtor, in the ordinary course of such seller's business, to reclaim such goods if the debtor has received such goods while insolvent, within 45 days before the date of the commencement of a case under this title, but such seller may not reclaim such goods unless such seller demands in writing reclamation of such goods—

(A) not later than 45 days after the date of receipt of such goods by the debtor; or

(B) not later than 20 days after the date of commencement of the case, if the 45-day period expires after the commencement of the case.

- (2) If a seller of goods fails to provide notice in the manner described in paragraph (1), the seller still may assert the rights contained in section 503(b)(9).



2.

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Section 2-702 of the Uniform Commercial Code affords a seller of goods certain rights to recover or "reclaim" goods delivered to an insolvent buyer.

Section 546(c) of the Bankruptcy Code recognizes and respects a seller's right to reclaim goods from a bankrupt buyer.

Section 503(b)(9) gives vendors a priority for goods delivered immediately before the filing of bankruptcy. This section places the holders of administrative expenses before the holders of general unsecured trade claims in receiving distributions.



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Sec. 503 (b) After notice and a hearing, there shall be allowed administrative expenses, 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.



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**Section 546 (c) as amended in 2005 :**

- Expanded the reclamation look-back period before a bankruptcy filing, during which goods may be subject to reclamation, from 10 days to 45 days. In other words, the 2005 Amendments permits vendors to make a written reclamation demand for goods transferred to a debtor in the 45-days immediately preceding the chapter 11 debtor's bankruptcy filing.
- Gave seller up to 20-days after the bankruptcy filing to transmit its reclamation demand if the 45-day reclamation-demand period expires after the bankruptcy filing. In other words, if the 45 day period expires after the bankruptcy filing, the vendor is now given an additional 20 days to make a demand (thereby potentially giving the vendor up to 65 days to recover goods);
- Removed the reference to the "statutory or common law right" of the seller.
- Removed language providing that, if the bankruptcy court denied reclamation, it was obligated to compensate the seller by means of an administrative-priority claim or lien.

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*In re M.P.G., INC.,*

222 B.R. 862 (Bankr. W.D. Ark. 1998)

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**Section 546 (c) as amended in 2005 :**

- Section 546(c) now states that any seller failing to provide timely notice of its reclamation claim "still may assert the rights contained in section 503(b)(9)," which confers administrative status on claims for the value of goods provided to the debtor within 20 days of a bankruptcy filing.
- Amended Section 546(c) may make reclamation rights subject to the prior rights of a secured creditor with a security interest in goods or their proceeds. In other words, a vendor's reclamation right is further limited by the possibility that the debtor may have granted a bank or other creditor a security interest in the goods, which will be senior to the reclamation right.

8.

Reclamation Demand Must be Made in Writing

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To invoke Reclamation under Sec. 546 (c), a seller must show the following :

The debtor received the goods within 45 days before the petition date and the debtor was insolvent at the time the goods were received

The goods were sold in the ordinary course of business

The goods were identifiable at the time of the demand

The debtor had the goods in its possession at the time the written reclamation demand was received. In other words, a debtor must have received the goods for them to be reclaimed.

The seller made a written demand for reclamation either (a) within 45 days after the date of the debtor's receipt of the goods, or (b) if the 45-day period expires after the bankruptcy petition date, then within 20 days after the petition date.

9.

Facts:

- Defendant Arkansas Meter & Supply Company (AMS) shipped certain goods to Debtor M.P.G., Inc., on credit, at the request of the president of the Debtor.
- The payment was due in one week. The Debtor failed to pay on time.
- The Defendant orally demanded return of the goods.
- The Debtor refused the demand for payment of goods.
- The Defendant went to the Debtor's premises and repossessed t. The Debtor had previously received an invoice from the Defendant in the sum of \$ 50,213.79 for the repossessed goods.
- Subsequently, the Defendant resold the repossessed goods in the ordinary course of business for \$ 47,251.07.
- Within 90 days of reclamation of goods, the Debtor filed for Chapter 11 bankruptcy.

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Facts Continued..

- A Chapter 11 Trustee was appointed and investigated all payments made by the Debtor to vendors within the 90 days prior to the bankruptcy filing, including the Debtor's return of any goods to vendors.
- The Trustee filed an action against the Defendant to recover an alleged preferential transfer of \$ 50,213.79.



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Sec. 547 (b) Except as provided in subsections (c) and (i) of this section, the trustee may avoid any transfer of an interest of the debtor in property –

- (1) to or for the benefit of a creditor;
- (2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
- (3) made while the debtor was insolvent;
- (4) made—
  - (A) on or within 90 days before the date of the filing of the petition; or
  - (B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and
- (5) that enables such creditor to receive more than such creditor would receive if—
  - (A) the case were a case under chapter 7 of this title;
  - (B) the transfer had not been made; and
  - (C) such creditor received payment of such debt to the extent provided by the provisions of this title.



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Issue :

- Whether the Defendant's prepetition exercise of its right of reclamation under state law was subject to the Trustee's power to recover a preference under section 547 of the United States Bankruptcy Code.



14.

Section 546(c)(1)

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- (A) not later than 45 days after the date of receipt of such goods by the debtor; or
  - (B) not later than 20 days after the date of commencement of the case, if the 45-day period expires after the commencement of the case.
- (2) If a seller of goods fails to provide notice in the manner described in paragraph (1), the seller still may assert the rights contained in section 503(b)(9).



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15.

Section 546(c)(1)

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- (2) If a seller of goods fails to provide notice in the manner described in paragraph (1), the seller still may assert the rights contained in section 503(b)(9).



