

## Lenders' Pre and Post-Petition Liens Trump Vendor's Reclamation Rights Under the Amended Bankruptcy Code

On January 22, 2007, the Delaware Bankruptcy Court issued a written opinion denying publisher Simon & Schuster's request for a temporary restraining order prohibiting book distributor and chapter 11 debtor Advanced Marketing Services, Inc. ("AMS") from selling goods received from the publisher in the 45 days prior to the bankruptcy filing. This decision, which may be appealed, appears to be the first opinion interpreting section 546(c) of the Bankruptcy Code, as amended by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA").

Prior to the enactment of the BAPCPA, the Bankruptcy Code required a reclamation claim to be based on a "statutory or common-law right," and allowed courts to deny a creditor's right to reclaim goods if the creditor received a replacement lien or an administrative claim. BAPCPA replaced the reference to "any statutory or common-law" reclamation right with a bankruptcy specific right of reclamation, and eliminated the language that specifically authorized the court to substitute a creditor's reclamation right with a lien or an administrative claim. These changes appeared to provide sellers an absolute right to reclaim goods received by the

debtor in the 45 days prior to the bankruptcy filing. While BAPCPA also codified existing case law by rendering reclamation rights "subject to the prior rights of a holder of a security interest" in the subject goods, many bankruptcy practitioners thought the new law enhanced reclamation rights.

In *Simon & Schuster v. AMS*, the Court determined that Simon & Schuster's right to reclaim goods delivered to AMS in the 45 days prior to the bankruptcy filing was subordinate to the liens of AMS' lenders. The lenders provided pre-petition financing to AMS secured, in part, by goods subject to Simon & Schuster's reclamation claim, and AMS obtained interim approval of post-petition financing secured by both post-petition liens and the existing pre-petition liens on the same goods. According to the Court, "the prior rights of a holder of a security interest" included both the pre-petition and post-petition liens. Moreover, the Court deemed it irrelevant that the lenders would be paid in full even if the subject goods are reclaimed. In reaching this conclusion, the Court extended the interpretation of "prior rights" to all debt, including debt that arises post-petition, regardless of amount, provided such debt is secured by a pre-

petition lien. Because the lenders' rights to the goods were unequivocally "superior" to Simon & Schuster's reclamation claim, the Court described the publisher's claim as "worthless." Apparently, Simon & Schuster is still entitled to assert a general unsecured claim for the value of the goods.

As a practical matter, the majority of chapter 11 cases involve debtors with at least some debt secured by pre-petition liens on inventory that subsequently become security for additional post-petition debt. If other jurisdictions follow this decision, reclamation rights for goods delivered in the 45 days prior to the bankruptcy filing will be virtually eliminated. As such, suppliers of goods to troubled companies may want to consider other remedies rather than rely on reclamation rights.

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