

**Of Claims, Planes and Automobiles – Recent Developments on
503(b)(9) and Reclamation Claims¹**

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The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“BAPCPA”) made various changes to the provisions of the Bankruptcy Code (“Code”) governing claims in a chapter 11 proceeding. Two of these changes, in large part, relate to trade creditors.

First, BAPCPA established a new administrative priority claim under Section 503(b)(9) of the Code for those creditors that provide goods (as opposed to services) to a debtor in the ordinary course of business within 20 days prior to the commencement of the case. While the legislative history surrounding this section is scant, presumably Congress was concerned about providing a vehicle to enhance payment to creditors that shipped goods to a debtor in the ordinary course of business and on the eve of bankruptcy at a time when the debtor knew that bankruptcy was imminent and that it would not have the ability to pay for such goods. *See 4 Collier on Bankruptcy*, ¶ 503.16 at 503-79 (Alan N. Resnick et al. eds., 15th ed. Rev. 2006). The addition of this provision to the Code represents a “dramatic departure from bankruptcy precedent” as it treats similarly situated creditors differently based solely on having provided goods to the debtor during the 20-day period preceding the filing of the case. *Id.* at 503-79.

Second, BAPCPA expanded the scope and reach of reclamation claims under Section 546(c) of the Code for sellers who provide goods to an insolvent buyer. Under BAPCPA, amended Section 546(c) of the Code expands the reclamation remedy in at least two significant ways, namely: (i) by expanding the look-back period before bankruptcy during which goods may be subject to reclamation from 10 days to 45 days, and (ii) by expanding the grace period, which gives a seller additional time after a bankruptcy filing during which to file its notice of reclamation from 10 days to 20 days. In addition, BAPCPA eliminated the requirement that reclaiming creditors be given an administrative claim as an alternative to the return of their goods and further made clear that the rights of a secured creditor are superior to the rights of a reclaiming creditor.

¹ A portion of this article was taken from a prior article written by Judith Greenstone Miller and Jay L. Welford. See Miller, Judith Greenstone and Welford, Jay L., “503(b)(9) Claimants – The New Constituent, A.K.A. ‘the 500 Pound Gorilla,’ at the Table,” *The Michigan Business Law Journal*, Vol. XXVIII (Spring 2008) at pg. 18 and 5 *DePaul Bus. & Com. Law Journal* 487 (Spring 2007).

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What is a 503(b)(9) Claim?

Section 503(b)(9) creates an administrative priority claim for the value of any goods sold to the debtor in the ordinary course of such debtor's business and received by the debtor within the 20 days before the commencement of the case. By its express terms, Section 503(b)(9) only applies to "goods" (not "services"). The term "goods" is not defined in Section 503(b)(9). As such, bankruptcy courts and practitioners have struggled to characterize the nature of the value provided to the debtor. *See New Recent Developments on 503(b)(9) Claims*, Section B, *infra*.

Section 503(b)(9) raises a number of issues, such as: (i) how does a supplier assert a 503(b)(9) claim, (ii) may Section 503(b)(9) claimants compel immediate payment of their claims, (iii) how is a Section 503(b)(9) claim calculated (*i.e.*, is the value of the goods determined by the invoice price of the goods (exclusive of interest, freight and other charges) or should some other method be utilized), (iv) must the debtor actually receive physical possession of the goods and not just the value of the goods, (v) does Section 502(d) of the Code apply to Section 503(b)(9) claims, (vi) is a Section 503(b)(9) claim available to secured creditors, and (vii) what setoff rights do debtors have pursuant to Section 553 of the Code against 503(b)(9) claims.

