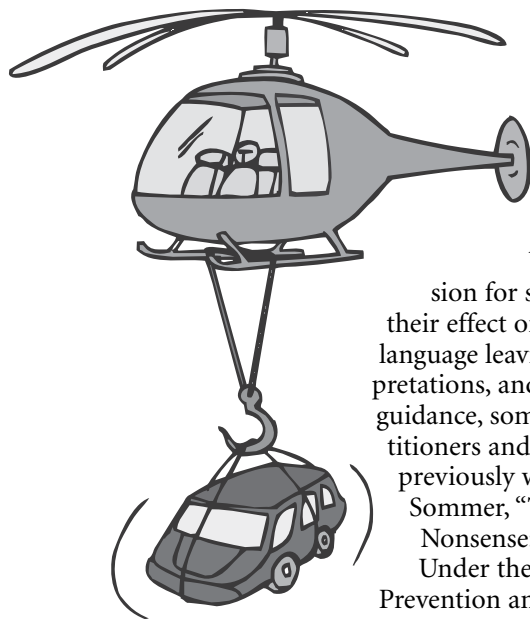


# BAPCPA changes

## A federal right of reclamation?



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Revisions made to the Bankruptcy Code through the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA), effective Oct. 17, 2005,

brought with them an occasion for scholarly debate regarding their effect on various code sections. With language leaving room for differing interpretations, and little legislative history for guidance, some revisions are causing practitioners and scholars to question what is previously well-settled law. See Henry J. Sommer, "Trying to Makes Sense out of Nonsense: Representing Consumers Under the 'Bankruptcy Abuse

Prevention and Consumer Protection Act of 2005," 79 Am. BANKR. L.J. 191, 193 (2005), and Hon. Keith M. Lundin, "Ten Principles of BAPCPA: Not What was Advertised," 24 Am. Bankr. Inst. J. 1, 70 (2005).

This article focuses on the revision made to 11 U.S.C. §546(c), dealing with a seller's reclamation rights. While the language has changed, the revised §546(c) does not provide a new federal right to reclamation: A seller asserting a right to reclamation in a bankruptcy case still has to prove that right under state law.

### Pre- and post-BAPCPA versions

Section 546 of the Bankruptcy Code contains limitations on the trustee's avoiding powers. Avoiding powers give the trustee the ability to undo certain transactions that may have the effect of benefiting one creditor over another and disturbing the bankruptcy goal

of equality of distribution among creditors. Under §546(c), if a seller can prove a right to reclamation, the trustee cannot use her avoiding powers to defeat that right. The recent revision to §546(c) has led some to question whether the Bankruptcy Code now gives a seller an absolute, federally created right to reclaim, or whether that right still derives from, and has to be proven under, state law. See *In re Tucker*, 329 B.R. 291 at n.8 (Bankr. D.Ariz. 2005) where, in a case decided under pre-BAPCPA law, the court questions the impact revisions to §546(c) might have on cases decided under the new law.

Prior to the enactment of BAPCPA, §546(c) read as follows:

Except as provided in subsection (d) of this section, the rights and powers of a trustee under sections 544(a), 545, 547, and 549 of this title 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 — (1) such a seller may not reclaim any such goods unless such seller demands in writing reclamation of such goods — before 10 days after receipt of such goods by the debtor; or if such 10-day period expires after the commencement of the case, before 20 days after receipt of such goods by the debtor; and (2) 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; or

(B) secures such claim by a lien. 11 U.S.C. §546(c) (2000). The current Section 546(c) reads:

(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 a 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).

11 U.S.C. §546(c) (2005).

Pre-amendment, Section 546(c) was understood as "the sole remedy for a creditor who seeks reclamation from a bankrupt debtor." See *In re Primary Health Systems, Inc.*, 258 B.R. 111, 114 (Bankr. D.Del. 2001). Prior to the effective date of BAPCPA, §546(c) provided that a trustee's avoidance powers were subject to "any statutory or common-law right of a seller of goods ... to reclaim." When originally enacted, this section was intended "to recognize, in part, the validity of section 2-702 of the Uniform Commercial Code." See *In re Affiliated of Florida, Inc.*, 237 B.R. 495 (Bankr. M.D.Fla. 1998), where the court quoted from Notes of the Committee on the Judiciary, Senate Report No. 95-989.

