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Before the House Judiciary Subcommittee on Commercial and Administrative Law

CIRCUIT CITY UNPLUGGED: WHY DID CHAPTER 11 FAIL TO SAVE 34,000 JOBS?

March 11, 2009

I. INTRODUCTION

Mr. Chairman and members of the Subcommittee, my name is Jack Williams. I am a Professor of Law at Georgia State University College of Law in Atlanta, Georgia, and currently the Robert M. Zinman Resident Scholar at the American Bankruptcy Institute (ABI). I am also a Managing Director in the Business Restructuring Group of BDO Consulting, a division of BDO Seidman, LLP. In that capacity, I provide financial advisory services to both debtors and official creditors committees in a broad range of retail bankruptcy cases. I am pleased to appear today to speak about bankruptcy law and the retail sector.

Founded on Capitol Hill in 1982, the ABI is a non-partisan, non-profit association of over 12,000 professionals involved in bankruptcy and insolvency, representing both debtors and creditors in consumer and business cases. The ABI is not an advocacy group and does not take lobbying positions on legislation before Congress or advocate any particular result in matters pending before the courts. Rather, the ABI is a neutral source for information about the bankruptcy system (such as how courts are interpreting provisions of the Bankruptcy Code) and a resource for members of Congress and their staff considering changes to the Code. As an academic, and as the ABI resident scholar, I am permitted to give my personal views on legislation, but those views should not be taken as the views of the ABI.

At Georgia State, I teach and write primarily in the areas of bankruptcy law (including business and consumer bankruptcies), commercial law, and taxation. My biography is attached to this written statement, but let me briefly say that after graduating from George Washington University Law School, clerking for Judge William J. Holloway, Jr., of the U.S Court of Appeals for the Tenth Circuit, and working for four years in the Dallas, Texas office of Hughes and Luce, I joined the faculty of Georgia State University College of Law, where I have taught for the past eighteen years. For the time period January 2008 to present, I am serving as the Resident Scholar at the ABI offices in Alexandria, Virginia.

Today's subject is not new to me; for over twenty years I have devoted time as an academic to the study of retail sector bankruptcies and have served as legal counsel or financial advisor to retail debtors, creditors committees, and secured creditors in retail bankruptcy cases. Most recently, as the ABI Resident Scholar, I am undertaking research and writing on retail bankruptcies.

The title of today's hearing is intriguing: *Circuit City Unplugged: Why Did Chapter 11 Fail To Save 34,000 Jobs?* Of course, Chapter 11 failed no one. If anything, recent amendments to chapter 11 of the Bankruptcy Code have failed to serve the law's original purposes and policy goals.

A major thrust of the drafters of chapter 11 of the Bankruptcy Reform Act of 1978 was to develop a flexible, adaptive, and transparent system that was business-plan agnostic. Our original chapter 11 design permitted a debtor a broad range of discretion, consistent with the exercise of sound business judgment and the best interests of the estate, to develop a business plan with the greatest chance of success. This system rested on a number of provisions in the Bankruptcy Code, including the stay of any creditor action against the debtor or property of the estate, relief from the payment of prepetition claims, a high priority in payment for those entities that deal with the debtor postpetition, the ability of the debtor to remain in possession of property of the estate, the ability of the debtor to continue to operate the business in the ordinary course without court approval, the ability of the debtor to incur debt postpetition, the exclusive right of the debtor to propose and confirm a plan of reorganization, and the discretion to either reject or assume (and assign) unexpired leases and executory contracts. The drafters infused discretion throughout the process with both the debtor, in the first instance, and the bankruptcy court. They recognized that famously, bankruptcy is a flexible process. Thus, the actual structure of the business plan was driven by the financial facts and circumstances on the ground and the sensibilities of the stakeholders, rather than any particular provision or combination of provisions found in the Bankruptcy Code. This is no longer the case.

II. BAPCPA CHANGES TO BANKRUPTCY CODE RELEVANT TO RETAIL CASES

On April 20, 2005, former President George W. Bush signed into law Senate bill number 256, the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA). BAPCPA is the most substantial revision of bankruptcy law since enactment of the Bankruptcy Reform Act of 1978. More specifically, BAPCPA dramatically changed several aspects of business bankruptcy law relevant to retail debtors. BAPCPA generally became effective as to cases filed on or after October 17, 2005. My remarks will address several business bankruptcy points. These points include the following:

- Consideration of relaxing the deadline by which commercial real property leases must be either assumed or rejected. The 2005 Amendments place a cap of 210 days. By that time, a lease is deemed rejected if not assumed. In my opinion, Congress should consider removing this cap and restoring the discretion of the bankruptcy court to determine on a case-by-case basis whether cause has been shown to extend the deadline.

