

CREDITOR'S RIGHTS TOOLKIT

I Just Learned My Customer Filed for Bankruptcy – Can I Stop the Shipment of Goods?

In many cases, first-day orders are entered to assure vendors that payment for goods shipped post-petition will be treated as administrative expense claims. Moreover, Section 503(b)(9) categorizes as an administrative expense any claim for “the value of any goods received by the debtor within 20 days before the date of commencement of a case... in which the goods have been sold to the debtor in the ordinary course of business.”¹ However, cases can become administratively insolvent, thereby jeopardizing payment, and Section 503(b)(9) does not require immediate payment of the claim, with most debtors only paying such claims pursuant to a confirmed plan. As such, a seller who learns that its customer just filed for bankruptcy may decide that its best course of action is to stop shipment on unpaid goods in transit.

Key Issues

- **RIGHT TO STOP SHIPMENT**

There is no specific language in the Bankruptcy Code that permits a seller to stop shipment of the goods in transit. Rather, Sections 2-702, 2-703, and 2-705 of Article 2 of the Uniform Commercial Code address the ability of a seller to stop delivery of goods. In order to stop shipment, the seller must show that the buyer is insolvent or has failed to timely pay for the goods.

- **GOODS IN POSSESSION OF CARRIER OR BAILEE**

If the goods are in possession of a carrier or bailee, the seller must instruct the carrier or bailee not to release the goods. This instruction must be complied with by the carrier or bailee. It is recommended that such instruction be in writing and provided to both the carrier/bailee and the buyer. Note that while the seller can stop shipment for the unpaid goods, the seller is responsible for all expenses, costs and damages incurred by the carrier or bailee in complying with such request.

- **PHYSICAL POSSESSION OF THE GOODS**

Under an FOB shipping arrangement, the buyer takes title to the goods as soon as they leave the seller's possession. Under a FOB destination arrangement, on the other hand, title to the goods passes when the buyer takes possession of the goods. Courts have held that even in a FOB shipping arrangement, the seller can stop the shipment of goods. In other words, the passage of title and the constructive delivery of the goods to the customer are not enough. The buyer must have received actual physical possession of the goods in order to foreclose this creditor remedy.

- **THE AUTOMATIC STAY**

When a company files for bankruptcy, a statutory injunction called the "automatic stay" immediately comes into effect. The automatic stay is intended to protect the debtor and the property of its bankruptcy estate from litigation and other creditor action while the bankruptcy case plays out. However, the automatic stay does not prevent a creditor from stopping unpaid goods in transit. If a creditor had to seek stay relief before stopping the goods, the practical effect would be to deny the seller its stoppage rights. This is because the seller has an extremely small window of time to effect this right before the buyer receives the goods.

- **PREFERENCE CLAIMS**

A seller's stoppage of goods in transit is not avoidable as a preference pursuant to Section 547 of the Bankruptcy Code.

- **DOWNSIDES TO STOPPAGE**

A seller that stops shipment of goods that otherwise would have been delivered to the buyer within 20 days before the buyer's bankruptcy, or after the buyer's bankruptcy, will lose the right to an administrative expense claim for the value of such goods. When deciding whether to stop shipment, the seller will want to weigh the relative benefits of having the goods back against the likely value of an administrative claim in the buyer's bankruptcy case. That calculus will be affected by any difficulties the seller expects to encounter in trying to re-sell the goods to a new buyer, particularly where the goods are specialized and have a limited market.

Takeaway

The claims administration process is multifaceted and nuanced. Real value in a creditor's claim can be lost due to improper responses to claim objections or, alternatively, a creditor could risk wasting resources litigating an objection that would be better negotiated or simply ignored. Experienced bankruptcy counsel can ensure that a creditor takes the best value-maximizing approach when faced with an objection to its claim.