

To Reclaim or Not to Reclaim, That Is the Question

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With many bankruptcy cases looming on the horizon as a result of the pandemic and the measures taken to contain it, prudent creditors are reacquainting themselves with their rights, including the right of reclamation. Reclamation is codified in section 2-702(2) of the Uniform Commercial Code, and allows a seller who discovers that the buyer is insolvent to reclaim the goods upon demand within 10 days after delivery. However, this right is junior to the rights of good faith purchasers and lien creditors. Once the buyer files for bankruptcy, § 546(c) of the Bankruptcy Code modifies the seller's ability to enforce its state-law reclamation rights. Sellers often debate whether to file a reclamation claim in a bankruptcy case because, in most instances, reclamation claims are ineffective.

The ineffectiveness of reclamation is highlighted in a seller's recent appeal of a bankruptcy court decision. The seller, a pharmaceutical supplier, made a reclamation demand for more than \$36 million on account of goods delivered to its insolvent buyer. The buyer had debt of more than \$400 million to its lenders and those debts were secured by, among other things, the pharmaceutical goods the seller supplied. The debtor received post-petition financing from the same lenders and sold most of the pharmaceutical goods. The bankruptcy court held, and the district court affirmed, that the reclamation seller had nothing more than an unsecured claim because the secured lenders were undersecured. *In re Specialty Shops Holding Corp.*, No. 19-405 (D. Neb. July 24, 2020).

However, this does not mean "all" reclamation claims are ineffective. There are two situations where quick assertion of a reclamation claim can yield results.

The first situation is where the goods in question are not subject to pre-petition liens. Under § 546(c), a seller's reclamation claim is "subject to the prior rights of a holder of a security interest in the goods or the proceeds thereof." Very often, the goods a debtor buys become subject to the floating liens of a secured lender. In these cases, if the value of the goods to be reclaimed does not exceed the debt secured by the lender's floating lien, a reclamation claim is valueless. See e.g., *In re Dana Corp.*, 367 B.R. 409, 419 (Bankr. S.D.N.Y. 2007). But, where there is no prior lien holder (or where the goods are worth more than the debt secured by the prior lien), the seller should assert a reclamation claim.

Second, even if the goods are subject to a prior lien, a seller may still have a reclamation remedy if it files its claim quickly and if the bankrupt debtor should subsequently obtain post-petition financing from a different lender which repays the loan secured by the prior lien. Some courts have found that, when this occurs, a seller's reclamation claim has priority over that of the debtor-in-possession lender. *In re Reichhold Holding US, Inc.*, 556 B.R. 107 (Bankr. D. Del. 2016). To be sure, not all courts agree on this point, but some sellers find it prudent to promptly file a claim to preserve their ability to make that argument, should it later appear promising.

Once a buyer files a bankruptcy petition, a seller has 20 days from that date to file a claim for reclamation. The goods must have been sold to the buyer in the ordinary course of business and received by the debtor no more than 45 days before the petition date. The seller must be prepared to show that the debtor was insolvent when the goods were received. Finally, when the reclamation demand is made, the goods must still be in the debtor's possession and identifiable (e.g., must not have already been processed into something else).

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Miller Canfield can help you decide whether filing a reclamation claim is warranted as you seek to maximize recovery on your claims and preserve your business in these uncertain times. Please contact the authors or your Miller Canfield attorney to discuss further.