

**RECLAMATION AND §503(B)(9):  
Issues in the Aftermath of *Phar-Mor v. McKesson***

BY

Lisa S. Gretchko  
HOWARD & HOWARD ATTORNEYS PLLC -AND-  
Royal Oak, Michigan

Steven M. Berman, Seth P. Traub,  
and Brad deBeaubien  
SHUMAKER, LOOP & KENDRICK, LLP  
Tampa, Florida

**INTRODUCTION<sup>1</sup>**

Outside of bankruptcy, the right of an aggrieved seller of goods, who ships to an insolvent buyer to reclaim his goods, has been one of the strongest rights an unsecured trade creditor has had in modern day commercial jurisprudence. Notwithstanding the Bankruptcy Code's philosophical bent in favor of preserving state law property rights in bankruptcy, for nearly twenty years, trade creditors and their counsel have bemoaned the evisceration of the reclamation remedy provided to trade creditors through both the Uniform Commercial Code and the Bankruptcy Code.

Over the past two decades, a trade creditor's reclamation right evolved from a sacrosanct remedy into little more than lip service as bankruptcy courts continued to move away from guarantees of administrative claims or liens in favor of deeming most reclamation claims valueless and subordinate to floating inventory liens. However, the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA") gave trade creditors new hope for additional protection in bankruptcy by appearing to grant broader reclamation rights under the Bankruptcy Code. BAPCPA, among other things, expanded a seller's right to reclaim goods and provided administrative expense status to certain claims for goods sold to the debtor within 20 days of the petition date. In practice, the revisions to 11 U.S.C. § 546 merely codified the case law that was in the process of dismantling a trade creditor's reclamation rights. Indeed, while newly added 11 U.S.C. § 503(b)(9) also appeared to benefit trade creditors in their battle to be repaid by a debtor in bankruptcy, the enthusiasm from the added section has been tempered by the procedural hurdles and potential expenses of making claims.

The Sixth Circuit Court of Appeals, however, recently provided trade creditors with new optimism for the future of reclamation claims. In *Phar-mor v. McKesson Corp*, the Sixth Circuit refused to follow the case law that had previously eroded the reclamation rights of trade creditors. Instead, the Sixth Circuit ruled—in a “flashback” to early reclamation decisions that protected defrauded vendors who delivered goods on credit to an insolvent buyer—that any goods properly subject to reclamation (under applicable state law) remained the *vendor's* property and never became the debtor's property, so the secured creditor's claim could not attach

---

<sup>1</sup> The substance of these materials was drawn in large part from two articles previously authored by Lisa Gretchko: “Sixth Circuit's *Phar-Mor* Decision Breathes New Life Into Reclamation Remedy”, *American Bankruptcy Institute Journal*, September 2008, and “The Bankruptcy Reform Act One Year Later—A Disappointment for Trade Creditors,” *American Bankruptcy Institute Journal*, February 2007.

to the reclaimed goods. With this renewed hope for reclamation claims also comes new obstacles, including determining whether the Sixth Circuit’s interpretation of pre-BAPCPA code will affect post-BAPCPA reclamation cases, how the Sixth Circuit’s decision can be applied to § 503(b)(9) claims, and whether debtors may still avoid the reclamation rights of creditors through creative procedural roadblocks.

## RECLAMATION UNDER THE PRE-BAPCPA CODE

Reclamation refers to the right of a creditor to reclaim property sold to the debtor immediately before the filing of a bankruptcy case. Under certain circumstances, when a seller discovers, after it delivers goods to a buyer, that the buyer is insolvent, the seller can demand the goods be returned to the seller. These reclamation rights flow from § 2-702 of the Uniform Commercial Code (“UCC”), which has been adopted by virtually every United States jurisdiction. UCC § 2-702(s) provides:

Where the seller discovers that the buyer has received goods on credit while insolvent he may reclaim the goods upon demand made within ten days after the receipt, but if misrepresentation of solvency has been made to the particular seller in writing within three months before delivery the ten day limitation does not apply. Except as provided in this subsection the seller may not base a right to reclaim goods on the buyer's fraudulent or innocent misrepresentation of solvency or of intent to pay.

