

Unsecured Trade Creditors Committee

To study and make recommendations on the rights of unsecured trade creditors in bankruptcy.



More Leverage for Suppliers, but No Quick Payday

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As most savvy collection managers know, the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) granted suppliers a priority in payment for goods received by the debtor within 20 days before bankruptcy.¹ The new statute undoubtedly increased the chances that suppliers will achieve a significant recovery. However, the courts have made it clear that Congress did not guarantee suppliers instant gratification on their newly created administrative priority claims.

To a lesser extent, BAPCPA also benefited suppliers by expanding the time period in which they may exercise their right to reclamation of goods under the Bankruptcy Code. Nevertheless, as under prior law, major obstacles exist to recovery by reclamation claimants.

No Instant Gratification on Newly Created Administrative Claims²

In the limited number of decisions construing the new vendor priority statute, §503(b)(9), the courts have denied immediate payment absent a showing by the vendor that: (1) the debtor would not be significantly prejudiced by ordering immediate payment, or (2) the vendor had a compelling need for payment.³ “[A] creditor must show a “necessity to pay and not merely that the Debtor has the ability to pay.”⁴ The “[c]ourts will also consider the particular needs of each administrative expense claim and the length and expense of the case’s administration.”⁵

In *Global Home Products*, the Delaware bankruptcy court denied the vendor’s motion for payment, in large part, based on the testimony of the debtors’ chief restructuring officer. He testified that if the debtors had to pay administrative claims immediately and in full, their

¹ 11 U.S.C. § 503(b)(9). See *In re Roland Pugh Construction, Inc.*, 2007 WL 509225 (Bankr. N.D. Ala. 2007). The goods must be received by the debtor in the time window established by Congress.

² *In re Global Home Products, LLC*, unreported, 2006 WL 3691955 (Bankr. D. Del. 2006); see also *In re Bookbinders’ Restaurant, Inc.*, unreported, 2006 WL 3858020 (Bankr. E.D. Pa. 2006).

³ *Id.*, at *4 (citing *In re Garden Ridge Corp.*, 323 B.R. 136 (Bankr. D. Del. 2005)).

⁴ *Id.* (quoting *In re Continental Airlines, Inc.*), 146 B.R. 520, 531 (Bankr. D. Del. 1992) (other citations omitted).

⁵ *Id.*

reorganization efforts would collapse. The chief restructuring officer's testimony establishes that:

- (1) the payment would adversely affect debtors' borrowing ability under their post-petition debtor-in-possession loan agreement,
- (2) debtors did not then have funds available to make payments on administrative claims,
- (3) debtors' availability under their current financing arrangement was needed to provide for continuing operations, and
- (4) debtor's payment of the administrative claim would create a default under their DIP Loan.

For its part, the supplier did not present any evidence to the court.

The *Global Home Products* court rejected the claimant's argument that it had been singled out for discriminatory treatment because other vendors were receiving payments based on their designation as "critical vendors" under a prior court order. The critical vendor order left the decision as to which vendors were "critical" to debtors' business judgment. The court found the fact that some pre-petition claims had been paid did not, taken alone, establish the claimant's right to payment. The court found that its critical vendor order enabled debtors to obtain favorable trade terms from those vendors whose products the debtors needed in order to reorganize. Absent evidence of a compelling need for payment on its claim, the court denied the supplier's request for immediate payment.

Similarly, the court in *In re Bookbinders' Restaurant, Inc.*⁶ denied a motion for immediate payment of a vendor's pre-bankruptcy administrative claim pending a further hearing on the facts underlying the claim. Like the vendor in *Global Home Products*, the claimant did not provide any evidence. The court found the fact that the Chapter 11 debtor had paid other administrative expense claims incurred post-petition was insufficient to entitle the § 503(b)(9) claimant to immediate payment as a matter of law. The court found that it was permissible for the debtor to pay post-petition claims which arose in the ordinary course of its business without payment to a § 503(b)(9) claimant. "Blue Crab's argument overlooks the fact that the Debtor's payments to postpetition trade creditors are being made pursuant to 11 U.S.C. § 363(c)(1), not 11 U.S.C. § 503(b)(1)". . . . "Thus, in a technical sense, Blue Crab's § 503(b)(9) administrative expense is being treated the same as any unpaid, allowed § 503(b) expenses."⁷ The court scheduled a further hearing at which, presumably, the vendor attempted to present evidence as to the debtor's ability to pay the claim or the vendor's critical need for the money.

Hurdles Remain for Reclamation Claimants

Congress extended the "reach-back period" for reclamation claims, now permitting claimants to reclaim goods received by the debtor up to 45 days before the reclamation demand. But this expansion of the reclamation period did not eliminate a number of significant obstacles to recovery on reclamation claims.

⁶ Unreported, 2006 WL 3858020.

⁷ *Id.*, at * ____.