Section 503(b)(9) also does not specifically indicate whether the goods shipped must remain unpaid (or otherwise unsatisfied) to qualify for treatment under Section 503(b)(9) even though to hold otherwise would appear to create a windfall for the creditor. For example, it is unclear whether Section 503(b)(9) claimants may obtain subsequent new value credit under Section 547(c)(4) of the Code for transfers made during the 20 day period to offset potential preference exposure. While this issue remains unresolved, a recent decision out of the Middle District of Tennessee in the context of a reclamation demand suggests that a reclamation creditor who reclaims the goods (or obtains an administrative claim for the value of such goods) is not entitled to use the value of those goods as new value to reduce potential preference exposure under Section 547(b) of the Code. *See In re Phoenix Restaurant Group, Inc.*, 373 B.R. 541 (M.D. Tenn. 2007) (holding that goods shipped on the eve of bankruptcy that are subject to reclamation are not the same "money or money's worth, as goods shipped free of the seller's strings" because they do not, in fact, enhance the estate and therefore cannot be used as subsequent new value). Application of this ruling to Section 503(b)(9) would suggest and support the conclusion that 503(b)(9) claimants that receive payment or other satisfaction (*i.e.*, in the form of subsequent new value) for goods shipped during the 20-day period are not entitled to a claim under Section 503(b)(9).

How Do I Assert a 503(b)(9) Claim?

Section 503 generally requires that administrative claims be asserted by motion. Since its enactment, a number of bankruptcy courts have established new local bankruptcy rules governing the manner and the timing for asserting claims under Section 503(b)(9). Some courts permit Section 503(b)(9) claims to be made by simply filing a proof of claim; while other courts require the filing of a motion. The local bankruptcy

rules also establish strict time lines for asserting such claims and, thus, practitioners must take care to carefully review the applicable local bankruptcy rules to determine if, how and when such claims must be asserted. Recognize, however, that not all bankruptcy courts have established local procedures to address the procedure for asserting claims under Section 503(b)(9). In such cases, a debtor will often file a motion seeking to establish a Section 503(b)(9) bar date and a specific process for creditors to assert such claims. Creditors must take care to carefully review all of the pleadings filed to ensure that they know when and if a process is established so that they timely and properly assert their claim under Section 503(b)(9). *See e.g.*, Kunz, III, Carl N., “*Section 503(b)(9) Claims and Bar Dates: Creditors Must Be Vigilant*,” American Bankruptcy Institute Journal, Vol. XXVII, No. 6, at pg. 20 (2008); Stickles, J. Kate and Dean, G. David, “*A Roadmap for Managing § 503(b)(9) Claims and Objections: The Debtor’s Perspective*,” American Bankruptcy Institute Journal, Vol. XXVII, No. 8, at pg. 26 (2008); Wheeler, David B., “*20-day Sales Claims Under § 503(b)(9): Finding Your Way Through Unchartered Territory*,” American Bankruptcy Institute Journal, Vol. XXVII, No. 9, at pg. 16 (2008).

When May I Get Paid on the 503(b)(9) Claim?

Section 503(b) provides that an administrative creditor may request payment of its claim but it does not provide any specific mechanism regarding when such claim must be paid. Prior to the adoption of Section 503(b)(9), the courts generally held that the timing for payment of an administrative expense claim was left to the sound discretion of the court. Section 1129(a)(9)(A) of the Code sets an outside date for payment of administrative expense claims, requiring that they be paid in cash, in an amount equal to the allowed amount of such claim, on the effective date of any plan of reorganization, unless creditors agree to a different treatment.

In some recent cases, Section 503(b)(9) claimants have filed motions early in the case, well before a plan was filed, seeking immediate allowance and payment of their claims. For example, in *In re Bookbinders’ Rest., Inc.*, 2006 WL 3858020 (Bankr. E.D.Pa. 2006) and *In re Global Homes, Inc.*, 2006 Bankr. LEXIS 3608 (Bankr. D.Del. 2006), the claimants sought immediate payment of their administrative claims. The claimants argued, among other things, that if they were not paid immediately, in *pari passu* with the other ordinary course post-petition expenses, there might not be sufficient funds at the end of the case to pay their claims in full. Furthermore, the claimants argued that immediate payment was required because: (i) the goods they provided were being used by the debtor and were necessary and essential to the debtor’s ability to continue its business operations, (ii) by paying other post-petition trade creditors, the debtor was treating similar claims differently (*i.e.*, an “equal protection” argument), and (iii) the debtor had sufficient cash to pay such claims.