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Arkansas' version of the Uniform Commercial Code (UCC) provides for the right of reclamation as follows:

Ark. Code Ann. § 4-2-702(2)

- (2) Where the seller discovers that buyer has received goods on credit while insolvent he may reclaim the goods upon demand made within (10) days after the receipt, but if misrepresentation of solvency has been made to the particular seller in writing within three (3) months before delivery the ten-day limitation does not apply. Except as provided in this subsection the seller may not base a right to reclaim goods on the buyer's fraudulent or innocent misrepresentation of solvency or of intent to pay.



19.

This Court has previously adopted the minority view that failure to give written demand but otherwise complying with applicable state law reclamation requirements only renders the seller's right of reclamation subject to attack under the Trustee avoiding powers. *Farmers Rice Milling Co. v. Hawkins* (*In re " "* Bearhouse, Inc), 84 B.R. 552, 560 (Bankr. W.D. Ark. 1998). [14](#) Accord *United Beef Packers v. Lee* (*In re A.G.S. Food Systems, Inc.*), 14 B.R. 27, 28-29 (Bankr. D.S.C. 1980). See also Richard A. Mann & Michael J. **[\*865]** Phillips, "Section 546(c) of the Bankruptcy Reform Act: An Imperfect Resolution of the Conflict Between the Reclaiming Seller and the Bankruptcy Trustee," 54 Am. Bankr. L.J. 239 (1980) (discussing the various approaches to construing state law reclamation rights in the bankruptcy context). These two views are referred to as the restrictive interpretation and the expansive interpretation by some leading bankruptcy commentators. 2 David G. Epstein et al., Bankruptcy § 6-65 at 148-49 (1992).

**[\*\*8]** Regardless of which view is appropriate, the Trustee will prevail on the facts in this case because the reclamation was completed prepetition without giving written notice. As stated by Professors Epstein, Nickles and White: (149-50)

**HMA** The only consequence of an accomplished [prepetition] reclamation not having satisfied section 546(c)'s requirements is that, upon the trustee attempting to avoid the reclamation on the basis of some other Code provision, the seller is denied the shield of immunity that section 546(c) gives when its requirements have been met. On the other hand, a seller gets the shield who reclaims prepetition in compliance with section 546(c)'s requirements.

2 David G. Epstein et al., Bankruptcy § 6065 at 149-50 (1992).

Because the demand to reclaim in this case was not made in writing, the prepetition exercise of the right of reclamation by the Defendant is subject to the Trustee's avoiding powers in accordance with section 547 of the Bankruptcy Code. The parties have stipulated that the transfer in



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20.

#### Court's Ruling

- The Court noted that the requirements for demanding reclamation under state law differ from those under the Bankruptcy Code.
- The Court held that Bankruptcy Code section 546(c) supersedes Arkansas' UCC and requires that a vendor's reclamation demand must be in writing: "[state] law requires only that 'demand' to reclaim be made within ten days after delivery of the goods while section 546(c) of the Bankruptcy Code requires that written demand be made".
- The Court noted that a majority of courts construe section 546(c) as the exclusive procedure for exercising the right of reclamation against a buyer who has previously filed for bankruptcy. Thus, under the majority view, a demand for reclamation must be in writing when the buyer is in bankruptcy.
- The Court concluded that as the reclamation demand was not in writing, and that the reclamation was made during the preference period, the vendor lost the shield of immunity provided by the Bankruptcy Code's reclamation provision and the reclamation was an avoidable preference.



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#### Arguments:

- The Trustee sued AMS, contending that AMS failed to comply with the reclamation provisions of the Bankruptcy Code as the it reclaimed the goods from the Debtor by making an oral reclamation demand.
- AMS argued that it repossessed the goods in compliance with Article 2 of the UCC, as it had made a demand on the Debtor for return of the goods within ten days after they were received.



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#### Conclusion :

- A reclamation demand must be made in writing
- A vendor gets the shield when a reclamation is made prepetition, if the vendor is in compliance with Section 546(c)'s requirements.



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In a preference action involving reclamation claim, a trustee gets credit only for the liquidation value of the reclaimed goods as opposed to a greater value which the Defendant had or could potentially realize from a sale of the reclaimed goods



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#### Facts

- An involuntary Chapter 7 petition was filed against the Debtor within 90 days of Parkdale's recovery of the yarn.
- The Debtor commenced a lawsuit against Parkdale for avoidance of the Debtor's pre-petition reclamation of Parkdale's yarn under § 547
- The Bankruptcy Court held that reclamation of yarn by Parkdale was an avoidable preference for which the Debtor was entitled to recover the liquidation value of the reclaimed yarn in an amount equal to \$27,459.
- The Bankruptcy Court found the liquidation value of the yarn to be \$ 27,459, although the parties agreed that Parkdale had sold or would sell the reclaimed yarn for between \$ 99,000 and \$ 105,000.



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*Active Wear, Inc. v. Parkdale Mills, Inc.,*

331 B.R. 669 (W.D. Va. 2005)



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#### Issue :

- Whether the Bankruptcy Court properly held that the Debtor should be given credit for the liquidation value of the yarn that the Defendant reclaimed or instead Debtor should get a greater value which the Defendant had or could potentially realize from a sale of the recovered yarn ?



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#### Facts

- Debtor Active Wear Inc. was a yarn spinner.
- Debtor purchased yarn from Defendant Parkdale Mills Inc.
- The Debtor ceased operations in 2004.
- The Debtor had unused yarn in its possession which it had purchased from Parkdale.
- When Parkdale became aware of the Debtor's cessation of operations, Parkdale made a reclamation claim against the Debtor.
- Thereafter, Parkdale picked up all of the unused yarn it had previously sold to the Debtor.



27.

Sec. 547 (b) Except as provided in subsections (c) and (i) of this section, the trustee may avoid any transfer of an interest of the debtor in property –

- (1) to or for the benefit of a creditor;
- (2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
- (3) made while the debtor was insolvent;
- (4) made—
  - (A) on or within 90 days before the date of the filing of the petition; or
  - (B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and
- (5) that enables such creditor to receive more than such creditor would receive if—
  - (A) the case were a case under chapter 7 of this title;
  - (B) the transfer had not been made; and
  - (C) such creditor received payment of such debt to the extent provided by the provisions of this title.