In bankruptcy, the exercise of state law reclamation rights is exclusively governed by 11 U.S.C. § 546(c) of the Bankruptcy Code. Prior to BAPCPA, § 546(c)(2) provided that:

[T]he rights and powers of a trustee ... are subject to any statutory or common-law right of a seller of goods that has sold goods to the debtor, in the ordinary course of such seller’s business, to reclaim such goods if the debtor has received such goods while insolvent, but... the court may deny reclamation to a seller with such a right of reclamation that has made such a demand only if the court –

(A) grants the claim of such a seller priority as a claim of a kind specified in section 503(b) of this title [i.e., an administrative expense]; or

(B) secures such claim by a lien.

11 U.S.C. § 546(c)(2) (1998) (amended in 2005 by Pub.L. 109-8, § 1227(a)).

Thus previously, if a seller satisfied all of the requirements of § 546(c), and in turn UCC § 702, then its right to reclaim goods was not avoidable under § 544(a) (as inferior to the rights of a hypothetical judgment lien creditor), § 545 (as a statutory lien that became effective on insolvency), § 547 (as a preference), or § 549 (as an unapproved post-petition transfer). Additionally, while a vendor’s UCC remedy is limited to return of the goods delivered to the

debtor, the prior version of § 546 provided an alternative—to deny reclamation by granting the seller an administrative claim or a secured claim, thereby allowing the debtor to continue to possess and use the goods otherwise subject to reclamation.<sup>2</sup>

At one time, the reclamation remedy was nearly untouchable. Once a trade creditor established a valid right to reclaim,<sup>3</sup> the creditor was entitled to either reclaim the goods or the bankruptcy court was *required* to give the creditor a lien or an administrative claim for the value of the goods sought to be reclaimed.<sup>4</sup> Over the 1990's, however, the reclamation remedy began to erode via a line of cases holding that §546(c) was designed only to *preserve* reclamation rights—not to enhance them. Consequently, bankruptcy courts began to look at reclamation claims more critically. Some courts held that the vendor's right to reclaim was extinguished by a secured creditor with liens on after-acquired inventory.<sup>5</sup> The majority position that grew out of these cases was that reclamation claims were subordinate to—rather than extinguished by—security interests in after-acquired inventory.<sup>6</sup> Although this line of cases did not *kill* reclamation altogether, they rendered it a fairly useless remedy—and far from the powerful remedy that it once was.

Reasoning that the reclamation remedy itself was “inventory-specific,” these courts held that §546(c)(2) did not empower them to grant a lien or administrative claim against *all* property of the estate but, instead, only allowed them to give a reclaiming vendor a lien or administrative claim *on the goods sought to be reclaimed* (or the traceable proceeds thereof). Under this line of cases, it was only when (i) the secured creditor released its lien on the goods sought to be reclaimed; or (ii) the reclaiming vendor's goods (or traceable proceeds therefrom) *exceeded* the amount of senior secured claims *in the goods sought to be reclaimed*, that the reclamation claim had value so as to entitle the vendor to an administrative claim or a lien.<sup>7</sup> Thus, the reclamation rights under the UCC became *subject to* the rights of a prior secured creditor with a lien on whatever the seller sought to reclaim. Consequently, the trade creditor's reclamation claim

---

<sup>2</sup> See, e.g. *In re Pester Refining Co.*, 964 F.2d 842, 845 (8<sup>th</sup> Cir. 1992).

<sup>3</sup> In order for a vendor to have the right to reclaim, Bankruptcy Code §546(c) requires the vendor to establish that (1) it has a statutory or common law right to reclaim the goods; (2) the goods were sold to the buyer on credit; (3) the goods were sold in the ordinary course of the seller's business; (4) the debtor was insolvent when the goods were received; (5) the vendor made a written demand for reclamation within the statutory time limit after the debtor received the goods; (6) the buyer was still in possession or control of the goods when the reclamation demand was made; and (7) the goods are identifiable as those sold to the debtor.

<sup>4</sup> See, e.g., *See, e.g., In re Marko Electronics, Inc.*, 145 B.R. 25, 29 (Bankr. N.D. Ohio 1992); *In re Sunstate Dairy and Food Products*, 145 B.R. 341, 346 (Bankr. N.D. Fla. 1992); *Diversified Food Service*, 130 B.R. 427, 430 (Bankr. S.D.N.Y. 1991); *In re Roberts*, 103 B.R. 396, 399 (Bankr. N.D.N.Y. 1988); *In re Bosler Supply Group*, 74 B.R. 250, 254-255 (N.D. Ill. 1987).