- Consideration of relaxing the deadline for the period of exclusivity from 18 months to a time period determined by the bankruptcy court. In my opinion, infusing more and not less judicial discretion is the appropriate way by which to provide a reasonable opportunity for debtor rehabilitation. The period of exclusivity is the period by which only a debtor may propose and obtain confirmation of a plan of reorganization. During this period, no other party may file a competing plan until that time period lapses.

- Consideration of removing the administrative priority for goods sold to the debtor within 20 days and returning that prepetition claim back to the prior practice of establishing a reclamation claim or living with a general unsecured claim.

A. Deadline to Reject or Assume Unexpired Leases

Prior to BAPCPA, chapter 11 debtors had a reasonable time period to make critical decisions involving commercial real property leases. For example, in the case of *In re Hechinger Investment Company of Delaware, et. al.*[1] on the June 11, 1999 petition date, the debtors had in excess of 260 leases and subleases of nonresidential real property. Through a series of motions, the time to assume or reject these leases was extended, over objection from landlords, until June 1, 2000, approximately 1 year later.[2] Similarly, in the case of *In re Montgomery Ward, LLC, et. al.*[3] when the case was filed on December 28, 2000, the debtor had approximately 300 non-residential real property assets. On January 24, 2002, in a motion for a further extension of time to assume and reject until August 31, 2002, the debtor reported that 137 leases had been rejected, 30 had been terminated, and 51 had been assumed and assigned.[4] Of course, as in the *Hechinger* case, this had taken over a year and they still needed more time. While the confirmation of a plan made the motion for additional time moot in *Montgomery Ward*, these cases are indicative of the length of time it takes to fully analyze leases in a large retail bankruptcy. Because of the 2005 Act's amendment to Section 365(d)(4),[5] debtors no longer have the time to make a meaningful decision either to assume or reject an unexpired lease. Where there used to be years, now, without the consent of the landlord, the maximum time is 210 days from the order for relief – the initial 120 days provided by Section 365(d)(4)(A) and the possible additional 90 days provided by Section 365(d)(4)(B). Any extension of time past the 210 days will require the consent of the landlord; which, in turn, will most like require the payment of a "consent fee." Of

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[1] United States Bankruptcy Court for the District of Delaware Case Number 99-02261. I thank Susan Seabury, Director, BDO Consulting, a division of BDO Seidman, LLP, for her research in support of this witness statement.

[2] Revised Disclosure Statement for Revised First Amended Consolidated Plan of Liquidation, *In re Hechinger Investment Company of Delaware, et. al,* Case Number 99-02261, United States Bankruptcy Court for the District of Delaware, page 22.

[3] United States Bankruptcy Court for the District of Delaware Case Number 00-4667.

[4] *In re Montgomery Ward, LLC et. al.*, Motion for Order Under 11 U.S.C. §§ 105, 365(d)(4) and Fed. R. Bankr. P. 9006 (I) Authorizing Extension of time Within which Debtors May Assume or Reject Unexpired Leases of Nonresidential Real Property and (II) approving Extension of Kimsward, LLC's Designation Rights, Docket Number 2577, p. 5.

[5] §365(d)

(4)(A) ~~Notwithstanding paragraphs (1) and (2), in a case under any chapter of this title, if the trustee does not assume or reject an unexpired lease of nonresidential real property under which the debtor is the lessee within 60 days after the date of the order for relief, or within such additional time as the court, for cause, within such 60-day period, fixes, then such lease is~~ Subject to subparagraph (B), an unexpired lease of nonresidential real property under which the debtor is the lessee shall be deemed rejected, and the trustee shall immediately surrender ~~such~~ that nonresidential real property to the lessor, if the trustee does not assume or reject the unexpired lease by the earlier of—

(i) the date that is 120 days after the date of the order for relief; or

(ii) the date of the entry of an order confirming a plan.

(B) (i) The court may extend the period determined under subparagraph (A), prior to the expiration of the 120- day period, for 90 days on the motion of the trustee or lessor for cause.

