

SCOTT AND GOLDMAN

ATLANTA OFFICE • 590 W. Crossville Rd. Ste. 104 • Roswell, GA 30076 • 770-993-1220 • Fax# 770-993-2220

WHAT CAN BE DONE IF YOU DISCOVER THAT YOU HAVE SHIPPED GOODS TO A CUSTOMER WHO MAY BE INSOLVENT?

You have just shipped an order to your customer on credit when you discover that he has become insolvent. Worse yet, you discover that he has filed bankruptcy. Is there any way you can recover your merchandise and sell it to another buyer, or is your only recourse a lawsuit seeking monetary damages?

What If Goods Were Not Delivered?

If the goods have not yet been delivered, you may stop delivery. Notice must be given to the carrier to either deliver the goods to another consignee or to return them to you. You are responsible to pay the carrier for any costs or damage that results from stoppage of the goods in transit.

Furthermore, the carrier has a right to be indemnified by you for damages suffered by your customer arising out of an unjustified stop order. Consequently, if you intend to stop delivery, notice should be given to the buyer.

What If Goods Were Delivered?

What can be done if the goods have already been delivered to your customer? The Uniform Commercial Code gives a seller the right to reclaim goods if the buyer is insolvent at the time the goods are delivered. Insolvency is defined as either the inability to pay debts as they become due, or the so called "balance sheet test" where liabilities exceed assets.

Once you are satisfied that the buyer is insolvent, you must then give formal notice of your intent to reclaim the goods. In most states the time in which to give the buyer notice is ten (10) days from the date of delivery. If the buyer has misrepresented his solvency, the time limit on most jurisdictions is extended to ninety (90) days.

What happens if you give timely notice to your customer of your intention to reclaim, but he refuses to release the goods? Your remedy is to proceed with an action in State

Court seeking an Order directing your customer to return the goods.

What If Bankruptcy Is Filed?

Suppose your customer files a bankruptcy petition within ten (10) days after delivery of the goods? Can you do anything without violating the automatic stay contained in the Bankruptcy Code? The answer is "Yes".

The Bankruptcy Code provides a creditor with the right to reclaim goods from the bankruptcy estate. This right of reclamation has priority over claims to the merchandise that may be asserted by general unsecured creditors or by the Trustee in Bankruptcy.

A question may arise as to whether a secured creditor with an after acquired property clause that covers the delivered goods can block a seller's reclamation right. In general, if the secured creditor has acted in good faith, it would appear to have priority over the rights of the reclaiming seller in the particular merchandise at issue.

The Bankruptcy Code establishes certain limitations not found in the Uniform Commercial Code which governs non-bankruptcy situations. Consequently, although you may comply with the provisions governing reclamation under the Uniform Commercial Code, this might not be sufficient to afford you protection under the Bankruptcy Code.

To begin with, the Bankruptcy Code provides that the goods must have been sold to the debtor in the ordinary course of your business. In addition, the insolvency standards is confined to the test of liabilities exceeding assets. Finally, while the Uniform Commercial Code does not indicate the manner in which notice of intent to reclaim should be given, the Bankruptcy Code requires written notice. This notice must be **received** by the buyer within ten (10) days of delivery of the goods. In the event this ten (10) day time

period expires after the bankruptcy filing, the "window of opportunity" may be extended, depending on the law of your state, to as much as twenty (20) days after the buyer's receipt of the goods. This is a very technical provision and you should call your attorney whenever you find it necessary to take advantage of the "extended window" provision.

Prudent practice would dictate that whenever you give notice, put it in writing. You may fax the notice and follow it up with a telegram or certified letter. This will provide you with sufficient proof that the notice was in writing and actually received by your customer.

Adversary Proceeding

In those situations where your customer has filed for protection under the Bankruptcy Code, you would ordinarily commence an adversary proceedings in the Bankruptcy Court in order to assert your right of reclamation. If the Court recognizes your reclamation, it may issue a variety of Orders. The Court may compel your buyer to return the merchandise, or alternatively, it may grant your claim priority as an administrative expense. The Court may even secure your claim by a lien on the goods or other property. In all of these situations, please note that your right of recovery may be limited to the goods or the value of the goods which are actually in the hands of your customer on the date the reclamation demand is made.

Under the Uniform Commercial Code, a right to reclamation is exclusive and bars any other remedy with respect to the goods in question. Consequently, a seller must elect either to seek reclamation of merchandise shipped to the buyer, or the commerce a lawsuit demanding monetary damages. If the goods have not been delivered to the buyer, the seller may stop delivery.