<sup>5</sup> See, e.g., *In re Lawrence Paperboard Corp.*, 52 B.R. 907, 911 (Bankr. D. Mass. 1985); *In re Shattuc Cable Corp.*, 138 B.R. 557, 563 (Bankr. N.D. Ill. 1992).

<sup>6</sup> See, e.g., *In re Pester*, 964 F.2d at 846; *In re Arlco*, 239 B.R. 261, 267 (Bankr. S.D.N.Y. 1999).

<sup>7</sup> See, e.g., *In re Pester*, 964 F.2d 842, 847 (8<sup>th</sup> Cir. 1992); *In re Houlihan's Restaurant, Inc.*, 286 B.R. 137, 140 (Bankr. W.D. Mo. 2002); *In re Arlco, Inc.*, 239 B. R. 261, 272 (Bankr. S.D.N.Y. 1999); *In re Steinberg's Inc.*, 226 B.R. 8,12 (Bankr. S.D. Ohio 1998).

became invalid or valueless when there was no equity in the item beyond the secured creditor's claim.

By the late 1990's, the case law had evolved in such a way to practically eviscerate the reclamation remedy. For example, *In re Arlco*, 239 B.R. 261 (Bankr. S.D.N.Y. 1999), held that reclamation rights evaporated when the debtor sold the inventory the vendor sought to reclaim and the sale proceeds were paid to the senior secured lender, who was deemed a "good faith purchaser" under UCC § 2-702(3). Cases like *Arlco* rendered the reclamation remedy so "toothless" that vendors often declined to even file a reclamation claim.

## REVISIONS TO RECLAMATION RIGHTS IN BAPCPA

BAPCPA gave trade creditors new hope for additional protection in bankruptcy by appearing to grant broader reclamation rights under the Bankruptcy Code. BAPCPA amended § 546(c) to read:

(c)(1) Except as provided in subsection (d) of this section and in section 507(c), and subject to the prior rights of a holder of a security interest in such goods or the proceeds thereof, the rights and powers of the trustee under sections 544(a), 545, 547 and 549 are subject to the right of a seller of goods that has sold goods to the debtor, in the ordinary course of such seller's business, to reclaim such goods if the debtor has received such goods while insolvent, within 45 days before the date of the commencement of a case under this title, but such seller may not reclaim such goods unless such seller demands in writing reclamation of such goods—

(A) not later than 45 days after the date of receipt of such goods by the debtor; or

(B) not later than 20 days after the date of commencement of the case, if the 45-day period expires after the commencement of the case.

(2) If a seller of goods fails to provide notice in the manner described in paragraph (1), the seller still may assert the rights contained in section 503(b)(9).

The BAPCPA revisions essentially made three changes. First, the reach-back period was extended from 10 days to 45 days. As a result, trade creditors have more time to reclaim their goods (and for a greater period of time) under the Bankruptcy Code than under state law. Thus, if a buyer filed for bankruptcy (or if involuntarily petitioned into bankruptcy within that period), the creditor's reclamation right extends to goods delivered up to 45 days beforehand. Second, the vendor's grace period was extended as well, giving the seller 20 days after a bankruptcy filing to deliver a reclamation notice. The seller is also given up to 20 days after the bankruptcy

filing to send its reclamation notice where the 45-day reclamation period expires after the bankruptcy filing. The effect of this change is to give a seller as many as 65 days after delivery of goods to a buyer (45 day reach-back plus 20 day period to deliver reclamation notice) to reclaim them. Finally, under § 503(b)(9) the seller is given an administrative claim equal to “the value of any goods received by the debtor within 20 days before [the date of the bankruptcy filing] in which the goods have been sold to the debtor in the ordinary course of such debtor’s business.” The effects of § 503(b)(9) are discussed in more detail below.