(ii) If the court grants an extension under clause (i), the court may grant a subsequent extension only upon prior written consent of the lessor in each instance.

course, in fact, the 210-day period is often shorter because of the need to consider and potentially conduct a going out of business (GOB) sale as an alternative to a rehabilitation of the debtor.

Professor Ken Klee suggests one other possible outcome – retail debtors with a significant number of leases will simply refuse to file voluntary petitions during slower periods and will instead wait to be forced into involuntary cases. The "gap period" created by the involuntary case will create additional time to analyze the leases during periods of greater sales activity but may also impose greater uncertainty and business risk.[6]

As discussed above, the 2005 Act imposes serious limitations on the time debtors-in-possession have to analyze leases and determine which ones should be assumed and which ones rejected. Inevitably, less time has lead to one of three outcomes: (1) some leases that should be assumed and/or assumed and assigned have been rejected; (2) some leases that should be rejected have been assumed; and (3) some leases that are assumed and assigned have been assigned for less than they would bring if more time were available for marketing after the lease analysis had been completed.

1. The "Consent Fee" and Other Concessions

There is, however, a fourth option – obtain the consent of the landlord so that the time can be extended past the 210 days specified in Section 365(d)(4). However, landlords are unlikely to consent without cost to the estate. To gain the landlord's consent to extend the assumption/ rejection period, the debtor will be forced to pay the landlord some sort of "consent fee" or make some other form of concession. To the extent that these other concessions limit the ability of the debtor to assign the lease to the highest bidder (*i.e.*, to gain consent, the landlord requires the debtor to assign the contract, if at all, to an entity that will operate a specific type or types of establishment therein.), obtaining this consent will be detrimental to the debtor's estate and the other unsecured creditors.

2. Premature Assumption Leads to Bigger Administrative Expenses

What happens if the landlord is unwilling to give consent for a reasonable price? In these cases, the debtor will be forced to make a premature decision. If that decision is to assume a lease which must later be rejected, there is a significant price to pay. While acknowledging authority to the contrary, *Nostas Assoc. v. Costich (In re Klein Sleep Products, Inc.)*[7] held that any damages arising from the rejection of a previously assumed nonresidential real property lease were entitled to administrative expense priority.[8] Further, in *Klein Sleep*, the Second Circuit also determined that the limitations on damages specified by Section 502(b)(6) are inapplicable to such damages[9] Thus, if a debtor prematurely assumed a nonresidential real property lease, the administrative expense related thereto could conceivably consume the entire estate.[10]

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[6] Klee, Kenneth N., *The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 – Business BankruptcyAmendments*,www.ktbslaw.com/publications/Business%20Bankruptcy%20Amendments202005.PDF.

[7] 78 F.3d 18 (2nd Cir. 1996).

[8] *Id*. at 28. (See also *In re Baldwin Rental Centers, Inc.*, 228 B.R. 504, 511-512 (Bankr. S.D. Ga. 1998) for a collection of cases so holding.)

[9] *Id*. at 30.

[10] Note, the provisions relating to the priority of rejection damages related to all executory contracts, not just nonresidential real property leases, however, in most cases, the costs of later rejection of an assumed contract or personal property lease are not usually as devastating.

The 2005 Act's amendment of Section 503(b) followed *Klein Sleep* to the extent that it provided some administrative expense for the damages arising from leases that are assumed and later rejected, but overruled that portion which excepted these damages from all caps.[11] Under Section 503(b)(7), as amended by the 2005 Act, the landlord will be entitled to rents for two years at non-penalty rates from the date of rejection or turnover, which ever is later, less and rents actually received from another entity during that period. All other damages fall under Section 502(b)(6), and are thus subject to the limitations contained therein.

Perhaps an example would be helpful. Suppose debtor, Retail Nightmares, files for Chapter 11 and assumes a nonresidential real property lease for one of its stores. Further suppose that the debtor is in year three of a ten year lease which requires it to pay $10,000 per month. At the time of the filing it was in arrears for one month, but cured that deficiency when it assumed the lease on day 90 of its case. However, things have not gone as anticipated for Retail Nightmares and now they are going to liquidate under Chapter 11 rather than try to reorganize. Retail Nightmares vacates the property and then, on the lease anniversary date, rejects the lease with exactly six years remaining. Finally, assume that after 18 months, the landlord is able to release the property at the rate of $9,000 per month. What are Landlord's damages?