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- (1) to or for the benefit of a creditor;
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  - (A) on or within 90 days before the date of the filing of the petition; or
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  - (C) such creditor received payment of such debt to the extent provided by the provisions of this title.



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#### Arguments

- The Debtor contended that the Bankruptcy Court erred in not assigning the yarn its fair market value. According to the Debtor, the yarn's fair market value was that price which the Defendant could realize from re-selling the yarn after Parkdale recovered the yarn from the Debtor.
- The Defendant argued that the Debtor should only get liquidation value of the yarn and not the value of the recovered yarn, which the Defendant might get after re-selling it.



34

Prior to BAPCPA, section 546(c) of the Bankruptcy Code provided that :

The rights and powers of a trustee under sections 544(a), 545, 547, and 549 of this title are subject to any statutory or common-law right of a seller of goods that has sold goods to the debtor, in the ordinary course of such seller's business, to reclaim such goods if the debtor has received such goods while insolvent, but-

(1) such a seller may not reclaim any such goods unless such seller demands in writing reclamation of such goods-

- (A) before 10 days after receipt of such goods by the debtor; or
- (B) if such 10-day period expires after the commencement of the case, before 20 days after receipt of such goods by the debtor; and

(2) the court may deny reclamation to a seller with such a right of reclamation that has made such a demand only if the court-

- (A) grants the claim of such a seller priority as a claim of a kind specified in section 503(b) of this title; or
- (B) secures such claim by a lien.



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#### Court's Ruling

- The District Court affirmed the holding of the Bankruptcy Court.
- Rejecting the Debtor's argument, the District Court limited recovery on the Debtor's preference claim to the sums the Debtor would realize from a liquidation sale of the returns.
- Relying on the pre-Bankruptcy Code decision of the U.S. Court of Appeals for the Fourth Circuit in *Virginia Nat'l. Bank v. Woodson (In re Decker)*, 329 F.2d. 836 (4th Cir. 1964), the Court noted that the recovery from Parkdale should be based on the extent to which the reclaimed yarn depleted the Debtor and its bankruptcy estate.
- The Court determined that the yarn's value to the Debtor was the amount the Debtor would realize from a liquidation sale of the yarn. The test is not what the creditor receives but what the bankrupt's estate has lost
- The Court refused to give the Debtor any credit for any greater recovery Parkdale derived from its disposition of the returned yarn, which the Court attributed to Parkdale's expertise, time, goodwill and advertising.



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The rights and powers of a trustee under sections 544(a), 545, 547, and 549 of this title are subject to any statutory or common-law right of a seller of goods that has sold goods to the debtor, in the ordinary course of such seller's business, to **reclaim such goods if the debtor has received such goods while insolvent**, but-

(1) such a seller may not reclaim any such goods unless such seller demands in writing reclamation of such goods-

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- (A) grants the claim of such a seller priority as a claim of a kind specified in section 503(b) of this title; or
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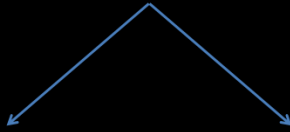
#### Conclusion

- In a preference claim involving reclamation, recovery from a defendant is limited to the extent to which the returned/reclaimed goods depletes the debtor and its bankruptcy estate.
- The appropriate value to be assigned to the reclaimed goods is a value that a debtor would realize from a liquidation sale of the returned goods.
- The test is not what a defendant receives after selling reclaimed goods but what the bankrupt's estate has lost



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There is a split amongst the courts concerning the enforceability of reclamation rights with respect to goods subject to a blanket security interest



- Some courts have taken the position that reclamation rights are effectively extinguished by the superior interest of a secured creditor in the goods.
- Other courts, representing the minority view, have concluded that such rights survive regardless of a secured creditor's superior right.
- According to this view, if a seller's reclamation right is superseded under applicable non-bankruptcy law by the superior rights of a secured creditor, the seller has no rights under section 546(c) and holds merely an unsecured claim for the value of the goods.



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Defendant's Reclamation Claims are not entitled to an administrative expense priority beyond that to which they may be entitled under Bankruptcy Code § 503(b)(9) \*

\* Post BAPCPA Ruling



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District/Circuit	Position
Delaware (Decided in 2016 per Post BAPCPA law)	<ul style="list-style-type: none"> <li>• Upholds vendor's reclamation rights.</li> <li>• Followed the rarely invoked holding of the U.S. Court of Appeals for the Sixth Circuit, in Phar-Mor.</li> <li>• A reclaiming creditor's rights were not extinguished when a pre-petition loan secured by a blanket security interest in the debtor's inventory was subsequently repaid by the proceeds of a post-petition loan also secured by the debtor's inventory.</li> <li>• Creditor's reclamation rights arose before, and had priority over, the post petition loan.</li> <li>• Thus, the debtor's post-petition lenders' liens were not superior to the vendor's reclamation claim.</li> </ul>
Sixth Circuit ( Lower Court Judgment Affirmed in 2008, applied pre-BAPCPA law)	<ul style="list-style-type: none"> <li>• Construing Ohio law, the Sixth Circuit held that Ohio Rev. Code § 1302.76(B) (UCC 2-207(2)) grants a properly reclaiming vendor, a right to reclaim its goods and that § 1302.76(C) (UCC 2-207(3)) does not allow a secured creditor's claim to defeat that right.</li> <li>• Although the Court recognized that 11 U.S.C. § 546(c)(2) grants the bankruptcy court the power to deny a properly reclaiming vendor its right to reclaim the goods, the Code requires that the denied vendor be granted either an administrative-expense priority in the amount of the goods or a lien on the proceeds resulting from the use of those goods by the debtor.</li> </ul>