Initially, trade creditors applauded BAPCPA’s extension of the reclamation period from 10 days to 45 days. But while the revisions looked good on paper, they proved to be largely illusory. Indeed, the Bankruptcy Code, while extolling a trade creditor’s reclamation rights, now codified the case law that eviscerated many of Article 2’s reclamation rights to begin with, expressly stating that reclamation rights are “subject to prior rights of a secured creditor with a lien on the goods that the seller seeks to reclaim, or the proceeds thereof.”

Cases interpreting the BAPCPA modifications to the reclamation provisions have not been particularly helpful to reclaiming creditors. In *In re Advanced Marketing Services, Inc.*,<sup>8</sup> publisher Simon & Schuster (“S&S”) delivered over \$5.1 million worth of goods to the debtor within the 45-day reclamation period, which the publisher timely sought to reclaim after the buyer filed a bankruptcy petition. The bankruptcy court denied S&S’s request for a temporary restraining order, holding that S&S failed to prove that it was likely to succeed on the merits of its reclamation claim due to the priority of senior lenders’ liens on substantially all of the debtor’s assets, including inventory and the goods. The bankruptcy court held that “the senior lenders’ pre-petition and post-petition [cross-collateralized] liens on the debtors’ inventory are superior to [S&S’s] reclamation claim,” and because once the senior lenders’ liens were satisfied through the sale of inventory, S&S’s reclamation claim was likely to be worthless.

Similarly, in *In re Dana Corporation*,<sup>9</sup> the debtor challenged the reclamation claims filed by hundreds of sellers, arguing that such claims were subject to pre-existing liens on the goods sought to be reclaimed. Here, the debtor’s pre-petition inventory, including the goods sought to be reclaimed, was subject to the secured creditors’ pre-petition blanket lien. Under a Court-approved DIP financing agreement, the debtors were authorized to use the lenders’ pre-petition collateral, with a replacement lien in all pre- and post-petition collateral and proceeds. The pre-petition indebtedness was then refinanced and paid off using the proceeds of the new loan. In support of their reclamation rights, the vendors argued that their reclamation claims must be allowed because (i) their reclamation rights were not extinguished by the existence of a prior lien, but only rendered subordinate to the prior lien, and (ii) the “Pre-petition Lenders” were oversecured, and thus they should recover from any excess value. Not surprisingly, the court ruled in favor of the debtor, holding that the reclaimed goods were either liquidated in satisfaction of the pre-petition indebtedness or were pledged as collateral for the DIP loan. In either event, the reclaimed goods were effectively disposed of, rendering the reclamation claim valueless.

---

<sup>8</sup> 360 B.R. 421 (Bankr. D. Del. 2007).

<sup>9</sup> 367 B.R. 409 (Bankr. S.D.N.Y. 2007).

## ADMINISTRATIVE EXPENSES UNDER § 503(B)(9)

Perhaps because new §546(c) provides little benefit, trade creditors were especially delighted to see the addition of 11 U.S.C. §503(b)(9) to BAPCPA. Section 503(b)(9) provides:

After notice and a hearing, there shall be allowed administrative expenses, other than claims allowed under section 502(f) of this title, including ... the value of any goods received by the debtor within 20 days before the date of commencement of a case under this title in which the goods have been sold to the debtor in the ordinary course of such debtor's business.

Section 503(b)(9) is important because it applies to *all* sellers, irrespective of whether the seller delivers a reclamation demand. In fact, § 503(b)(9) was intended to “provid[e] relief to sellers of goods who fail to give the required notice under the reclamation provision of section 546(c).”<sup>10</sup> Section 503(b)(9) even applies if the goods are no longer in the possession of the debtor or are not identifiable. It applies even if the reclamation claim under § 546(c) is determined to be valueless.<sup>11</sup> The §503(b)(9) claim is high on the bankruptcy priority ladder; indeed, it enjoys the same payment priority as do the debtor's professionals.<sup>12</sup>

As with the changes to § 546(c), the actual application of §503(b)(9) has dampened trade creditors' enthusiasm. The first hurdle is that administrative claims are not procedurally automatic, and there can be significant cost to exercising the right to pursue an administrative claim when a trade creditor must file and prosecute an application for allowance and payment of an administrative claim. Moreover, if challenged, the parties may need to conduct discovery to determine the value of goods received by the debtor within 20 days of the bankruptcy filing and a trial may be ordered to fix the value of the trade creditor's claim. This is a rude awakening to creditors who don't want to have to retain counsel (often in a distant jurisdiction) to litigate to get the administrative priority claim BAPCPA promised them.