In both cases, the courts denied the request for immediate payment of the Section 503(b)(9) claims and held that the timing of the payment is within the discretion of the court. The *Global Homes* Court noted that Section 503 “does not specify a time for payment of these expenses.” *In re Global Home Products*, 2006 WL 3791955 at *3. In

exercising its discretion in determining whether to allow immediate payment, the Court noted that one of the chief factors to consider is “bankruptcy’s goal of an orderly and equal distribution among creditors and the need to prevent a race to the debtor’s assets.” *Id.* As such, according to the Court:

Distributions to administrative creditors are generally disallowed prior to confirmation if there is a showing that the bankruptcy estate may not be able to pay all of the administrative expenses in full. Courts will also consider the particular needs of each administrative claimant and the length and expense of the case’s administration.

Id. Moreover, the Court noted that to qualify for “the exceptional remedy of immediate payment, a creditor must show that there is a necessity to pay and not merely that the Debtor has the ability to pay.” *Id.*

Ultimately, in denying immediate payment to the 503(b)(9) claimant, the Court relied on the 3-prong test used by courts to determine the timing of payment of an administrative claim pursuant to Section 503(a), as articulated in *In re Garden Ridge Corp.*, 323 B.R. 136, 143 (Bankr. D.Del. 2005), to wit: (i) the prejudice to the debtor; (ii) hardship to the claimant; and (iii) potential detriment to other creditors. After applying these factors, the Court denied immediate payment finding that: (i) the claimant had not submitted any evidence of hardship, other than self-serving conclusory statements, (ii) there was no evidence that failure to pay this claim would put the claimant out of business, (iii) the debtors had presented evidence that they would suffer substantial hardship in their reorganization effort if immediate payment were required, and (iv) in balancing the relative hardships, the balance tipped in favor of the debtor. The *Global Home* decision suggests that absent demonstrating a necessity to pay, as opposed to the ability of the debtor to pay, an administrative claimant is not entitled to immediate payment.

Likewise, the *Bookbinders’* Court recognized that “there may be circumstances in which it would be inequitable or inappropriate to permit a debtor to pay certain administrative expenses but not others.” *In re Bookbinders’ Rest., Inc.*, 2006 WL 3858020 at *5. The *Bookbinders’* Court agreed that the timing of the payment was within the bankruptcy court’s discretion and, in that case, elected to hold an evidentiary hearing on the matter before exercising such discretion.

The Court did, however, reject the 503(b)(9) claimant’s argument that it was entitled to immediate payment as a matter of law because the debtor had been paying other administrative expenses. According to the Court: “The text of § 503(b)(9) neither states nor even implies that allowance of the expense encompasses an unqualified right to immediate payment.... [H]ad Congress intended to provide § 503(b)(9) claimants with some type of enhanced right to payment after allowance of the expense, I am convinced that it would have made its intent express in the statute and it has not done so.” *Id.* at *5-6. Moreover, legislative policy would not otherwise trump the clear and unambiguous language of this section based on rules of statutory construction.

Is Section 503(b)(9) Available for Secured Creditors? What Setoff Rights Do Debtors Have Against 503(b)(9) Claims?

In *In re Brown & Cole Stores, LLC*, a decision by the Ninth Circuit BAP, the Court addressed two previously unanswered questions regarding Section 503(b)(9), namely: (i) whether a Section 503(b)(9) claim is available to secured creditors, and (ii) whether Section 503(b)(9) claims may be subject to setoff if the debtor possesses pre-petition claims against the creditor. *In re Brown & Cole Stores, LLC*, 375 B.R. 873 (B.A.P. 9th Cir. 2007).

With respect to the first question, the BAP held that the plain language of Section 503(b)(9) permitted a secured creditor to also seek payment as an administrative expense priority claimant. *Id.* at 877-78. The debtor had argued that the fundamental principle of statutory interpretation of enforcing a plain statute by its terms should be disregarded because at the same time Section 503(b)(9) was added by BAPCPA, Congress amended section 503(b)(1)(B)(i), a subsection of Section 503 dealing with tax claims, to clarify that it was available to creditors “whether secured or unsecured.” *Id.* In contrast, Congress did not include the words “secured claim” in Section 503(b)(9). Further, all of the other provisions of Section 503 provide for unsecured claims that are incurred by the estate after commencement of a case. *Id.*

The BAP rejected that argument stating:

The provision is not ambiguous; as such, we must enforce it according to its terms and should not inquire beyond its plain language. Apart from finding no ambiguity in § 503(b)(9), we note that Congress also declined to put the word “unsecured” into the same statute. The obvious conclusion, therefore, is that all claims arising from twenty-day sales are entitled to administrative priority.