At common law, a seller had a right to reclaim only by proving that the buyer misrepresented its solvency in order to fraudulently induce the seller to deliver goods. *In re Pester Refining Co.*, 964 F.2d 842, 844 (8th Cir.1992). The Uniform Commercial Code (UCC) provided a statutory right to reclamation in Section 2-702, in some instances eliminating the requirement the seller prove fraudulent inducement. New Jersey has adopted its own version of the UCC, including Section 2-702. N.J.S.A. 12A:2-702. In interpreting the Code pre-amendment, courts recognized that "§546(c) does not create an independent right to reclamation ... it merely recognizes that such a right exists to a limited degree in a bankruptcy case, provided that such a right exists either under common law or under state statute." *In re Zeta Consumer Products Corp.*, 291 B.R. 336, 350 (Bankr. D.N.J. 2003).

The new version of §546(c) deletes the reference to "statutory or common-law" reclamation rights and instead states that the trustee's avoidance powers are subject to "the right of a seller of goods ... to reclaim." Some argue this change evidences the creation of a right to reclamation, independent of state law rights. Additionally, under pre-BAPCPA law, the bankruptcy court clearly had the right to grant administrative priority or a lien as a substitute to a seller's right of reclamation, as provided for in §546(c)(2). Therefore, it may be argued that the deletion of these alternate remedies suggests

a seller has an absolute right to a return of its goods if it makes a timely reclamation demand.

Despite these changes, revised §546(c) should not be read as giving a seller an absolute right to reclamation, but rather as referring to the fact that a seller must establish a right to reclamation pursuant to state law, and provided such right is established, the trustee's strong arm powers will be curtailed by that right. The suggestion that BAPCPA creates an absolute, federal right to reclamation must fail. §546(c) is a limitation on a trustee's avoiding powers where a seller has a right to reclamation under state law, it is not a section dedicated to the granting of an independent federal right of reclamation to sellers.

## Rules of statutory construction

Rules of statutory construction guide the interpretation of provisions of the Bankruptcy Code. See *In re Allied Digital Technologies Corp.*, 341 B.R. 171, 173 (Bankr. D.Del. 2006), citing *In re Price*, 370 F.3d 362, 368-70 (3d Cir.2004) which set forth the statutory construction approach to Bankruptcy Code.

The first rule of statutory construction is to "begin with the text of [the] provision and, if its meaning is clear, end there." *In re Allied Digital*, at 173, quoting *Hartford Underwriters Ins. Co. v. Union Planners Bank, N.A.*, 530 U.S. 1, 6, 120 S.Ct. 1942, 147 L.Ed.2d 1 (2000). The District Court of Delaware recently discussed the 3rd Circuit rules of statutory construction in analyzing §546(a) of the Code:

"[w]hether or not statutory language is plain or ambiguous 'is determined by reference to the language itself, the specific context in which that language is used, and the broader context of the statute as a whole.' A provision can be considered ambiguous only 'when, despite a studied examination of the statutory context, the natural reading of a provision remains elusive.' That is not to say that a provision of the Bankruptcy Code should be read in isolation. On the contrary, 'in interpreting the Bankruptcy Code, the Supreme Court has ... prefer[red] instead to take a broader, contextual view.' Nevertheless, the focus must be on the language of the statutory scheme. The court may only look to 'policy, pre-[Bankruptcy] Code practice, and legislative history' for guidance when 'the meaning of a provision is not plain.' *In re Allied Digital*

The meaning of §546(c)(1) is not plain on its face. The new reference to "the right of a seller of goods" does not make clear whether the statute is creating a new, independent, federal right to reclamation or acknowledging the well-settled, pre-amendment reference to a state-defined statutory or common law right to reclamation. Furthermore, it is not clear if the addition of the language "subject to the prior rights of a holder of a security interest in such goods or the proceeds thereof" is a substitute for the deleted language, "any statutory or common law" right. At the very least, the addition of this language affirms well-settled case law that prior security interests in reclamation goods trumps the right reclaiming sellers might have to those goods. See *In re Pester Refining Co.*, 964 F.2d 842 (8th Cir. 1992).