Administrative Expense Under Section 503(b)(7) of the Bankruptcy Code:

	2 years worth of lease payments: (10,000*2*12):	$ 240,000.00
Less	Six months worth of mitigation rent (10,000*6):	$ (60,000.00)
		$ 180,000.00

Unsecured Claim Under Section 502(b)(6) of the Bankruptcy Code:[12]

The Greater of one years rents: (10,000*12):	**$ 120,000.00**	
and the lesser of:		
(i) 15% of the remaining lease rents (10,0000*12*6*.15):	**$ 108,000.00**	
and (ii) Three years rents (10,000*12*3):	$ 360,000.00	
		$ 120,000.00

Strictly following the guidelines set by *Klein Sleep*, Landlords damages, without the cap provisions specified in Section 503(b)(7) as amended by the 2005 Act, would have been treated

[11] 11 U.S.C.A. § 503(b)(7) provides:

> with respect to a nonresidential real property lease previously assumed under Section 365, and subsequently rejected, a sum equal to all monetary obligations due, excluding those arising from or relating to a failure to operate or a penalty provision, for the period of 2 years following the later of the rejection date or the date of actual turnover of the premises, without reduction or setoff for any reason whatsoever except for sums actually received or to be received from an entity other than the debtor, and the claim for remaining sums due for the balance of the term of the lease shall be a claim under Section 502(b)(6);

[12] Note, *In re PPI Enterprises, Inc.*, 324 F.3d 197, 208 (3rd Cir. 2003) in footnote 17, the Third Circuit states:

> The landlord retains a duty to mitigate the tenant's breach, but any mitigation of damages secured by reletting the premises will offset only the landlord's overall potential recovery, and does not affect the § 502(b)(6) cap. The "overwhelming majority of courts" have held that the § 502(b)(6) statutory cap is not reduced by any amount a landlord has received by reletting the leased premises and mitigating its damages. *5th Ave. Jewelers*, 203 B.R. at 381; *see also In re Atl. Container Corp.*, 133 B.R. 980, 990 (Bankr.N.D.Ill.1991).

as a $720,000 administrative expense. While the limitation on the administrative expense could be seen as a loss, the clear recognition of the fact that this situation, which is likely to occur more often after the 2005 Act, entitles the landlord to an administrative expense not capped by Section 502(b)(6), makes these provisions a draw at worst for the landlord.

B. Period of Exclusivity

Along with the period to analyze leases, the period in which the debtor has the exclusive right to propose a plan has also been tightened, which may cause the debtor to contemplate an exit strategy earlier in the case. The legislative history prior to the 2005 Act shows that "[e]xclusivity is intended to promote an environment in which the debtor's business may be rehabilitated and a consensual plan may be negotiated."[13] This seems to be an acknowledgement that it takes time for the debtor to determine how a case will shake out and negotiate with differing constituencies the terms of a plan. It also seems to be an acknowledgement of the fact that competing plans cause dissention and cause the cost of the process to spiral upward exponentially.

The questions is, then, how big an impact does limiting the period in which only the debtor can propose a plan (the "Exclusivity Period") to a maximum of 18 months have? Again, looking at *Montgomery Ward*, the docket and certain documents reveal that plans were filed by two competing groups – the creditors' committee on one hand and the debtors and their secured creditor on the other. The condensed timeline looks as follows:

Date	Docket Number	Description
12/28/2000		Petition Date;
04/11/2001	1060	Motion filed by the debtors to extend 120 "exclusivity" period provided by Section 1121(b) pursuant to the provisions of Section 1121(d);
04/27/2001	1217	Initial period 120 day period specified by Section 1121(b) set to expire – extended by order of the court until October 29, 2001;
10/05/2001	2126	Motion filed by the debtors to extend the "exclusivity" period - seeking an extension until February 28, 2002; (while the docket does not appear to show objections to this motion, the "bridge order" states that the secured lender and the creditor's committee each sought additional time to consider the motion.)
10/25/2001	2219	Order entered – the "bridge order" extending the "exclusivity" period until a hearing on November 8, 2001;
11/08/2001		Exclusivity period appears not to have been extended;
01/16/2001	2549	Joint plan filed by debtors and secured lender
01/24/2001	2582	Competing plan filed by creditor's committee
02/15/2002	2750	Amended plan filed by creditor's committee
03/04/2002	2885	Amended joint plan filed by debtors and secured lender

[13] H.R.Rep. No. 103-835, at 36 (1994), reprinted in 1994 U.S.C.C.A.N. 3340, 3344.