Under prior law, the courts held that a supplier's right of reclamation was junior in priority to the prior blanket lien of a bank.⁸ Congress codified this case law when it enacted BAPCPA. Section 546 of the Bankruptcy Code now states that a reclaiming seller takes subject to the "prior rights" of a secured lender. Furthermore, as under pre-BAPCPA law, a creditor only possesses a right of reclamation to the extent that the goods which are the subject of the reclamation demand remain in the possession of the debtor.⁹

In the *Advanced Marketing*¹⁰ case, the court followed the plain language of the statute in denying a reclaiming seller's request for an injunction to prevent the debtor from selling the goods. The court denied the request, in large part, because it did not believe that the reclamation claimant would prevail on the merits of its reclamation claim. The court held that the debtor's bank lenders had superior liens in the goods that the supplier sought to reclaim. Because the bank lenders had not been paid in full, the supplier's reclamation claim was still junior to their interests.

The court rejected a number of clever arguments by the supplier. The bankruptcy court rejected the supplier's attempt to require "marshaling"¹¹ i.e., that the banks be required to seek payment first from collateral other than the disputed goods. "[U]nsecured creditors cannot invoke the equitable doctrine of marshaling."¹²

In addition, the supplier argued that its reclamation claim was only subject to the secured lender's pre-petition liens, not the liens the lender obtained through a post-petition debtor-in-possession loan used by the debtor to fund operations. Because the supplier believed that the debtor would soon satisfy the senior lender's pre-bankruptcy loan, it argued that it was likely to receive payment on its right of reclamation. While the court acknowledged that the pre-petition loan might be satisfied at some future date, it declined to forecast such an event. According to the court, the pre-petition debt to the senior lender was only being satisfied by the inventory that was its collateral. The bank lender's loan facility was being paid down, in part, through the sale of the goods. The court also concluded that the vendor could not show that any of the goods subject to its reclamation claim would still be in the debtor's possession at some later date when the pre-petition loan was extinguished.

In addition, the court further concluded that the vendor did not establish the "the irreparable harm" it would suffer outweighed any potential harm to the debtor. The court found that both the supplier and the debtor faced the prospect of potential irreparable harm.¹³ The court

⁸ See *Yenkin-Majestic Paint Corp. v. Wheeling-Pittsburgh Steel Corp. (In re Pittsburgh-Canfield Corp.)*, 309 B.R. 277, 283-88 (B.A.P. 6th Cir. 2004).

⁹ *In re Waccamaw's Homeplace*, 298 B.R. 233 (Bankr. D. Del. 2003).

¹⁰ *In re Advanced Marketing Services, Inc.*, __ B.R. __, 2007 WL 162685.

¹¹ "Marshaling of assets applies when a senior secured creditor can collect on its debt against more than one property or fund held by the debtor but a junior secured creditor can only proceed against one of those sources. Assuming certain elements are met, the process then requires the senior secured creditor to first collect its debt against the collateral other than that in which the junior secured creditor holds an interest, thereby leaving that collateral for the junior secured creditors benefit." *Pittsburgh-Canfield Corp.*, 309 B.R. at 291 (citations and emphasis omitted).

¹² *Pittsburgh-Canfield Corp.*, 309 B R at 291.

¹³ "In order to demonstrate irreparable harm the plaintiff must demonstrate potential harm which cannot be redressed by a legal or an equitable remedy following a trial. The preliminary injunction must be the only way of protecting

acknowledged that permitting the debtors to continue to sell the goods would likely render the supplier's reclamation claim worthless. Nevertheless, the court found that debtors would be significantly harmed by the imposition of an injunction preventing them from selling the goods. Because the balance of the equities did not favor the supplier, the court denied its request for an injunction.

Conclusion

In sum, even though vendors should benefit in the long run from the new priority granted to them by Congress, courts have declined to order immediate payment of newly created priority claims for goods received by the debtor within 20 days prior to the bankruptcy petition. Further, while Congress extended the "reach-back" period in which suppliers may assert reclamation claims, suppliers seeking to recover on such claims still face a number significant obstacles.

the plaintiff from harm." *Instant Air Freight Co. v. C.F. Air Freight, Inc.*, 882 F.2d 797, 801 93d Cir. 1989). "[I]njunctions will not be issued merely to allay the fears and apprehensions or to soothe the anxieties of the parties." *Campbell Soup Co. v. ConAgra, Inc.*, 977 F.2d 86, 892 (3d Cir. 1992) (citations omitted). Further, "[t]he availability of adequate monetary damages belies a claim of irreparable injury." *Frank's GMC Truck Center, Inc. v. General Motors Corp.*, 847 F.2d 100, 102 (3d Cir. 1988). The Third Circuit has also noted "that a purely economic injury, compensable in money, cannot satisfy the irreparable injury requirement." *Id.* (citing *Morton v. Beyer*, 822 F.2d 364, 372 (3d Cir. 1987)).