---

<sup>10</sup> *In re Brown & Cole Stores, LLC*, 375 B.R. 873, 875 n.3 (9th Cir. BAP 2007).

<sup>11</sup> *Id.*, 375 B.R. at 878 n.7; *In re Dana Corp.*, 367 B.R. 409 (Bankr. S.D.N.Y. 2007).

<sup>12</sup> 11 U.S.C. § 507(a)(2).

## DELIVERING THE GOODS: *PHAR-MOR, INC. V. MCKESSON CORP.*

On July 17, 2008, after twenty years of trade creditors bemoaning the diminution of their reclamation remedies and the not-so-substantial improvements through BAPCPA, the Sixth Circuit Court of Appeals gave trade creditors something to smile about when it issued its opinion in *Phar-Mor, Inc. v. McKesson Corporation*.<sup>13</sup> In *Phar-Mor*, the Sixth Circuit rejected and *refused* to follow the long line of cases that had rendered the pre-BAPCPA reclamation remedy a valueless one.

In *Phar-Mor*, the issue was whether the vendor's reclamation claim was extinguished when the goods sought to be reclaimed were sold and the proceeds were paid to satisfy a secured creditor's superior claim. When Phar-Mor filed for Chapter 11 protection, it owed its secured creditors \$103 million. With bankruptcy court approval, Phar-Mor borrowed \$135 million to pay its pre-petition secured creditors and gave its post-petition lenders post-petition security interests and super-priority status. Phar-Mor's assets were eventually liquidated and generated enough money so that Phar-Mor was able to repay the \$135 million in post-petition secured debt, with \$64.5 million left over. After attorneys' fees and the amount allotted to reclamation claims, Phar-Mor would have approximately \$30 million to distribute against the \$185.5 million in general unsecured claims. Apparently, there were 141 vendors who filed reclamation claims totaling \$18 million. McKesson was the only trade creditor who did not settle its reclamation claims.

Phar-Mor filed a motion to reclassify McKesson's reclamation claims as general unsecured claims, arguing that reclamation claims were *extinguished* when the inventory sought to be reclaimed was sold, and the sale proceeds were paid to the post-petition lender. The bankruptcy court denied Phar-Mor's motion, holding that even though the reclamation claims were "subject to" the claims of the post-petition lender, they still had administrative expense priority over general unsecured claims. After the bankruptcy court denied Phar-Mor's *two* motions for reconsideration, Phar-Mor appealed to the district court. The district court affirmed the bankruptcy court, and Phar-Mor appealed to the Sixth Circuit Court of Appeals.

On appeal Phar-Mor argued that McKesson had no right to reclaim, because McKesson did not have the *ability* to reclaim inasmuch as the Ohio version of the reclamation statute provided that the right to reclaim was subject to the rights of a "buyer in the ordinary course or other good faith purchaser or lien creditor." Phar-Mor argued that McKesson's right to reclaim was eliminated once the inventory was sold and the proceeds thereof were paid to the secured creditor. In other words, Phar-Mor made the very arguments that the bankruptcy court for the Southern District of New York adopted in *In re Arlco*, 239 B.R. 261 (S.D.N.Y. 1999).

However, unlike the *Arlco* Court, the Sixth Circuit *affirmed* both lower courts, and expressly declined to follow *Arlco* and the line of cases that had gutted the reclamation remedy (including the Sixth Circuit's *Pittsburgh-Canfield Corp.*, 309 B.R. 277, 287 (B.A.P. 6th Cir. 2004)).<sup>14</sup> Throughout its opinion, the Sixth Circuit emphasized the purpose of the reclamation

---

<sup>13</sup> 534 F.3d 502 (6<sup>th</sup> Cir. 2008).

