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## **A Closer Look At ASM Capital V. Ames**

*by Scott H. Bernstein, Hunton & Williams LLP*

A case of first impression before the Second Circuit — *ASM Capital LP v. Ames Department Stores Inc.* (In re Ames Department Stores Inc.), 2009 U.S. App. LEXIS 20764 (2d Cir. Sept. 18, 2009) — has raised the question of whether Section 502(d) of the Bankruptcy Code, which bars allowance of certain claims against the debtor’s estate by alleged recipients of preferential transfers until they have returned any voidable preferential payments or transfers from the debtor’s estate, also bars postpetition administrative expenses pursuant to Section 503(b).

Appellant ASM Capital LP, an investor in distressed debt, acquired claims against Ames’ bankruptcy estate from various of Ames’s creditors. This included two claims held by G&A Sales Inc., a supplier to Ames, consisting of an administrative expense claim for \$360,117.65 and a reclamation claim for \$33,292.50.

Administrative expenses are the “actual, necessary costs and expenses of preserving the estate,” including goods and services that are provided to the debtor during the pendency of its bankruptcy case.

A reclamation claim provides the supplier with a right to reclaim goods that a customer received on credit while insolvent in the period just prior to the commencement of the bankruptcy proceeding.

Thereafter, Ames filed adversary proceeding complaints seeking to recover alleged preferential transfers pursuant to Section 547 of the Bankruptcy Code against certain of its creditors, including G&A.

While the preference actions were still pending, Ames began making interim distributions to holders of administrative expense claims, but refused to make distributions to holders who (a) were defendants in a preference action, (b) acquired their claims from a defendant in a preference action, or (c) would not agree to sign a release fixing the amount of their administrative expenses.

Ames refused to make an interim distribution to ASM on the grounds that ASM’s predecessor in interest (G&A) was a defendant in a preference action. See *id.* at \*\*5-6.

ASM moved the bankruptcy court for an order both allowing the administrative expense claim it purchased from G&A and compelling Ames to pay it.

Both the bankruptcy court and the district court held that Section 502(d) of the Bankruptcy Code barred allowance of the claims ASM had acquired from G&A until the preference action against G&A was resolved and G&A had paid or disgorged the amount, if any, for which G&A was liable to Ames. See *id.* at \*\*5-6.

The courts made this ruling even though the disallowance would likely be permanent because G&A had filed its own Chapter 11 bankruptcy, suspended its business and had transferred all of its assets to a secured creditor, thereby making it highly unlikely that Ames would ever be paid the amount of the preference. See *id.* at \*7.

On appeal, the Second Circuit reversed the two lower courts, citing a difference in opinion with the lower courts regarding statutory interpretation and policy of the Bankruptcy Code.

In particular, the Second Circuit noted that Section 502 (entitled “Allowance of claims or interests”), in conjunction with Section 501 (entitled “Filing of proofs of claims or interests”), provides a procedure for the allowance of claims that is entirely independent and separate from the procedure for allowance of administrative expense claims under Section 503 (entitled “Allowance of administrative expenses”). See *id.* at \* 20.

The court also noted that the plain language of Section 502(d) suggests that it applies only in the context of Section 502, and not to administrative expenses claims addressed by Section 503.

Section 502(d) provides that “[n]otwithstanding subsections (a) and (b) of this section,” the court shall disallow any claim of any entity from whom property is recoverable under certain avoidance provisions of the Bankruptcy Code, unless the entity has returned the recoverable property.

In other words, the plain language introduces Section 502(d) as an exception to the automatic allowance of prepetition claims under Sections 502(a) and (b).

Based on a plain reading, the Second Circuit reasoned that the subsection scope’s is limited and does not extend to administrative expense claims under Section 503(d). See *id.* at 22.

The Second Circuit pointed out that the administrative expense claims are given a higher priority than prepetition claims to encourage the continued supply of goods and services on credit to the debtor’s estate, to the benefit of all of the estate’s creditors.

The court stated “[t]hat intent would be frustrated by allowing a debtor automatically to forestall or avoid payment of administrative expenses by alleging that the vendor had been the recipient of a preferential transfer.” *Id.* at \*\*25-26.

Thus, the Second Circuit held that Section 502’s ban on payments to recipients of preferential transfers does not extend to administrative expense claims. See *id.* at \* 25.

This case is important because it is the first decision of an appeals court on the interplay of Sections 502(d) and 503(b). It will have an impact on the claims trading industry by providing guidance to parties who are involved in the buying and selling of claims against bankrupt companies.

The selling of claims against debtors is often critical to the liquidity needs of companies whose businesses are affected by the bankruptcy filings of their customers.

By removing the possibility of disallowance of administrative expense claims on the basis of an alleged prepetition preference, this case will enable parties engaged in the claims trading market to better price claims to the benefit of the parties involved.

This will be especially significant for sellers who are often asked to significantly discount their administrative expense claims based on their prepetition dealings with debtors.

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