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*In re Circuit City Stores, Inc.,*

441 B.R. 496 (Bankr. E.D. Va. 2010)



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District/Circuit	Position
Southern District of New York (Decided in 2007)	<ul style="list-style-type: none"> <li>• Denied relief on reclamation claims to the creditors.</li> <li>• Creditors' reclamation claims are rendered valueless when prior floating liens are satisfied by post-petition financing.</li> <li>• Treat the pre-petition and post-petition loans as one transaction that allow the Chapter 11 secured lenders' security interests in the debtors' inventory to retain priority over creditors' reclamation rights because the security interests related back, prior to the assertion of reclamation rights, to the attachment and perfection of the prepetition security interests.</li> </ul>
Fifth Circuit (Decision 2010)	<ul style="list-style-type: none"> <li>• Denied relief on reclamation claims to the creditors.</li> <li>• Vendors are not entitled to reclaim the goods so long as their reclamation rights remain subordinate to the rights of the prepetition secured lenders</li> <li>• Although the reclamation claims are subordinate to the pre-existing liens, the pre-existing liens do not extinguish the reclamation claims.</li> </ul>



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**Facts**

- Debtor Circuit City was a national retailer of consumer electronics.
- Debtor filed for bankruptcy and six creditors filed claims asserting secured or priority status pursuant to Section 503(b)(9) and 546(c).
- The Creditors sent letters to the Debtors' claims and noticing agent demanding the return of goods they had sold to the Debtor and timely filed reclamation claims against the Debtor.
- The Debtor objected to the Creditors' reclamation claims and sought to reclassify the claims as prepetition general unsecured, non priority claims.



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Section 546(c)(1) Except as provided in subsection (d) of this section and in section 507(c), and subject to the prior rights of a holder of a security interest in such goods or the proceeds thereof, the rights and powers of the trustee under sections 544(a), 545, 547, and 549 are subject to the right of a seller of goods that has sold goods to the debtor, in the ordinary course of such seller's business, to reclaim such goods if the debtor has received such goods while insolvent, within 45 days before the date of the commencement of a case under this title, but such seller may not reclaim such goods unless such seller demands in writing reclamation of such goods—

(A) not later than 45 days after the date of receipt of such goods by the debtor; or

(B) not later than 20 days after the date of commencement of the case, if the 45-day period expires after the commencement of the case.

(2) If a seller of goods fails to provide notice in the manner described in paragraph (1), the seller still may assert the rights contained in section 503(b)(9).



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### Sec. 503 (b) - Administrative Claims

(b) After notice and a hearing, there shall be allowed administrative expenses, 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



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### Arguments

- The Debtors moved for summary judgment, asserting that there was no relevant dispute as to any material fact regarding their objections to the reclamation claims.
- The Creditors claimed that they sold goods to the Debtor in the ordinary course of business during the 45-day period preceding the petition date. The Respondents alleged that they have made timely reclamation demands for the return of those goods and that they were entitled to administrative expense priority.



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(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



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[\*505] Prior to the enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, [164](#) it was well established that [Bankruptcy Code § 546\(c\)](#) did not create a federal right to reclamation. See [In re Hartz Foods, Inc.](#), 264 B.R. 33, 35-36 (Bankr. D. Minn. 2001) ("Section 546(c) does not create any right to reclamation for vendors of goods to insolvent buyers; it merely recognizes such a right exists to a limited extent in a bankruptcy case, provided such right exists either under common law or under statute other than the Bankruptcy Code."); see also [Allegiance Healthcare Corp. v. Primary Health Systems, Inc. \(In re Primary Health Systems, Inc.\)](#), 258 B.R. 111, 114 (Bankr. D. Del. 2001) ("Section 546(c) [\*21] does not create an independent right of reclamation."). One of the significant changes that was made to former [Bankruptcy Code § 546\(c\)](#) by BAPCPA was the deletion of the phrase "the rights and powers of a trustee . . . are subject to any statutory or common-law right of a seller of goods" and the insertion in its stead of the language "the rights and powers of a trustee . . . are subject to the right of a seller of goods." If the right to reclaim goods is not a statutory or common law right, then from where does this right derive? Some commentators have suggested that Congress meant to create an independent right in the federal law by way of this change. See, e.g., 4 White & Summers, *Uniform Commercial Code* § 32-11 (6th ed. 2009) ("[I]f this section does not create a freestanding right in federal law, then it is difficult to see what Congress had in mind when it deleted 'any statutory or common-law' from 546."). The court in [In re Dana Corporation](#) rejected this view. After extensive analysis of the language used, the context of [§ 546\(c\)](#), and the policies inherent in the Bankruptcy Code, the Bankruptcy Court for the Southern District of New York concluded that BAPCPA did not create [\*22] a new federal right of reclamation. [In re Dana Corporation](#), 367 B.R. 409, 416-18 (Bankr. S.D.N.Y. 2007). This Court finds the [In re Dana Corporation](#) analysis persuasive and concludes that [HN8](#) there still exists no federal right to reclamation post-BAPCPA. [174](#)



48

Prior to BAPCPA, if a court denied a seller a valid right to reclaim its goods in a bankruptcy case, the court was required to provide the seller with an administrative claim or a junior lien. Among the many amendments made by BAPCPA, Congress deleted former [subsection \(c\)\(2\) 11\\*271](#) from [Bankruptcy Code § 546](#) and replaced that subsection with an entirely new provision. [18A](#). As a result, [HN13](#) [Bankruptcy Code § 546\(c\)](#) no longer expressly provides that the court must grant a reclamation seller an administrative claim or junior lien if it prevents the claimant from reclaiming its goods. [19A](#).