04/24/2002	3203	Supplement to plan filed by secured lender
04/30/2002	3227	Second amended plan filed by creditor's committee
05/01/2002	3244	Order approving disclosure statement for plan amended – 3203
05/06/2002	3257	Third amended plan filed by creditor's committee
05/06/02	3277	Order approving disclosure statement for plan as supplemented 3257
05/08/2002	3304	Amended Order approving disclosure statement for plan 3257
7/11/2002	3498	Supplement to third amended plan (3257) filed by creditor's committee
8/6/2002	3593	Order confirming third amended plan (3257)

At the end of the day, the debtors' exclusive period was approximately 315 days long, but no plan was proposed within that period. The debtor, along with its secured creditor did propose a plan, which was amended or supplemented twice. The creditors' committee proposed the competing plan, which was eventually confirmed, but not before being amended three times and supplemented on top of that. In this case, the cap on the Exclusivity Period imposed by the 2005 Act would have been of no impact – the plan that was eventually confirmed was proposed within 16 months and confirmed within 19. Therefore, it is possible, even in a contentious case, to propose a plan within the 18 month, and have it confirmed within the 20 month, period mandated by Section 1121(d) as amended by the 2005 Act.

But will it become more difficult to meet the 18-month deadline? Many constituencies in retail bankruptcy cases have concluded that it is more difficult to move to a consensual plan and may provide a disincentive to certain parties in interest in seeking a consensual plan so that such parties may propose their own plan. Moreover, additional time in a bankruptcy case would allow a greater opportunity to obtain exit financing, a difficult task at the present time when the financial systems are dysfunctional.

C. Goods Sold in the Days Before the Petition Date

1. Reclamation Rights

The Bankruptcy Code incorporates the state law and Uniform Commercial Code right of a seller of goods to reclaim those goods through the inclusion of section 546(c) which provides:

> (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).[14]

Timing is a key issue when making a reclamation demand. However, reclamation under section 546(c) of the Bankruptcy Code is rarely an issue, as most debtors have asset based financing which provides a prior perfected lien on most goods such that the right of reclamation is rendered moot.[15] Thus, while many creditors still go through the motions of reclamation, it rarely produces results.

2. 503(b)(9) Administrative Expenses

On the other hand, the inclusion of a new section 503(b)(9), gives vendors supplying goods in the 20 days before the petition is filed significantly more power. This section states:

(b) After notice and a hearing, there shall be allowed administrative expenses, other than claims allowed under section 502 (f) of this title, including— …

(9) 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.[16]

The series of decisions in *In re Plastech Engineered Products, Inc.*, provides a wealth of information on how at least one court views this provision. The first decision, "*Plastech I*",[17] begins by summarizing the previous decisions on this provision stating that both *In re Global Home Products, LLC*,[18] and *In re Bookbinder's Restaurant, Inc.*,[19] the courts determined that the allowance of a claim under 503(b)(9) does not give an unqualified right to immediate payment. Further, other than as of the effective date of the chapter 11 plan, payment of administrative expenses is left to the discretion of the court. In determining when the payment should be made, the court in *Global Home* determined that it should consider three factors:

1. The prejudice to the debtor of making the payment;

[14] 11 U.S.C. § 546(c).

[15] There was some thought that the changes to this provision made by BAPCPA somehow created a federal right of reclamation different from the UCC and state law, but at least one court has found otherwise. See, *In re Dana Corp.*, 367 BR 409 (Bankr. S.D.N.Y. 2007).

[16] 11 U.S.C. § 503(b)(9).

[17] 394 B.R. 147 (Bankr. E.D. Mich. 2006) decided on September 16, 2008.

[18] 2006 WL 3791955 (Bankr. D. Del. Dec. 21., 2006)

[19] 2006 WL 3858020 (Bankr. E.D. Pa. Dec. 28, 2006)

2. The hardship on the administrative expense holder of not making the payment; and

3. The potential detriment to other parties in the case (i.e. how would the cash drain impact the ongoing operations of the debtor).[20]

There, the court denied the motion seeking immediate payment. It would seem that filing a motion seeking such a payment may be a way to cause the court to: (a) direct the payment; (b) direct the debtor to determine if the case is administratively solvent; and/or (c) convert the case to chapter 7.