Id. at 878. This result, the BAP held, was mandated by the statute regardless of whether giving priority to a secured creditor may be inequitable to other creditors.

With respect to the setoff question, the BAP reversed the denial of the debtor’s setoff request, holding that although pre-petition claims held by the debtor against a creditor cannot generally be set off against administrative claims because of the mutuality requirement set forth in Section 553(a), here the administrative claim itself arose pre-petition. Therefore, unlike other administrative priority claims, Section 503(b)(9) claims may be subject to setoff if the debtor possesses pre-petition claims against the claimant. *Id.* at 879. Ultimately, the BAP concluded that because: (i) there was insufficient evidence of inequitable conduct to deny a setoff, and (ii) the Debtor had not established that a right of setoff exists, “we must remand for application of the appropriate standards for determining whether to grant a setoff.” *Id.* at 880.

New Recent Developments on 503(b)(9) Claims

Until recently, there had been only a paucity of new cases discussing the issues related to the elements of a Section 503(b)(9) claim. Over the past few months, however, Judge Phillip J. Shefferly has released three of the most comprehensive opinions interpreting the language of Section 503(b)(9) in the *Plastech Engineered Products, Inc.* case. The following is a summary of these recent decisions.

A. *In re Plastech Engineered Products, Inc, et al., Case No. 08-42417 (Chapter 11) (Bankr. E.D.Mich. September 16, 2008) – Section 502(d) does not apply to Administrative Expenses under Section 503(b)(9) Claims.*

Plastech Engineered Products, Inc. and its related entities, a tier one automotive supplier, filed voluntary chapter 11 petitions on February 1, 2008 in the United States Bankruptcy Court for the Eastern District of Michigan. Various creditors asserted administrative priority claims for goods delivered to the debtors within 20 days of the filing pursuant to Section 503(b)(9) of the Code. The debtors objected to the allowance and payment of a number of these claims based on, among other things, the fact that the claimants had allegedly received voidable preferences during the 90 days prior to the commencement of the cases. The debtors contended that application of Section 502(d), which generally requires the return of all preferential transfers as a prerequisite to claim allowance, precluded payment on such claims until the claimants returned the voidable preferences to the estates. The debtors further contended that Section 502(d) applied regardless of whether the claims arose pre-petition or post-petition and irrespective of whether the claims arose under Section 501, 502 or any other section of the Code.

Conversely, the 503(b)(9) claimants argued that the Section 502(d) disallowance provision was inapplicable to their claims because, among other reasons, Section 502(d) does not apply to claims asserted under Section 503. Rather, Section 502(d) only applies to claims filed and asserted under Section 501 and allowed under Section 502 of the Code. Once the claimants had filed a motion on notice and opportunity seeking allowance and payment of their claims under Section 503, they argued, they had fulfilled the requirements of the Code and were entitled to be paid on their claims notwithstanding Section 502(d).

The Court held that Section 502(d) did not apply to claims asserted under Section 503(b)(9). The Court began its analysis by looking at the statutory framework governing claims under the Code. Section 501 governs the filing of proofs of claims or interests while Section 502 sets forth the process for allowance and disallowance of claims asserted under Section 501. Looking at these sections, the Court found that the process for allowance of administrative claims under Section 503(b) is completely separate and distinct from the process for addressing other claims under Sections 501 and 502 of the Code. Moreover, the disallowance provisions in Sections 502(d) expressly refer only to subsections (a) and (b) of Section 502, not to administrative claims determined under Section 503(b). The Court noted that if the drafters of the Code had meant to apply

Section 502(d) to administrative claims arising under Section 503(b), qualifying language would and should have been provided in Section 503(b). No such qualifying language or reference was set forth in Section 503(b) and, therefore, the Court could not infer that there was any legislative intent to apply Section 502(d) to administrative claims under Section 503(b)(9). Citing *Beasley Forest Products, Inc., v. Durango Georgia Paper Co. (In re Durango Georgia Paper Co.)*, 297 B.R. 326, 331 (Bankr. S.D.Ga. 2003), the Court reasoned: “Absent a qualifying clause, one mandatory statutory provision should not be presumed to trump another mandatory provision. To subject requests filed under § 503, which also provides for their allowance, to disallowance under authority of § 502 discounts the plain meaning of both sections and unnecessarily requires resolution of a “conflict” between sections 502 and 502.”

