

Insights

Seventh Circuit Confirms that the Bankruptcy Code Expressly Subordinates a Seller's Reclamation Claim to the Prior Rights of a Secured Creditor

February 19, 2020

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In *Whirlpool Corp. v. Wells Fargo Bank, National Association (In re hhgregg, Inc.)*, (7th Cir. Feb. 11, 2020), the United States Court of Appeals for the Seventh Circuit held that the current enactment of the United States Bankruptcy Code (the "Bankruptcy Code"), specifically 11 U.S.C. §546(c), expressly subordinates a seller's reclamation claim to the prior rights of a lienholder. This is good news for secured lenders.

Whirlpool arises out of the hhgregg chapter 11 bankruptcy case pending in Indianapolis, IN. As noted by the Seventh Circuit, hhgregg, Inc. (the "Debtor"), was an appliance retailer. Whirlpool Corporation ("Whirlpool"), one of the Debtor's longtime suppliers, delivered appliances to the Debtor during the period immediately preceding the Debtor's March 6, 2017 bankruptcy filing. Wells Fargo Bank, as administrative agent for several lenders (collectively, the "Secured Lender"), extended operating financing to the Debtor in the years prior to the bankruptcy. Under the Secured Lender's pre-bankruptcy credit agreement, the Secured Lender's advances were secured by a first-priority Uniform Commercial Code ("UCC") Revised Article 9 floating lien on nearly all of the Debtor's assets, including the Debtor's existing and after-acquired inventory and its proceeds.

As part of the so-called "first day orders" sought by the Debtor after filing its chapter 11 case, the Debtor sought the bankruptcy court's approval for \$80 million in post-bankruptcy financing, with the Secured Lender now acting as administrative agent for a group of post-bankruptcy lenders. The post-bankruptcy financing agreement authorized what the Seventh Circuit described as a "creeping roll-up" of the Secured Lender's pre-bankruptcy debt, and gave the Secured Lender a priming, first-priority floating lien on substantially all of the Debtor's assets, including existing and after-acquired inventory and its proceeds. The bankruptcy court immediately approved this post-bankruptcy financing arrangement.

Three days later, Whirlpool sent a reclamation demand to the Debtor, seeking the return of appliances Whirlpool had delivered to the Debtor during the 45-day period before the Debtor filed its bankruptcy petition. As noted by the Seventh Circuit, "[r]eclamation is a limited *in rem* remedy that permits a seller to recover possession of goods delivered to an insolvent purchaser — subject, however, to significant temporal, procedural, and substantive restrictions." The right of reclamation appears in Article 2 of the UCC — not Article 9 — and is codified at UCC §2-702. Within a bankruptcy case, a reclamation claim is governed by 11 U.S.C. § 546(c).

Whirlpool raised various equitable arguments as to why its reclamation claim should prevail over the Secured Lender's secured claim. Rejecting these arguments, the Seventh Circuit held that by operation of the Bankruptcy Code, specifically 11 U.S.C. §546(c), Whirlpool's later-in-time reclamation demand is "subject to" the Secured Lender's prior rights as a secured creditor, so that Whirlpool's reclamation claim is subordinate to the Secured Lender's post-bankruptcy financing lien. Put another way, the Seventh Circuit held that 11 U.S.C. §546(c) "explicitly renders an otherwise valid reclamation claim under state law subordinate to a secured creditor's prior lien rights." The Seventh Circuit emphasized that Congress' 2005 revision of §546(c) constituted the "adoption of a federal priority rule for resolving disputes between reclaiming sellers and secured lenders over the same goods", which "means as a practical matter . . . that 'if the value of any given reclaiming supplier's goods does not exceed the amount of debt secured by the prior lien, that reclamation claim is valueless.'" Thus, the proverbial "bottom line" for the Seventh Circuit was that the current enactment of §546(c) of the Bankruptcy Code "expressly subordinates a seller's reclamation claim to the prior rights of a lienholder."

Takeaways: *Whirlpool* emphasizes how being a properly-perfected secured creditor protects the secured lender should its borrower later file bankruptcy, especially where the borrower is a retailer of goods.

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