[HN15](#) In making these changes to [Bankruptcy Code § 546\(c\)](#), Congress appears to have limited a reclamation seller's right to an administrative expense claim to that provided under [Bankruptcy Code § 503\(b\)\(9\)](#). See, e.g., *U.S. Trustee v. Equip. Servs. (In re Equip. Servs.)*, 290 F.3d 739, 745 (4th Cir. 2002) (holding that [HN16](#) when words were deleted from the Bankruptcy Code, the Court "must presume that Congress intended what it said when it . . . delete[d]" the words). The Reclamation Claims asserted by the Respondents are simply not entitled to an administrative expense priority beyond that to which they may be entitled under [Bankruptcy Code § 503\(b\)\(9\)](#).



49

## Conclusion

- Prior to BAPCPA, if a court denied a seller a valid right to reclaim its goods in a bankruptcy case, the court was required to provide the seller with an administrative claim or a junior lien. However, post BAPCPA Bankruptcy Code § 546(c) no longer expressly provides that the court must grant a reclamation seller an administrative claim or junior lien if it prevents the claimant from reclaiming its goods.
- Under a reclamation claim, all that creditors are entitled to is return of identifiable goods in possession of the debtor on the date the demand was made, which right does not extend to proceeds of sale.
- A seller cannot reclaim any goods that a debtor has sold before or after receiving the seller's reclamation demand.



52

## Court's Ruling

- The Court granted the Debtor's motion for summary judgment and ordered that the alleged reclamation claims, if not otherwise entitled to priority under § 503(b)(9), were to be reclassified generally as non-priority, unsecured claims.
- The Court rejected the Creditors' argument that the reclaiming creditors were entitled to administrative expense priority. The Court reasoned that under the current version of the statute, the Creditors were not entitled to administrative expense priority unless they establish a benefit to the estate that would qualify as an administrative expense under § 503(b)(1) or unless they can establish the criteria that would qualify as an administrative expense under § 503(b)(9).
- The Court stated that Sec. 546(c) does not grant the Creditors either administrative expense priority or secured lien status on account of their reclamation claims. The reclamation seller must take some affirmative action to pursue its claim. The reclamation seller must be able to identify its goods which must remain in the possession of the purchaser.



50

A lender's pre-petition and post-petition liens on debtors' goods were superior to a vendor defendant's reclamation claim.\*

\*Post BAPCPA decision denying the Vendor's reclamation claims



53

## Court's Ruling

- The Court stated that the right to reclaim was grounded in state law, often U.C.C. § 2-702, with § 546(c) supplying additional conditions, and the reclamation right pertained to the goods themselves, not to proceeds thereof.
- The Court stated that all Creditors had been entitled to was a return of identifiable goods in possession of the Debtor on the date the demand was made, which right did not extend to proceeds of sale.
- The Court ruled that the Creditors' cannot come into court at a late date arguing that they have some claim against whatever proceeds may ultimately be traceable from their reclamation goods. The Court held that by operation of § 2-702 of the UCC, the Creditors reclamation claims were inferior to the interests of buyers in the ordinary course and other good faith purchasers.
- The Court also noted that since, the Debtors obtained post-petition financing secured by inventory and proceeds regarding § 546(c) claims, the alleged reclamation claims were deemed rejected.



51

*Simon & Schuster, Inc. v. Advanced Mktg. Servs. (In re Advanced Mktg. Servs.)*,

360 B.R. 421 (Bankr. D. Del. 2007)\*

\*Post BAPCPA decision denying the Vendor's reclamation claims



54

#### Facts

- Debtor Advanced Marketing Services, Inc is a wholesaler of general interest books to membership warehouse clubs as well as certain specialty retailers, e-commerce companies, traditional bookstores and bookstore chains.
- Defendant Simon & Schuster is a publisher and delivered over \$5,000,000 of goods to the Debtor within the 45 day reclamation period.
- The Defendant timely sought to reclaim these goods after the Debtor filed for bankruptcy and filed a written complaint for reclamation of goods pursuant to 546(c).
- The Debtor and its certain lenders (Senior Lenders) were also parties to a loan and security agreement. The Debtors' obligations under the agreement were secured by a floating lien on substantially all of the Debtors' assets, including inventory. Thus, the Senior Lenders' first priority security interest extended to the goods that the Defendant sought to reclaim.
- The Debtor also sought post-petition financing pursuant to a court order and continued to receive financing from the Senior Lenders even post-petition.



55

Section 546(c)(1) Except as provided in subsection (d) of this section and in section 507(c), and subject to the prior rights of a holder of a security interest in such goods or the proceeds thereof, the rights and powers of the trustee under sections 544(a), 545, 547, and 549 are subject to the right of a seller of goods that has sold goods to the debtor, in the ordinary course of such seller's business, to reclaim such goods if the debtor has received such goods while insolvent, within 45 days before the date of the commencement of a case under this title, but such seller may not reclaim such goods unless such seller demands in writing reclamation of such goods—

(A) not later than 45 days after the date of receipt of such goods by the debtor; or

(B) not later than 20 days after the date of commencement of the case, if the 45-day period expires after the commencement of the case.

(2) If a seller of goods fails to provide notice in the manner described in paragraph (1), the seller still may assert the rights contained in section 503(b)(9).



58

#### Facts

- The post-petition loan was also secured by a lien on all of the Debtors' pre-petition, present and future assets and this lien was senior to all other liens other than validly perfected pre-petition liens.
- Additionally, the post-petition agreement also provided that the pre-petition liens granted to the Senior Lenders continue in full force and effect, and secure repayment of all obligations owed to the lenders.
- S&S filed a complaint for reclamation of goods pursuant to § 546(c), asserting the reclamation of goods in the aggregate amount of \$ 5,105,629.65.



