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# Bankruptcy Law News

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## Reclamation or Section 503(b)(9) Claim? - A Potential Trap

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With the 2005 amendments to the Bankruptcy Code, Congress may have created a potential trap for a creditor who wants to preserve its reclamation rights but also exercise the administrative expense claim, which was created by these amendments, for goods sold to a debtor. One bankruptcy debtor has attempted, albeit unsuccessfully in this instance, to spring this trap on the creditor.

Reclamation has been a remedy available to creditors since ancient times. It has long been a feature of the Uniform Commercial Code, which provides in section 2-702 that a buyer ***may reclaim*** good sold on credit to an insolvent buyer. This section of the UCC also provides that ***successful*** reclamation of goods excludes all other remedies with respect to them. More on these emphasized words later. Most vendors of goods are familiar with the reclamation rights and procedures under the UCC.

The Bankruptcy Code has also recognized reclamation rights in section 546. This section was subject to different interpretations by bankruptcy courts, so with the 2005 amendments to the Bankruptcy Code, Congress made certain existing issues more clear, but introduced new issues. As amended, section 546 provides that a reclamation demand served on a bankruptcy debtor within 20 days after the filing of the bankruptcy petition will give a seller certain reclamation rights in goods delivered to the debtor within 45 days prior to the bankruptcy filing. As under the UCC, a reclamation demand can apply only to goods that are then still in the possession of the debtor (not sold to the debtor's customer) and have not been changed in form (wheat now baked into bread) or incorporated into another product (bolts now holding an engine together). Congress expressly provided that a reclamation demand in a bankruptcy case is subject to a prior security interest in such goods, which was an issue not clear prior to 2005.

With the 2005 amendments, Congress also created section 503(b)(9), which grants an administrative expense claim priority for goods delivered to the debtor within 20 days before the bankruptcy filing. This claim is independent of whether there is any security interest in the debtor's inventory and independent of whether the goods are still in the debtor's possession and unchanged in form and unincorporated into another product.

There is an overlap between a reclamation demand and a 503(b)(9) claim for those goods that were delivered within 20 days, are not subject to a security interest in inventory, and are still in the debtor's possession and unchanged in form and unincorporated. This overlap is the subject of this article.

Reclamation demands must be served within 20 days of the bankruptcy filing, and there is generally a deadline set early in the case for filing 503(b)(9) claims. At this very early stage of the case, a creditor generally does not know whether it will be better off asserting its reclamation rights in 45 days' worth of goods or asserting its 503(b)(9) rights in 20 days' worth of goods. The bankruptcy estate may end up being administratively

insolvent and thus unable to pay the 503(b)(9) claims, so in such an instance the creditor, if it is able to do so, would be better off reclaiming all of the goods. Generally, a creditor will serve its reclamation demand within the 20-day time period, on the theory that it "can't hurt," and figure out later if there is a prior security interest in inventory that would make the reclamation demand valueless. The creditor will also timely file its 503(b)(9) claim and later see, which is almost always the case, that the 503(b)(9) is the more valuable claim regarding the goods that fit within the 20-day criterion. Obviously, for these goods, the creditor cannot be paid its 503(b)(9) claim and also reclaim the goods—the creditor will have only one remedy.

In the bankruptcy case of GT Advanced Technologies, Inc., nearly a year after the reclamation demands were served and the 503(b)(9) claims were filed, the debtor attempted to jam reclamation down the throat of a creditor. The debtor's operations had by then collapsed, and it filed a motion to compel reclamation by the creditor. With the cessation of the debtor's operations and the piece-meal liquidation of its assets, the goods described in the reclamation demand, being specially made to the debtor's specifications, were valueless to the creditor. The debtor objected to allowance of the creditor's 503(b)(9) claim on the ground that the goods covered by the invoices comprising this claim were subject to an "unopposed" reclamation demand, and thus reclamation was the creditor's sole remedy. The debtor also told the creditor to come by the debtor's facility and pick up the creditor's "reclaimed" goods.

On behalf of the creditor, we responded to the debtor's objection on several grounds:

- Reclamation is an exclusive remedy only when reclamation is ***successful*** (as noted earlier in this article), and successful reclamation requires that the creditor actually take possession of the reclaimed goods, which the creditor was refusing to do.
- Reclamation is a remedy of the seller (hence the ***"may reclaim"*** earlier), and cannot be forced upon the seller.
- Reclamation does not occur when at some undefined moment the debtor decides in its mind that it does not wish to oppose a much-earlier reclamation demand, rather it occurs only when the creditor takes physical possession.
- A creditor may rescind a reclamation demand at any time prior to taking possession of the goods.
- It is not equitable to force reclamation on a creditor, when the demand had to be served very early in the case, successful reclamation had not occurred, and the debtor's subsequent drastically changed financial condition has rendered the reclamation demand worthless to the creditor, while the alternative remedy of the 503(b)(9) claim was quite valuable.

This was the unusual situation of the debtor trying to force reclamation on the creditor, with the creditor strenuously resisting, which is the opposite of the usual contested reclamation situation. The court was persuaded by our arguments, and ruled at the hearing that the debtor's objection to the creditor's 503(b)(9) claim was overruled and the creditor was entitled to rescind its reclamation demand.

The takeaway from this decision is that a creditor should probably continue to timely serve reclamation demands, and certainly timely file 503(b)(9) claims, but the creditor may want to monitor the progress of the case and the debtor's financial fortunes. If later in the case it becomes clear that the reclamation claim, with regard to goods delivered within 20 days of the bankruptcy filing, will have little or no value, but the case is administratively solvent so the 503(b)(9) claim will have value, the creditor may want to file a document rescinding its reclamation claim with regard to the goods that are also the subject of the 503(b)(9) claim. By beating the debtor to the punch, the creditor can avoid the risk of having reclamation forced upon it by a court that might be more friendly to the debtor's position.

We hope you found this article useful and informative. If you would like to discuss the issues and techniques concerning any of these topics, please do not hesitate to contact David Grogan in the Bankruptcy and Creditors' Rights Group of Shumaker, Loop & Kendrick, LLP, at dgrogan@slk-law.com or 704-375-0057.