The court in *Plastech I* then addressed the question at hand, which was the interplay of section 501 which governs the filing of claims; section 502 which governs the allowance of claims; and section 503 administrative expenses. Specifically, the question was whether section 502(d) of the Bankruptcy Code which provides for the disallowance of a claim filed under section 501 of the Bankruptcy Code due to the failure to repay an allegedly preferential transfer under section 547 of the Bankruptcy Code apply to section 503(b)(9) administrative expenses. Noting that no other court had ruled on the matter, the court reviewed decisions on the question of whether section 502(d) applies to section 503(b) in general and noted a split in the circuits. The court found that section 502(d) did not apply to section 503(b)(9) for a variety of reasons, most importantly:

1. The court agreed with the line of cases finding that section 502(d) was not applicable to section 503, rather 502(d) only applied to claims filed under section 501 and allowed under section 502;

2. Requests for administrative expenses, including 503(b)(9) are not filed under section 501 but rather under section 503(a); and

3. Determining that 502(d) did apply to section 503(b)(9) violates statutory rules of construction.[21]

The second decision in the *In re Plastech Engineered Products, Inc., et al.* ("*Plastech II*") case involving section 503(b)(9) is an unpublished decision dated October 7, 2008.[22] This decision determined the question of whether the goods in question had to be received by the debtor, or simply the value of the goods. The court stated: "In the Court's view, the word *received* modifies the word *goods* and not the *value* that must be received by the debtor to trigger § 503(b)(9)."[23] Thus, the goods in question must actually be received by the debtors to give rise to the claim under section 503(b)(9). This line of reasoning is cited heavily in *In re Goodys' Family Clothing, Inc.*[24]

[20] *Global Home*, 2006 WL 3791955 at *4.
[21] *Plastech I*, 394 B.R. at 161-64.
[22] 2008 WL 5223014.
[23] *Id.* at *2.
[24] 2009 WL 294384 (Bankr. D. Del. 2009)

The third decision in this case is dated December 10, 2008 ("*Plastech III*")[25] This decision provided several important points. First, the UCC definition of goods applies to section 503(b)(9) such that there is no claim for services provided.[26] The court cited favorably to *In re Samaritan Alliance,*[27] which provided that electricity is more in the form of a service and does not give rise to a 503(b)(9) expense and *In re Deer*[28] which also consulted the UCC to determine the definition of goods when determining if advertising was a good or a service.[29]

Second, *Plastech III* states that the predominate purpose test used in some instances to determine if a contract was for goods or services is not applicable to section 503(b)(9). Where an entity provides both goods and services, it is entitled to section 503(b)(9) treatment for the goods provided, but not the services in a bifurcated manner, unlike the "winner take all" result of the predominate purpose test.[30]

Finally, *Plastech III* states that the goods need not be reclaimable (i.e. identifiable, still in the hands of the debtor, in their original state, and not subject to a superior lien) to give rise to section 503(b)(9) treatment. The court states: "…there is nothing in § 503(b)(9) that requires a claimant to be also be entitled to a reclamation right under § 546. Section 546 does not limit or control in any way the rights that a claimant has under § 503(b)(9)"[31]

The decision of *In re Brown & Cole Stores, LLC*[32] filed on August 17, 2007 addressed a different set of questions. Specifically, whether the creditor needed to be unsecured to be entitled to section 503(b)(9) treatment and whether the 503(b)(9) expense's prepetition nature possessed the requisite mutuality for setoff purposes with regard to alleged prepetition breach of contract claim against the holder of the section 503(b)(9) expense. There, the court determined that the provision of goods on a wholly secured basis can give rise to a section 503(b)(9) expense. In answer to the debtors contention that this was unfair to other creditors, the court stated: "…if AGI's twenty-day sales claim is fully secured, then payment of it by B&C will free the value of the security for that claim for the benefit of other creditors. If AGI's claim proves to be undersecured or unsecured, then to deny administrative priority would be to ignore the statute, something we cannot do." [33] The court then noted that there was mutuality under the test set forth in *Biggs v. Stovin (In re Luz Int'l, Ltd.)*[34] which states:

