

I Take It Back – How to Recover Goods From a Distressed Customer?

Creditor's Rights Toolkit

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This article focuses on strategies to recover unpaid goods from a customer, both before and once a bankruptcy has been filed.

Sometimes, a vendor may first become aware of its customer's financial woes when the customer files for bankruptcy. At that point, the automatic stay will foreclose many options that a vendor of goods otherwise might have to recover its unpaid goods. Often, though, a diligent vendor will learn of a customer's financial distress, and sometimes even of a customer's plans to file for bankruptcy, before bankruptcy actually occurs. This article will explore some of the options a fast-acting creditor may have to recover its goods.

KEY ISSUES

STOPPAGE OF DELIVERY IN TRANSIT

A vendor may stop delivery of goods in the possession of a carrier or other bailee when it learns the buyer is insolvent. A vendor may also stop delivery of carload, truckload, planeload, or larger shipments of goods if the buyer repudiates or fails to make a payment that is due before delivery, or if for any other reason, the vendor has a right to withhold or reclaim the goods. Delivery may be stopped at any time until:

- (a) Receipt of the goods by the buyer; or
 - (b) Acknowledgment to the buyer by any bailee of the goods, except a carrier, that the bailee holds the goods for the buyer; or
 - (c) Such acknowledgment to the buyer by a carrier by reshipment or as warehouseman; or
 - (d) Negotiation to the buyer of any negotiable document of title covering the goods.
- To stop delivery, the vendor must provide sufficient notice to enable the bailee to prevent delivery of the goods.
 - After that notice, the bailee must hold and deliver the goods according to the vendor's directions, but the seller is liable to the bailee for any ensuing charges or damages.
 - If a negotiable document of title has been issued for goods, the bailee is not required to obey a notification to stop delivery until surrender of the document.
 - A carrier that has issued a nonnegotiable bill of lading is not required to obey a notification to stop delivery received from a person other than the consignor.

RECLAMATION

If the customer already has received (but not yet paid for) the goods and the vendor learns that the customer is insolvent, the vendor may demand return of the goods through a process called reclamation.

If the customer has not filed for bankruptcy, a reclamation demand must be made within 10 days after the customer's receipt of the goods. That demand is made by written notice to the customer.

- If misrepresentation of solvency has been made to the vendor in writing within three months before delivery of the goods, then the 10-day limitation does not apply.
- Subject to certain notice requirements, in bankruptcy, the 10-day reclamation period is extended to cover goods delivered within 45 days prior to the commencement of bankruptcy.

The vendor's reclamation right is subordinate to the rights of a buyer in ordinary course or other good faith purchaser, which is likely to include a lender to the customer that holds a pre-existing perfected lien on any category of assets (inventory, etc.) that includes the goods.

Importantly, successful reclamation of goods excludes all other remedies with respect to the goods. Therefore, where goods are successfully reclaimed, the vendor may forego any claim under Section 503(b)(9) of the Bankruptcy Code on account of the goods.[1] For that reason, in bankruptcy situations, the vendor will want to carefully consider whether it is better served by attempting to reclaim the goods or instead asserting a 503(b)(9) claim.

- For a variety of reasons, in many bankruptcy situations, a 503(b)(9) claim will be the preferred approach.

If the customer wrongfully refuses to allow the vendor to recover the goods, a valid reclamation right may be enforced through litigation. However, because the objective in reclamation is to recover the goods themselves, in most situations any litigation strategy must be evaluated and, if appropriate, commenced extremely quickly, before the goods are sold by the customer.

TAKEAWAY

While a creditor's rights will depend on the unique facts of each situation, options may be available to the diligent vendor to recover goods that are en route to, or already received by, an insolvent customer. However, time is of the essence. It is important to assess and handle the situation quickly to maximize the likelihood of recovery and to avoid creating any liability to the customer. Credit managers should consult with experienced in-house or outside counsel immediately upon learning that a customer to whom trade credit has been extended is in financial distress, insolvent, or considering bankruptcy.

[1] See *What Is a Section 503(B)(9) Claim and How Can It Improve My Chances For Recovery?*

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