A second rule of statutory construction used in analyzing an amendment to a code section is that "no changes in law or policy are to be presumed from changes in language in [a statutory] revision unless an intent to make such changes is

clearly expressed.” *In re Peter DelGrande Corp.*, 138 B.R. 458, 460-61 (Bankr. D.N.J. 1992); quoting *Finley v. U.S.*, 490 U.S. 545, 109 S.Ct. 2003, 104 L.Ed.2d 593 (1989). “This rule — one which bars a court from construing a statute to have abrogated the common law, or to have established a new rule of law, without clear evidence in favor of such a construction — is firmly and sensibly entrenched in federal jurisprudence.” *In re Mark Anthony Const.*, 886 F.2d 1101, 1107 (9th Cir.1989). In enacting BAPCPA, there is no evidence that Congress expressed an intention to create a new rule that would give reclaiming sellers an absolute federal right to reclamation that would not exist outside of the bankruptcy context. Congress did not evidence an intention to overrule the Supreme Court holding in *Butner v. United States*, that “Congress has generally left the determination of property rights in assets of a bankrupt’s estate to state law.” 440 U.S. 48, 99 S.Ct. 914, 59 L.Ed.2d 136 (1979) “Property interest are defined by state law. Unless some federal interest requires a different result, there is no reason why such interest should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding.”

## What the revisions don’t change

Based on the rules of statutory construction and on a fair reading of the revised code, §546(c) remains primarily as an exception to the trustee’s strong arm powers, if the seller has a right of reclamation under state law. *In re Primary Health*, 258 B.R. at 114. It does not create an independent right of reclamation. Pre-amendment cases, to the extent that they interpret the intent of §546(c) generally, remain applicable.

Accordingly, if a reclaiming seller meets the statutory requirements of notice provided in Bankruptcy Code §546(c), it must then be determined if there are prior security interests that would prevent the seller from return of the goods. As provided by statute: “[t]he seller’s right to reclaim ... is subject to the rights of a buyer in the ordinary course or other good faith purchaser...” N.J.S.A. 12A:2-702(3). The term “purchaser” is broad and includes those taking by “mortgage, pledge, lien, security interest, issue or reissue, gift or any other voluntary transaction creating an interest in property.” A creditor with a prior perfected security interest in inventory which contains an after acquired property clause, i.e. a “floating lien,” also is a good faith purchaser. *In re Primary Health*, 258 B.R. at 114.

In view of that, secured creditors, with a security interest in the goods sought to be reclaimed, would come ahead of the interest of the reclaiming seller, and the reclaiming seller’s interest would come ahead of general unsecured creditors. Therefore, if an interest of a secured creditor is released or satisfied by less than all of the goods sought by reclamation, “the reclaiming seller retains a priority interest in any remaining goods, and in surplus proceeds from the secured creditors’ foreclosure sale.” *In re Pester*, 964 F.2d at 846. But where the goods to be reclaimed are exhausted by the rights of the secured creditors, the reclaiming seller does not get a priority interest in any other asset of the debtor at the expense of general unsecured creditors of the debtor. This rule has not changed with the revisions to §546(c). There is no independent federal right to reclamation that would trump this well-settled case law.



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## What the revisions do change

Under 11 U.S.C. §546(c), as amended by BAPCPA, where no pre-existing liens on inventory exist, and where a seller takes all steps necessary to enforce its reclamation claim, the seller’s sole remedy is a return of the goods. The alternative remedies available to reclaiming sellers under the old §546(c) — a replacement lien in the debtor’s assets and/or an allowed administrative priority claim in the amount of the reclamation claim — have been deleted from §546(c).

Concededly, the positions of reclaiming sellers in a bankruptcy case have been improved. Provided a right to reclamation can be established, §546(c)(1) increased the amount of time for sellers to give notice of that right to reclaim from 10 days to 45 days after the debtor receives the goods. If bankruptcy is filed in that 45-day period, the seller has 20 days after filing to give notice and preserve the reclamation claim. This change “could significantly limit the extent of unencumbered assets in a bankruptcy case.” Samuel K. Crocker & Robert H. Waldschmidt, “Impact of the 2005 Bankruptcy Amendments on Chapter 7 Trustees,” 79 Am. Bankr. L.J. 333 (2005). It also gives reclaiming sellers an opportunity to improve their position over general unsecured creditors.

Additionally, if the seller fails to provide the requisite notice, the seller can still receive an administrative expense claim under the new §503(b)(9). This certainly will diminish funds available to pay general unsecured creditors. Debtors will be further affected as administrative expense claims must be paid in full prior to confirmation of a plan. Richard Levin & Alesia Ranney-Marinelli, “The Creeping Repeal of Chapter 11: The Significant Business Provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005,” 79 Am. Bankr. L.J. 603 (2005).

## Conclusion

Despite the additions and deletions to §546(c) under the newly enacted BAPCPA, the rules of statutory construction and a fair reading of the code section support the contention that no independent federal right to reclamation has been granted. As no case law to date has considered the impact of the revisions to this section, we wait for a judicial determination to confirm that reclaiming seller must still prove a state law right to reclaim. ☺