56

Section 546(c)(1) Except as provided in subsection (d) of this section and in section 507(c), and **subject to the prior rights of a holder of a security interest in such goods or the proceeds thereof, the rights and powers of the trustee under sections 544(a), 545, 547, and 549 are subject to the right of a seller of goods that has sold goods to the debtor, in the ordinary course of such seller's business, to reclaim such goods if the debtor has received such goods while insolvent, within 45 days before the date of the commencement of a case under this title, but such seller may not reclaim such goods unless such seller demands in writing reclamation of such goods—**

(A) **not later than 45 days after the date of receipt of such goods by the debtor; or**

(B) **not later than 20 days after the date of commencement of the case, if the 45-day period expires after the commencement of the case.**

(2) If a seller of goods fails to provide notice in the manner described in paragraph (1), the seller still may assert the rights contained in section 503(b)(9).



59

#### Issue

- Whether Defendant could show a likelihood of success in establishing it has a valid reclamation right under section 546(c) of the Bankruptcy Code.



57

#### Arguments

- The Defendants asserted that they are entitled to reclaim goods as its reclamation claim was only subject to pre-petition liens and those will soon be satisfied through the "creeping rollup" and the Defendant ultimately will succeed on the merits of its reclamation claim.
- The Debtors alleged that Section 546(c)(1), as amended explicitly provides that the rights of a seller of goods are subject to the prior rights of a holder of a security interest in such goods or the proceeds thereof.
- Accordingly, under the express language of Section 546(c)(1) of the Bankruptcy Code, as amended, the Senior Lenders' pre-petition and post-petition liens on the Debtors' inventory were superior to S&S's reclamation claim.
- The Defendant also sought a temporary restraining order against the Debtor selling the inventory.



60

#### Court's Ruling

- The Court rejected the Defendant's argument and stated that although the Debtor's lien may be satisfied at some future date, S&S did not establish when that will occur and, more importantly, there was no surety whether any of the goods subject to the Defendant's reclamation claim will still be in the Debtors' possession at that time.
- The Court stated that the Senior Lenders' pre-petition and post-petition liens on the Debtors' inventory were superior to the Defendant's reclamation claim.
- The Court concluded that S&S's reliance on *In re Phar-Mor, Inc.*, in support of its argument was not persuasive because *Phar-Mor* can be easily distinguished from the case at hand. In *Phar-Mor*, the prior secured lenders had already been paid in full from collateral other than the reclaimed goods. However, in the case at bar, the Senior Lenders had not been paid in full, and S&S's reclamation claim was still subject to their interests.



61

A defendant's reclamation claims are not subordinate to a debtors' pre-petition lender's liens ( Pre-BAPCPA position)\*

\* Pre-BAPCPA bankruptcy law allowed the Bankruptcy Court to deny valid reclamation rights only if the Court granted the creditor a replacement lien to secure the reclamation claim, or gave the seller a priority, administrative expense claim. As a result of these alternatives, debtors in cases such as *Phar-Mor*, Kmart gained Court approval for reclamation procedures that, on their face, appeared to provide an administrative expense claim in exchange for denying creditors the ability to reclaim physical possession of their goods. Courts still rely on reasoning in these precedents in post-BAPCPA cases



64

#### Court's Ruling

- The Court denied the injunction, holding that the Defendant failed to prove that it was likely to succeed on the merits of its reclamation claim due to the priority of the Senior lender's liens on substantially all the Debtor's assets, including inventory and the goods.
- The Court also concluded that once the senior lender's liens were satisfied through sale of the inventory, the reclamation claim of the Defendant would likely be valueless.
- The Court ruled that S&S failed to establish that there was a strong probability that it will succeed on the merits of its reclamation claim. Thus, this factor weighed heavily against granting the temporary restraining order.



62.

*Phar-Mor, Inc. v. McKesson Corp.*,

301 B.R. 482 (Bankr. N.D. Ohio 2003),  
aff'd, 534 F.3d 502 (6th Cir. 2008)\*\*

\*Pre- BAPCPA Case Law in favor of Defendant

\*\* Courts still rely on the reasoning in this case post-BAPCPA



65

#### Conclusion

- Under the express language of § 546(c)(1) of the Bankruptcy Code, as amended, the secured pre-petition and post-petition liens on a debtors' assets are superior to a defendant's reclamation claim.



63

#### Facts

- Debtor *Phar-Mor, Inc.*, a chain of discount drugstores based in Youngstown, Ohio, filed for Chapter 11 bankruptcy protection in September 2001.
- Several vendors, including Defendant *McKesson Corporation* filed reclamation claims for goods shipped to *Phar-Mor* immediately before its bankruptcy filing.
- The Bankruptcy Court approved *Phar-Mor's* proposal that each such vendor be granted a priority administrative claim in lieu of returning the goods.
- The Court subsequently authorized *Phar-Mor* to incur up to \$135 million in DIP financing with super-priority secured and super-priority administrative status.
- *Phar-Mor*, however, continued to lose money and eventually conducted a going-out-of-business sale. It was able to repay the \$135 million loan from the proceeds but was left with only \$30 million toward satisfaction of more than \$185 million in general unsecured claims.



66

### Arguments

- Phar-Mor moved to reclassify McKesson's reclamation claim as a general unsecured claim, arguing that the vendor's priority was extinguished when the goods subject to reclamation were sold and the proceeds used to satisfy the claims of the DIP lenders.
- Phar-Mor contended that the DIP lenders, by virtue of the after-acquired property clause in their security agreement, were good-faith purchasers and, because McKesson's reclamation claims were "subject to" the lenders' security interests, McKesson had no right to reclaim the goods.
- McKesson argued that McKesson properly filed reclamation claims and that their reclamation claims have administrative-expense priority



67

### Conclusion

- A post-petition lender's floating lien on a debtor's inventory did not constitute an assumption of the prepetition creditor's lien, but an entirely new lien that did not defeat an intervening reclaiming seller's rights



70

### Court's Ruling

- The Bankruptcy court denied the motion, holding that even though the reclamation right was rendered "subject to" the DIP lender's super-priority liens, McKesson's properly filed reclamation claim still had administrative-expense priority.
- Phar-Mor appealed to the Sixth Circuit after the District Court upheld that determination on appeal.
- The Sixth Circuit also upheld the Bankruptcy Court's decision.
- The Sixth Circuit held that Ohio Rev. Code § 1302.76(B) (UCC 2-207(2)) grants a properly reclaiming vendor, such as McKesson, a right to reclaim its goods and that § 1302.76(C) (UCC 2-207(3)) does not allow a secured creditor's claim to defeat that right.