<sup>14</sup> In declining to follow an opinion of the Bankruptcy Appellate Panel in its *own* circuit, the Sixth Circuit expressly held that decisions by the Bankruptcy Appellate Panel are not binding on the circuit court, and relied on *Weber v.*

remedy was to give rights to a “defrauded seller”—namely the vendor who discovered that it recently delivered goods to an insolvent buyer who purchased goods on credit. In *Phar-Mor* the Sixth Circuit cites cases from “reclamation’s golden era” when love was freer and platform shoes were taller—e.g. *In re Mel Golde Shoes, Inc.*, 403 F. 2d 658, 651 (6<sup>th</sup> Cir. 1968), and *In re American Food Purveyors, Inc.*, 17 UCC Rep. Serv. 436, 1974 WL 21665 (Bankr. N.D. Ga. 1974), both of which reasoned that any goods that were properly subject to state law reclamation rights remained the **vendor’s** property and never became the debtor’s property, so the secured creditor’s claim could not attach to the properly reclaimed goods. These cases viewed the debtor as essentially holding the reclaimed goods “in trust” for the reclaiming vendor.

*Phar-Mor’s* holding that the reclamation claims have administrative priority (and should *not* be reclassified as general unsecured claims) was based upon two findings:

We find that Ohio Rev. Code § 1302.76(B) (UCC 2-207(2)) [sic] grants a properly reclaiming vendor, such as McKesson, a right to reclaim its goods and that § 1302.76(C) (UCC 2-207(3)) [sic] does not allow a secured creditor’s claim to defeat that right. *But, correspondingly*, we find that 11 U.S.C. §546(c)(2)(1998) grants the bankruptcy court the power to deny a properly reclaiming vendor, such as McKesson, its right to reclaim the goods, but only by granting the denied vendor either an administrative-expense priority in the amount of the goods or a lien on the proceeds resulting from the use of those goods by the debtor. In this case, the bankruptcy court granted McKesson an administrative-expense priority, and we have no basis to overturn its decision in this matter.

While *Phar-Mor* dealt with the UCC’s narrower reclamation period, and the Sixth Circuit’s holding is based upon the language in the pre-BAPCPA version of § 546(c) that *required* the bankruptcy court to grant the properly reclaiming vendor either a lien or an administrative claim if the right to reclaim is denied, the decision focuses on the *intent* behind the reclamation remedy itself. The Court’s approving references to cases from the 1960’s and 1970’s<sup>15</sup> (which were decided when the reclamation remedy was a bit more sacrosanct) in support of its *refusal* to reclassify the reclamation claims to that of general unsecured status, coupled with the Court’s refusal to follow the recent decision of the Bankruptcy Appellate Panel in its own circuit, conveyed the Court’s disapproval of the erosion of the reclamation remedy.

---

U.S., 484 F.3d 154, 158 (2d Cir. 2007) and *In re Healthcentral.com*, 504 F.3d 775, 784 n.3 (9th Cir. 2007) in reaching its conclusion.

<sup>15</sup> E.g., *In re Mel Golde Shoes, Inc.*, 403 F. 2d 658, 651 (6<sup>th</sup> Cir. 1968), *In re American Food Purveyors*, 17 U.C.C. Rep. Serv. 436, 1974 WL 21665 (Bankr. N.D. Ga. 1974), and *In re Federal’s Inc.*, 553 F.2d 509, 518 (6th Cir. 1977).

## APPLICATION OF *PHAR-MOR* TO ADMINISTRATIVE CLAIMS UNDER § 503(b)(9)

Despite BAPCPA having created §503(b)(9) nearly three years prior to the decision in *Phar-Mor*, the Sixth Circuit does not mention the §503(b)(9) remedy at all. The absence of any discussion, however, should not prevent its application to §503(b)(9) claims. Indeed, the Sixth Circuit reinforced the purpose of the reclamation remedy, which is to protect creditors from the debtor who continues to purchase goods on credit knowing the debtor does not have the money to pay for the goods. Like the reclamation remedy, §503(b)(9) is also designed to protect creditors who sell to a debtor on credit during the 20 days before the debtor files a bankruptcy petition. Therefore, if the Sixth Circuit is as determined to protect reclamation creditors as it appeared to be in *Phar-Mor*—it did, after all, reject two decades worth of precedent to do so—then it, and other courts following its reasoning, are not likely to let debtors erode the newly created rights of § 503(b)(9).