The Court next looked at the term, “claim,” finding that it broadly refers to both pre-petition and post-petition rights to payment. According to the Court, Section 502(d) only applies to those post-petition claims that are governed by either Sections 501 or 502. In reaching this determination, the Court did not conclude that a 503(b)(9) administrative expense cannot be a “claim,” but rather it held that it was not the type of “claim” that is subject to Section 502(d). In reaching this determination, the Court disagreed with the holdings in *In re Triple Star Welding, Inc.*, 334 B.R. 778 (B.A.P. 9th Cir. 2005), *MicroAge, Inv. v. Viewsonic Corp. (In re MicroAge, Inc.)*, 291 B.R. 503, 508 (B.A.P. 9th Cir. 2002) and *In re Georgia Steel, Inc.*, 38 B.R. 829, 839-40 (Bankr. M.D.Ga. 1984), wherein the courts, in the context of administrative expenses generally, had held that Section 502(d) applies to preclude payment until the creditor has returned the preferential property transferred. Those courts, in contrast to the *Plastech* Court, held that the definition of “claim” under Section 101(5) was broad enough to include administrative expenses and that Section 502(d) did not include any language to qualify this definition. Contra *In re Lids Corp.*, 260 B.R. 680, 683 (Bankr. D.Del. 2001) (“administrative expense claims are accorded special treatment under the Bankruptcy Code and thus, are not subject to Section 502(d)”); *Camelot Music v. MHW Advertising & Public Relations, Inc. (In re DM Holdings, Inc.)*, 264 B.R. 141, 158 (Bankr. D.Del. 2000) (because administrative claim did not arise prepetition, it is not a claim under Section 101(5), and thus, Section 502(d) does not apply).

Finally, the debtor attempted to distinguish the case law governing administrative claims because the claim at issue in this case – a Section 503(b)(9) claim – arose prepetition, as opposed to most claims under Section 503 which arise post-petition. Section 503(b)(9), the debtor argued, merely gave priority status to what was previously a general unsecured claim. The debtor suggested that to hold that Section 502(d) does not apply to claims under Section 503(b)(9) would result in disparate treatment to similar claims; in other words, other unsecured claims arising prepetition would be treated differently than 503(b)(9) claims that, absent the grant of this new priority, would simply be treated as general unsecured claims subject to Section 502(d). Again, the Court dismissed this argument holding that “if Congress only intended to make section 503(b)(9) a ‘special class’ of pre-petition claims and thereby continue to make them subject to the claims allowance provisions of section 501 and 502, it could have easily accomplished that.” However, by taking this “special class” of pre-petition claims and determining that they are administrative expenses, payable and allowable under Section

503(b), “Congress placed § 503(b)(9) administrative expenses beyond the reach of § 502(d).”

This decision is currently on appeal to the United States District Court for the Eastern District of Michigan. Appellate briefs have been submitted but no decision has yet been issued by the court.

B. *In re Plastech Engineered Products, Inc, et al.*, Case No. 08-42417 (Chapter 11) (Bankr. E.D.Mich. October 7, 2008) – Section 503(b)(9) requires that the debtor receive the goods and not just the value of the goods.

In this case, a supplier asserted a claim under Section 503(b)(9) for goods that were shipped by the supplier to the debtors’ customer. Because the goods were shipped directly to the debtors’ customer, the debtors never took actual possession of the subject goods. Nevertheless, the claimant contended that it was entitled to a Section 503(b)(9) claim because the debtors had received the “value of the goods.” Alternatively, the claimant asserted that even if the goods were not actually received by the debtors, the requirement of receipt provided in Section 503(b)(9) could be met so long as the debtors had “constructive possession” of the goods.