68

A defendant vendor's reclamation rights are superior to a lender's post-petition liens

\*Post BAPCPA Case Law allowing Defendant's reclamation rights



71

### Court's Ruling

- The Court added that pre-BAPCPA § 546(c)(2) (1998) grants the Bankruptcy Court a power to deny a properly reclaiming vendor, such as McKesson, its right to reclaim the goods, but only by granting the denied vendor either an administrative-expense priority in the amount of the goods or a lien on the proceeds resulting from the use of those goods by the debtor
- The Court thus, affirmed the Bankruptcy Court's ruling and granted McKesson an administrative-expense priority,



69

*In re Reichold Holdings US, Inc.*,  
556 B.R. 107 (Bankr. D. Del. 2016)\*

\*Post BAPCPA Case Law in favor of Defendant



72

#### Facts

- Debtor Reichold was a leading manufacturer of unsaturated resins utilized in a variety of consumer goods.
- The Debtor filed for Chapter 11 bankruptcy on September 30, 2014.
- At the time of filing, the Debtor was a borrower under a prepetition credit facility with Oaktree Capital Management, L.P. Oaktree maintained a blanket lien on substantially all of the Debtor's assets, including inventory.
- Upon filing for bankruptcy, the Debtor obtained a post-petition loan from a different group of lenders. The post-petition loan was secured by a first priority lien on all pre- and post-petition property of the estate, including inventory. The post-petition loan repaid Oaktree's prepetition loan.
- Within days of the bankruptcy filing, one of the Debtor's suppliers, Covestro LLC, delivered a written reclamation demand to the Debtor for goods delivered within 45 days of the petition date under Bankruptcy Code section 546(c).



73

#### Section 546(c)(1)

Except as provided in subsection (d) of this section and in section 507(c), and subject to the prior rights of a holder of a security interest in such goods or the proceeds thereof, the rights and powers of the trustee under sections 544(a), 545, 547, and 549 are subject to the right of a seller of goods that has sold goods to the debtor, in the ordinary course of such seller's business, to reclaim such goods if the debtor has received such goods while insolvent, within 45 days before the date of the commencement of a case under this title, but such seller may not reclaim such goods unless such seller demands in writing reclamation of such goods—

(A) not later than 45 days after the date of receipt of such goods by the debtor, or

(B) not later than 20 days after the date of commencement of the case, if the 45-day period expires after the commencement of the case.

(2) If a seller of goods fails to provide notice in the manner described in paragraph (1) the seller still may assert the rights contained in section 503(b)(9).



76

#### Facts

- The Debtor made payments to satisfy the 503(b)(9) portion of Covestro's claim for goods sold within 20 days of the petition date.
- However, Covestro remained unpaid for goods sold between 21 and 45 days of the petition date and accordingly, filed a proof of claim asserting administrative expense priority on account thereof (the "Reclamation Claim").
- The Debtor and later the liquidating trustee objected to the Reclamation Claim, arguing that it was rendered valueless when the Debtor's fully secured prepetition, first priority loan was repaid by the Debtor's post-petition financing.



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#### Section 546(c)(1)

Except as provided in subsection (d) of this section and in section 507(c), and subject to the prior rights of a holder of a security interest in such goods or the proceeds thereof, the rights and powers of the trustee under sections 544(a), 545, 547, and 549 are subject to the right of a seller of goods that has sold goods to the debtor, in the ordinary course of such seller's business, to reclaim such goods if the debtor has received such goods while insolvent, within 45 days before the date of the commencement of a case under this title, but such seller may not reclaim such goods unless such seller demands in writing reclamation of such goods—

(A) not later than 45 days after the date of receipt of such goods by the debtor; or

(B) not later than 20 days after the date of commencement of the case, if the 45-day period expires after the commencement of the case.

(2) If a seller of goods fails to provide notice in the manner described in paragraph (1) the seller still may assert the rights contained in section 503(b)(9).



77

#### Issue :

- Does a post-petition lender's subsequently perfected security interest trump the Defendant's reclamation rights when the proceeds from the post-petition loan were used to repay the Debtor's prepetition loan?



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#### Arguments

- Covestro filed a reclamation claim and sought \$411,781.72 as an administrative expense. The reclamation claim sought the value of goods delivered to the Debtor between 21 and 45 days prior to the commencement of the Debtor's bankruptcy case.
- The Trustee for the Debtor argued that the post-petition lenders' rights, although granted after Covestro's reclamation rights arose, related back to the prepetition lender's rights because the post-petition loan repaid the prepetition loan, and the two liens should be viewed as an "integrated transaction."
- The Trustee further contended that Covestro's rights were extinguished when the Debtor repaid the prepetition loan because reclamation permits a seller to reclaim only the goods themselves.
- Covestro responded that its reclamation rights were not subject to the post-petition lenders' rights because the post-petition lenders' floating lien was distinct and separate from the prepetition lender's lien, and arose after Covestro's rights arose



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### Court's Ruling

- The Delaware bankruptcy court focused on whether the post-petition lender's rights (which were granted after Covestro's reclamation rights arose) "related back" to the prepetition lender's rights.
- The Court concluded that the pre- and post-petition loans were separate transactions and that repayment of the prepetition loan from the post-petition loan did not affect Covestro's reclamation rights. Covestro's goods were not sold and their proceeds were not paid to the prepetition lender. The prepetition lender was paid from the proceeds of the post-petition loan and the reclaimed goods were merely pledged to secure that loan.
- The Court determined that the post-petition loan and the pre-petition loan were not an "integrated transaction." They were two different loans by two different lenders at two different times.
- The Court stated that because Covestro's rights arose before the post-petition lenders had any rights in the goods, the post-petition lenders do not have prior rights in the goods under section 546(c).