1. The debtor owes the creditor a prepetition debt;

2. the creditor owes the debtor a prepetition debt;

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[25] 397 B.R. 828 (Bankr. E.D. Mich. 2008)
[26] *Id*. at 835-6.
[27] 2008 WL 2520107 (Bankr. E.D. Ky. June 20, 2008)
[28] No. 06-02460, slip op. at 2 (Bankr. S.D. Miss. June 14, 2007)
[29] See Also *In re Goodys' Family Clothing, Inc.,* 2009 WL 294384 (Bankr. D. Del. Feb. 6, 2009)
[30] *Plastech III*, 397 B.R. at 837.
[31] 397 B.R. at 838.
[32] 375 B.R. 873 (9th Cir. BAP 2007).
[33] 375 B.R. at 878.
[34] 219 B.R. 837 (9th Cir. BAP 1998).

3. the debts are mutual.[35]

Since both the potential breach of contract claim and the sale giving rise to the 503(b)(9) expense were prepetition, setoff was available.[36] The court went on to note, however, that the issue was premature because the debtor simply alleged a breach of contract claim and had not filed a contested matter or an adversary proceeding to determine those rights. Until the right to payment from the creditor was established, there was nothing to setoff against.[37]

The creation of a new *per se* administrative expense priority for what has in the past been presumptively an unsecured claim has taken a toll in retail bankruptcy cases. Debtors must account for and pay over in cash these claims at some point in the bankruptcy process. This favored treatment drags down cash flow at a point in the life of a business when liquidity is king.

III. CONCLUSION

As shown by cases both before and after enactment of BAPCPA, the 2005 law has made it more difficult for businesses to reorganize in chapter 11. Thank you again for the opportunity to appear today. Please do not hesitate to call upon me or the ABI if we can be of further assistance on this or any other bankruptcy policy issue.

[35] 219 B.R. at 843-44.
[36] 375 B.R. at 879-80.
[37] 375 B.R. at 880-881.A

ATTACHMENT

Jack F. Williams, JD, CIRA, CDBV
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Since 1991, Professor Williams has served as a Professor at Georgia State University College of Law in Atlanta, Georgia, where he teaches or researches in the areas of bankruptcy and business reorganizations, mergers and acquisitions, law and accounting, taxation, and military legal and national security issues. In January 2008, Professor Williams returned to the American Bankruptcy Institute to serve again as its Robert M. Zinman Scholar in Residence. He has also served as the Resident Scholar of the Association of Insolvency and Restructuring Advisors. Professor Williams further serves as a Managing Director in the Business Restructuring Practice at BDO Consulting, a division of BDO Seidman, LLP, where he advises debtors and creditor committees on retail bankruptcy reorganizations. Professor Williams is a Fellow in the American College of Bankruptcy.

Professor Williams' areas of specialization include retail and real estate bankruptcies, servicemember civil relief, financial fraud, tax fraud, money laundering, international banking and finance, financing and commercial matters under Islamic law, corporate security, the foreign corrupt practices act, and insolvency taxation. He has investigated numerous alleged fraudulent transfers of assets that total in the aggregate over $3 trillion. Additionally, among his areas of expertise is the use of sophisticated statistical techniques to detect fraudulent activity. Professor Williams has investigated suspected domestic and international fraud and misappropriations in the areas of asset transfers and concealments, banking, bankruptcy fraud, check collection, conflicts of interest, employee embezzlement, corporate security, and tax.

Professor Williams has served as the Tax Adviser to the National Bankruptcy Review Commission (NBRC) and as Chair of the Tax Advisory Committee to the NBRC. He has served as Chair of the ABI Bankruptcy Taxation Committee, as Reporter (Taxation) for the ABI Bankruptcy Code Review Project, as Dean of the American Board of Certification, as a Commentator on the Republic of Croatia's and Bulgaria's Bankruptcy Codes, and as a Co-Drafter of the Russian Federation's Energy and Natural Resources Taxation Code.

Professor Williams has written seven books and over 150 articles and monographs. He is a frequent speaker on bankruptcy law and policy and is active in providing pro bono service to those in need, including servicemembers and their families, those folks facing foreclosure, and small businesses in financial distress. Professor Williams may be reached by phone at 404.413.9149 or by email at jwilliams@gsu.edu.