The Court ultimately ruled, based on the plain meaning and language of the statute, that Section 503(b)(9) requires receipt of the “goods,” and not just the “value of the goods.” According to the Court:

the word *received* modifies the word *goods* in § 503(b)(9). It is the *goods* and not the *value* that must be received by the debtor to trigger § 503(b)(9). The word *value* in the statute is merely the measure of the amount of the “allowed administrative expense” under § 503(b)(9). The statute does not say *value received*. Instead, it says *goods received*.

To rule otherwise, the Court held, “strain[s] and ignore[s] the plain meaning of the language used in the statute. If that was what Congress intended, then the language would or could have provided for allowance of an administrative claim for the value or the benefit received by the debtor, as opposed to the “goods received by the debtor.”

The Court declined to determine whether actual, as opposed to constructive, receipt was necessary to trigger rights under Section 503(b)(9). First, the Court held, the Code does not define “received.” Second, while the parties cited to various provisions of the Uniform Commercial Code (“UCC”) and case law construing “receipt”, the parties had not yet introduced or stipulated to the admission of any evidence regarding their relationship to allow the Court to ultimately determine the issue. Third, although the parties suggested that the holding in *In re Pridgen*, 2008 WL 1836950 (Bankr. E.D.N.C. 2008), the only reported decision discussing the word *received* in the context of Section 503(b)(9), provided the Court with a basis to interpret the meaning of *received*, the Court dismissed this argument because: (i) the case was an unpublished decision from another

circuit decided in the context of a motion for reconsideration after an evidentiary hearing, and (ii) the facts of that case were distinguishable in that the debtors in that case were required to take physical possession of the goods (gasoline) for title to transfer.

C. *In re Plastech Engineered Products, Inc, et al.*, Case No. 08-42417 (Chapter 11) (Bankr. E.D.Mich. December 10, 2008) – Court addresses and considers what is a “good” under Section 503(b)(9).

In this opinion, the Court addressed the debtors’ objections to certain 503(b)(9) claims asserted for: (i) snow removal, salting and de-icing at the debtors’ various plants, (ii) turning the debtors’ own post-industrial scrap into plastic pellets that were subsequently sold back to the debtors to make automotive bumpers and fascia panels, (iii) inspecting, repairing and cleaning electric motors for the debtors and obtaining such parts as were necessary to make such motors work, and (iv) providing the debtors with natural gas. In each of these instances, the debtors objected to the claims based on their contention that the claimants had provided services, as opposed to goods and, thus, were not entitled to administrative expense treatment under Section 503(b)(9).

To the extent that the claim related to a mixture of goods and services, the debtors contended, the “predominant purpose test” should be the standard by which the court should determine whether goods or services were provided to the debtor. Application of that standard, the debtors posited, meant that if the predominant purpose of a contract was a service, as opposed to a good, then the contract would be treated entirely as a service, *i.e.*, “winner takes all.” Additionally, in the case of the natural gas provider, the debtors contended that the claimant’s rights, as a utility provider, were limited to those set forth in Section 366 of the Code and, thus, the claimant was not entitled to assert a claim under Section 503(b)(9).

The Court recognized that the Bankruptcy Code does not contain a definition of the term “goods.” Furthermore, there was no controlling case law within the Sixth Circuit governing the meaning of the term “goods.” The Court acknowledged that there is a line of case law adopting the predominant purpose test to determine whether a contract is for the sale of “goods.” However, such an approach, the Court held, was necessary in those cases so that the Court could determine whether the UCC was even applicable to the legal issues before it. Conversely, the Court reasoned:

there is nothing in § 503(b)(9) that requires that approach for the purposes of that section of the Bankruptcy Code. If a particular transaction provides for *both* a sale of goods and a sale of services, and the value of each can be ascertained, why shouldn’t the value of the services be relegated to an unsecured non-priority claim?

Put simply, the Court held, nothing in Section 503(b)(9) requires an “all or nothing” or “winner take all” approach.