79

A lender's post-petition liens are superior to a defendant vendor's reclamation rights (Post-BAPCPA)

\*Post BAPCPA Case Law Denying Vendor's Reclamation Claims

82

### Court's Ruling

- Judge Walrath agreed with the decision in Phar-Mor. The Court stated that in the case at bar, when the prepetition loan was paid from the post-petition loan, the pre-petition lender's lien was satisfied but Covestro's reclamation rights remained in force. The fact that funds obtained from the post-petition loan were used to satisfy the pre-petition loan, or that the Debtor granted the post-petition lenders a lien in inventory to obtain such funds, was irrelevant. Covestro's reclamation rights arose before the post-petition lenders' security interest attached, and the post-petition lender's lien was expressly subject to reclamation rights under section 546.
- The Court ruled in favor of Covestro and overruled the Debtor's objection to the reclamation claim

80

*In re Pilgrim's Pride Corp.,*

No. 08-45664-DML-11, 2009 Bankr. LEXIS 3635 (U.S. Bankr. N.D. Tex. Nov. 10, 2009)\*

\*Post BAPCPA Case Law Denying Vendor's Reclamation Claims

83

### Conclusion

- Vendors may have a reclamation right remedy despite a senior secured lender's lien.
- The post-petition lender's floating lien on the debtor's inventory did not constitute an assumption of the prepetition creditor's lien, but rather was an entirely new lien that did not defeat the creditor's reclamation rights
- The creditor's goods were not sold and the proceeds of those goods were not paid to satisfy the prepetition lender's secured claim. Rather, the prepetition lender was simply paid from the proceeds of the post-petition loan and the creditor's reclaimed goods were merely pledged as collateral for the post-petition loan.
- Post-petition lenders' lien were subject or junior to the vendor's reclamation claim

81

### Facts

- Debtors' pre-petition lenders had perfected security interests in all or most of Debtors' property.
- Certain of Debtors' vendors filed claims based on their right to reclaim goods that were delivered to the Debtor prepetition but not paid for by the Debtor.
- The Debtor objected to the vendor's reclamation's claims

84

#### Issue

- To what extent the pre-existing liens extinguish or subordinate any asserted reclamation claims of the Defendants' for goods that were subject to those liens



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#### Arguments

- The Defendants relied on the decision in *Phar-Mor, Inc. v. McKesson Corp.* to support their position that their reclamation claims, despite the changes to the statute, were not subordinate to pre-existing lender's liens on the property they sought to reclaim.
- The Debtor argued that under the governing precedents of the Fifth Circuit, even absent BAPCPA, the lenders' rights would be superior to those of reclamation claimants.



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#### section 546(c)

(1) Except as provided in subsection (d) of this section and in section 507(c), and subject to the prior rights of a holder of a security interest in such goods or the proceeds thereof, the rights and powers of the trustee under sections 544(a), 545, 547, and 549 are subject to the right of a seller of goods that has sold goods to the debtor, in the ordinary course of such seller's business, to reclaim such goods if the debtor has received such goods while insolvent, within 45 days before the date of commencement of a case under this title, but such a seller [\*4] may not reclaim such goods unless such seller demands in writing reclamation of such goods--

(A) not later than 45 days after the date of receipt of such goods by the debtor; or

(B) not later than 20 days after the date of commencement of the case, if the 45-day period expires after the commencement of the case. (2) If a seller of goods fails to provide notice in the manner described in paragraph (1), the seller may still assert the rights contained in section 503(b)(9).



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#### Court's Ruling

- The Court noted that since the passage of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), the avoiding powers expressly set forth in § 546(c) were subject to the seller's right of reclamation which was, in turn, subject to the prior rights of a holder of a security interest in such goods or the proceeds thereof.
- The Court added that the Code (as amended by BAPCPA) and the Fifth Circuit precedents are consistent with the Debtors' position that the claims of reclamation claimants in the case at bar were subordinate to the perfected security interests of Debtors' pre-petition lenders.
- However, the Court added that although the reclamation claims were subordinate to the pre-existing liens, the pre-existing liens did not extinguish the reclamation claims.



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#### Section 546(c)

(1) Except as provided in subsection (d) of this section and in section 507(c), and **subject to the prior rights of a holder of a security interest in such goods or the proceeds thereof, the rights and powers of the trustee under sections 544(a), 545, 547, and 549 are subject to the right of a seller of goods that has sold goods to the debtor**, in the ordinary course of such seller's business, to reclaim such goods if the debtor has received such goods while insolvent, within 45 days before the date of commencement of a case under this title, but such a seller [\*4] may not reclaim such goods unless such seller demands in writing reclamation of such goods--

(A) not later than 45 days after the date of receipt of such goods by the debtor; or

(B) not later than 20 days after the date of commencement of the case, if the 45-day period expires after the commencement of the case. (2) If a seller of goods fails to provide notice in the manner described in paragraph (1), the seller may still assert the rights contained in section 503(b)(9).



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#### Conclusion

- In the Fifth Circuit, the lenders' rights are considered superior to those of reclamation claimants.
- Responding vendors are not entitled to reclaim the goods so long as their reclamation rights remain subordinate to the rights of the prepetition secured lenders.



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Roland Gary Jones, Esq.  
**Jones & Associates**  
1745 Broadway 17th Floor  
New York, New York 10019  
Tel. (877) 869-3998 Ext. 701  
Fax: (212) 202-4416

