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The New Bankruptcy Law: Will Reclamation Demands Become Obsolete?

(For Cases Filed After October 17, 2005)

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The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the "BAPCPA") significantly rewrote the provision of the Bankruptcy Code relating to reclamation demands. At first blush, BAPCPA appears to greatly expand reclamation rights because it more than doubles the reclamation period under prior law. However, as explained below, it does not appear that this change will significantly enhance creditor rights. On the other hand, BAPCPA does provide for a new, priority administrative expense claim that automatically applies for all goods delivered to bankruptcy debtors within 20 days *before* they file their bankruptcy petition, without the need for a formal reclamation demand. This new administrative claim may prove much more valuable than the reclamation claim.

Prior Reclamation Law

Under reclamation law of the Uniform Commercial Code, a seller that discovers the buyer has received goods on credit while insolvent may seek to recover (reclaim) the goods, if a written demand for their return is made within ten days after receipt by the debtor. Under the pre-BAPCPA Bankruptcy Code, if the ten-day period expired on or after the date a bankruptcy petition was filed, the seller could reclaim goods delivered pre-bankruptcy, in writing, up to 20 days after the goods were received, essentially getting a ten-day extension to exercise reclamation rights.

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. (After secured claims, administrative claims have the highest priority to distributions.) As a result of these alternatives, debtors in large cases such as *Phar-Mor*, *KMart*, *Fleming Companies*, and *Winn-Dixie Stores* 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.

However, debtors usually reserved the right to challenge reclamation claims based upon the prior liens of secured creditors, the debtors' prior sale or consumption of the goods, or some defect in the creditor's written reclamation demand. Therefore, reclamation creditors sometimes ended up receiving no higher priority for their reclamation claims, despite the elaborate procedures concocted by the debtors. This is what occurred in the *Phar-Mor* case, when the debtor later objected to any priority based upon the lenders' prior liens.

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BAPCPA Reclamation Law—More Time, But the Secured Creditor Still Wins

Under BAPCPA, the amount of time a supplier has to ask for reclamation is greatly expanded. Creditors now have up to 45 days after the date of receipt of the goods by the debtor to assert reclamation rights in writing. If the bankruptcy petition is filed within that 45-day window, however, the creditor has until 20 days after the filing of the bankruptcy petition to make a written reclamation claim. Accordingly, for certain deliveries, a creditor could have up to 65 days after the receipt of the goods to make a reclamation demand, with a minimum of 21 days to make the reclamation demand (if the goods were delivered just before the filing).



However, even with these expanded time lines, BAPCPA explicitly provides that reclamation claims are subject to the prior rights of secured creditors who hold liens in the goods or their proceeds. Moreover, BAPCPA does not appear to alter current law that holds reclamation rights are extinguished if the goods are consumed, commingled with other goods of the debtor or sold to the debtor's customers. In our experience, we routinely see reclamation claims reduced to just a fraction of their original amount due to just this type of consumption or sale by the debtor. KMK will continue to recommend the filing of the broadest reclamation claims supported by the law.

However, we do not believe that simply expanding the amount of time within which to make a reclamation demand guarantees that reclamation rights will be substantially expanded.

The Real Plus for Creditors — The New Administrative Claim

Even though the new reclamation periods may not greatly enhance creditors' ability to be paid on reclamation claims, another change in the law does create a brand new claim for suppliers. Under BAPCPA, creditors now have a priority administrative expense claim for the value of all goods received by the debtor within 20 days before the commencement of the case, so long as the goods were sold to the debtor in the ordinary course of the debtor's business. While goods delivered in this period certainly *could* be covered by a reclamation claim, actually making a written reclamation claim is not required in order to establish the administrative claim. Moreover, while a right of reclamation can be cut off if a secured creditor exists, the goods are consumed, or are subsequently sold by the debtor, there is no such limitation on the new administrative expense claim. This is an important right that benefits all unsecured suppliers, and should have a significant impact on recoveries from bankruptcy debtors.

The effective date

These changes under the 2005 act apply to bankruptcy cases filed 180 days after President Bush signed the new law on April 20, 2005. This means that cases filed before October 17, 2005 remain subject to the prior reclamation law described above. However, creditors should implement procedures now (if they have not already done so) to support the new administrative claim by ensuring proof of delivery documents are promptly obtained and preserved, after learning of a customer's bankruptcy filing, for all deliveries received by the debtor within 20 days of the filing. Such records were already valuable under prior law to support proofs of claim and defenses to preference actions. Under the new law they have taken on even greater significance.

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