The debtors suggested that application of the predominant purpose test “would avoid expensive, fact intensive inquiry in ascertaining the value of those items that are goods versus those items that are services in the case of contracts containing a mixture of good and services.” While the Court agreed that it may be more difficult to analyze a contract and to characterize its separate components, there is nothing in the Bankruptcy Code that suggests that a contract with a mixture of goods and services should be disqualified from treatment under Section 503(b)(9). As long as the value of the goods provided were capable of being calculated, the claimant is entitled to a claim for such value under Section 503(b)(9). Application of this analysis to the claims at issue in this particular case resulted in the portion of the claims deemed to be goods to be granted administrative priority under Section 503(b)(9).

The Court dismissed the debtors’ contention that if the items were not reclaimable, they could not be subject to treatment under Section 503(b)(9). According to the Court, “there is nothing in § 503(b)(9) that requires a claimant to also be entitled to a reclamation right under § 546.” Thus, the Court held, Section 546 does not limit or control in any way the rights that a claimant has under Section 503(b)(9).

The Court also dismissed the debtors’ contention that utility providers are not entitled to a Section 503(b)(9) claim for the value of goods provided to a debtor because such providers are entitled to other special protections set forth in Section 366 of the Code. The two Code sections, the Court held, are not mutually exclusive. One can be a seller of goods (and thus entitled to a claim under Section 503(b)(9) of the Code) and also simultaneously be entitled to the protections accorded to a utility in Section 366 of the Code. “The rights afforded by § 503(b)(9) to a seller of goods are not dependent either explicitly or implicitly upon either the availability or the lack of availability of other remedies under the Bankruptcy Code for such seller.”

Finally, in making this ruling, Judge Shefferly made reference to two other bankruptcy court decisions regarding the meaning of “goods” under Section 503(b)(9). In *In re Samaritan Alliance, LLC*, 2008 WL 2520107 (Bankr. E.D.Ky. 2008), a creditor sought allowance of an administrative claim for the value of electricity provided to the debtor during the 20-day period prior to the petition date. In that case, while recognizing that courts are divided on the issue of whether electricity is a good, the Court held that “for purposes of § 503(b)(9), electricity is ‘more properly characterized as a ‘service,’” *Id.* at *4. In another unreported case, *In re Deer*, No. 06-02460, slip op. at 2 (Bankr. S.D.Miss. 2007), after applying the definition of “goods” from the UCC, the Court held that advertising from Yellow Book did not constitute a good and thus, was not entitled to treatment under Section 503(b)(9).

Reclamation Claims under BAPCPA

Reclamation is the right of a seller to recover possession of goods delivered to an insolvent buyer. Specifically, Section 2-702(2) of the UCC permits a creditor to reclaim goods shipped to a buyer on credit if the seller discovers that the buyer was insolvent, provided that the seller makes a written demand within 10 days after receipt of the goods

by the buyer. Section 2-702(2) of the UCC also makes clear that a seller may not base a right to reclaim goods on the buyer's fraudulent or innocent misrepresentation of solvency or of intent to pay unless the buyer makes a misrepresentation of solvency in writing to the particular seller within 3 months before delivery of the goods, in which case, the 10-day limitation does not apply. Moreover, Section 2-702(3) provides that the seller's rights to reclaim are subject to the rights of a buyer in the ordinary course or other good faith purchaser under Section 2-403 of the UCC.

Section 546(c) of the Bankruptcy Code originally provided that creditors had the same 10-day period to make a written demand for reclamation unless the 10-day period expired after the petition was filed. In that case, the time for making the written demand for reclamation was extended until 20 days after the petition date. Prior to BAPCPA, a creditor could demand the goods back or request that it be allowed an administrative claim for the value of the goods.

With the enactment of BAPCPA, several changes were made with respect to the treatment of reclamation claims. First, the time for making a reclamation demand was extended from 10 days to 45 days *if* the debtor received the goods from a creditor when insolvent. The creditor, however, is still required to make a written request to the debtor identifying the goods subject to reclamation. Second, if such time period expires after the petition is filed, then the request must be made no later than 20 days after the petition date. Third, Section 546(c), as amended, makes clear that a reclaiming creditor is not entitled to an administrative claim for the goods it is seeking to reclaim. Rather, the creditor may only seek return of the subject goods (the creditor may, however, be entitled to an administrative claim under Section 503(b)(9)). Fourth, BAPCPA clarified a conflict that existed among various courts in making clear that the rights of a reclaiming creditor are subject and subordinate to the rights of a lien creditor. In other words, the reclaiming creditor does not have any rights in the subject goods unless there is equity in the goods.