### FURTHER ROADBLOCKS TO PRESERVING A VENDOR'S § 503(b)(9) RIGHTS

The administrative expense claim for vendors created by § 503(b)(9) is unique for a couple of reasons. Among the nine categories of expenses entitled to priority under § 503(b), only a few, including § 503(b)(9), afford that priority to claims that arise pre-petition.<sup>16</sup> What's more, among the allowed administrative expense claims that arise pre-petition, § 503(b)(9) claims have the potential to be far more common and constitute much higher dollar value claims, as many businesses order and receive large inventories of supplies mere days before they are to be put to use. Consequently, parties to bankruptcy cases whose interests are not in line with the § 503(b)(9) claimants stand to improve their own fates considerably by defeating the administrative expense priority created by § 503(b)(9). However, the recently decided *In re Plastech Engineered Products, Inc.*, 394 B.R. 147 (Bankr. E.D. Mich. 2008), stands as a cautionary tale for those who would use § 502(d) in the hopes of defeating § 503(b)(9) claims.

In *Plastech*, the debtor, Plastech, filed for Chapter 11 protection. Plastech made plastic products for the automotive industry, and it often received its raw materials from suppliers “just in time” to make its products and get them delivered. Due to the “just in time” nature of its business, Plastech’s creditors filed \$26 million in § 503(b)(9) claims; Plastech, however, had only reserved approximately \$17 million to cover those claims under its Joint Plan of Liquidation filed with the court. In an effort to defeat its suppliers’ § 503(b)(9) claims, Plastech cited § 502(d), arguing that all § 503(b)(9) claims should be disallowed, since any creditor asserting a § 503(b)(9) claim might be subject to a preference action.<sup>17</sup>

---

<sup>16</sup> Other categories include the expenses incurred by a petitioning creditor that files an involuntary bankruptcy petition against a debtor, and reasonable compensation for professional services rendered to a petitioning debtor, such as those of an attorney or accountant.

<sup>17</sup> Section 502(d) provides that, notwithstanding subsections (a) and (b) of § 502, the court shall disallow any claim of an entity from whom property is recoverable under certain avoidance actions. The claims included in § 502 include pre-petition claims and certain post-petition claims that are treated as pre-petition claims. Section 502(d) is frequently asserted as a basis in preference complaints to bar payment of a general unsecured claim until the preference case is resolved.

Citing numerous bankruptcy court decisions holding that § 502(d) cannot operate as a bar to recovery of § 503(b) administrative expenses, the court rejected Plastech's arguments and, in so doing, rejected the reasoning of a 2002 Ninth Circuit BAP opinion which explained that, since § 502(d) did not provide an express exception for § 503(b) administrative expenses, the proper construction of that section places § 503(b) administrative expenses within the purview of § 502(d).<sup>18</sup> Counsel for one of the § 503(b)(9) claimants<sup>19</sup> in *Plastech* even used *Phar-Mor* to make its point: Since *Phar-Mor* clearly evinces the Sixth Circuit's intention to restore vendors to their rightful place at the front of the recovery line, allowing § 502(d) to stand as a bar to administrative expense recovery under § 503(b)(9) would be to ignore the clear message set out in *Phar-Mor*.

## CONCLUSION

With its decision in *Phar-Mor*, at least in the Sixth Circuit, the Circuit not only restored the rights of vendors to recover from debtors with whom they had dealt immediately preceding the bankruptcy filing, but also went out of its way to explain why it was important to protect vendors in this way. BAPCPA's expansion of the reclamation right, and its addition of the administrative expense claim under § 503(b)(9), would seem also to be affirmative steps in the direction of restoring vendors' rights to a place of prominence among creditors in a Chapter 11 case. Further, the overwhelming approach to the Code is to permit state law created property rights to be exercisable, in large part, in bankruptcy. Bankruptcy ought not be a tool to gut otherwise valid state law rights. How debtors, other creditors, and courts will respond to the not-so-subtle message that *Phar-Mor* and BAPCPA send, however, remains to be seen. And, as they say in the recently adopted hometown of our newly elected President, Reclaim Early, and Reclaim Often.

---

<sup>18</sup> *MicroAge, Inc. v. Viewsonic Corp.*, 291 B.R. 503 (9<sup>th</sup> Cir. BAP 2002).

<sup>19</sup> One of this paper's co-authors, Lisa Gretchko, participated in the *Plastech* case and is the counsel referred to here.