New Recent Developments on Reclamation Claims

The Sixth Circuit Court of Appeals recently issued an opinion on reclamation claims entitled *Phar-Mor, Inc. v. McKesson Corp.*, 534 F.3d 502 (6th Cir. 2008). On first blush one might argue that the opinion is of limited relevance because it involved an interpretation of the pre-BAPCPA version of Section 546(c). However, a more extensive review and analysis of the decision suggests, unless the decision is limited to the facts of the case, that the opinion may have more far-reaching implications for secured creditors that provide inventory financing.

The creditor, McKesson, had sold goods to the debtor prior to the petition date. After the chapter 11 case was commenced, the creditor timely made a written demand for reclamation of the goods under Section 546(c) of the Code. Because the goods subject to the reclamation demand could not be taken back, the creditor was given an administrative claim for the value of such goods. Ultimately, the secured parties were paid off during the chapter 11 case and the remaining assets were utilized to pay creditors, including the administrative expense claim of McKesson.

The debtor objected to such treatment in part because at all relevant times all of the debtor's assets, including those goods subject to the demand for reclamation, were part of the secured lender's collateral (both prepetition and as part of the security interest in such assets granted to the DIP lender). Therefore, the debtor argued, McKesson actually had no reclamation rights and was not entitled to an administrative claim. The bankruptcy court overruled this objection.

On appeal, the Sixth Circuit concluded that McKesson was entitled to an administrative expense priority claim after the bankruptcy court had denied its rights to reclaim the goods subject to the written demand for reclamation. In reaching this conclusion, the Court analyzed reclamation rights under Section 2-702 of the UCC and acknowledged the limitations imposed under Section 2-702(3), which makes "the seller's rights subject to the rights of a buyer in the ordinary course or other good faith purchaser." The Court noted that secured creditors qualify as a purchaser under Section 1-201(b)(29) and (30) of the UCC.

Nevertheless, despite the apparent clarity of these provisions and prior Sixth Circuit law to the contrary, *see In re Pittsburgh-Canfield Corp.*, 309 B.R. 277, 287 (B.A.P. 6th Cir. 2004) (when goods subject to a reclamation are sold to satisfy a secured creditor's superior claim, the goods subject to the reclamation are gone and the vendor's right to a priority claim is gone with them), the Court held that it would be unjust to deny the reclaiming creditor an administrative claim when an insolvent debtor obtained such goods fraudulently (*i.e.*, the debtor obtained the goods under fraudulent promises to pay for such goods when it knew it was insolvent and unable to pay for such goods). In reaching this conclusion, the Court failed to take into account the fact that title to the goods may still pass upon delivery to a good faith purchaser even if fraud is committed by the seller. *See* Section 2-403 of the UCC.

Finally, perhaps the most disturbing aspect of the decision by the Sixth Circuit is the Court's suggestion, in *dicta*, that "the property was still [the seller's] even after it was delivered, at least for the ten day period provided for in § 2-702," and "further that [the debtor] acquired 'no rights in the collateral' as required under [UCC § 9-204], in regard to the [goods]." In other words, the Court seems to hold that the seller's rights are paramount and superior to that of the buyer and the seller may enforce such rights in equity to keep or, in this case, to reclaim such goods. Taken to its next logical extension, that would mean that if title to such goods does not transfer, the goods do not become part of the collateral base subject to the secured creditor's liens (even though such goods were delivered to the buyer and upon receipt would normally become part of the lender's inventory base).

Conclusion

These issues will continue to plague the courts particularly in the typical case where there are insufficient assets to pay creditors in full. Trade vendors will attempt to leverage their rights under Sections 503(b)(9) and 546(c) of the Code to obtain greater

distributions than they otherwise might be entitled to receive solely as unsecured creditors. While these sections may have been intended to enhance the rights of trade creditors, the benefits actually received from enforcing rights thereunder may be insignificant and minimal at best, and may lead to time-consuming and expensive litigation.