

RECLAMATION- A Seller's Right to Reclaim Goods

As of January 1, 2003 the information contained in this document is correct. Bankruptcy Reform Law and Revisions that may have changed reclamation were not placed before Congress as scheduled in calendar year 2002. The contents contained herein are subject to future changes in the bankruptcy law adopted by Congress.

GROUNDS FOR RECLAMATION – Reclamation is the seller's right to require an insolvent buyer to return goods purchased on credit. The seller's right of reclamation arises under Section 2-702 of the Uniform Commercial Code (UCC). The Uniform Commercial Code has been adopted as state law in all 50 states. Under state law, which takes precedence over bankruptcy law, provided the appropriate motions are filed in Federal Bankruptcy Court, a seller can reclaim goods delivered to a buyer if the seller first satisfies Nos. 1-4 of the following conditions. Please note that No. 5 is the standalone exception:

- 1) The goods were shipped on credit.
- 2) The buyer was insolvent at the time the goods were received.
- 3) The seller demands return of the goods within ten days of the buyer's receipt of the goods.
- 4) The buyer was in possession of the goods when the seller made its reclamation demand.
- 5) The creditor has an unlimited period of time in which to make its reclamation demand if the buyer provided a written misrepresentation of solvency to the seller within three months of the seller's delivery of the goods.

Condition No. 5 referenced above typically involves a Balance Sheet or other type of financial statement directed to the seller and can include financial information disseminated to a trade or credit association. This would include false financial information given to serve as an inducement to extend credit.

When the buyer sells goods obtained from the seller in the buyer's normal course of business prior to the reclamation demand, then goods sold in that situation will defeat the right to reclaim those goods. Reclamation is denied if the goods have been converted into a different form prior to demand.

The Federal Bankruptcy Law under Section 546(c) requires a written reclamation demand. Section 2-702 of the Uniform Commercial Code is silent on this point and permits an oral reclamation demand. It is always recommended that the seller seeking reclamation do so in a written form. Section 546(c) of the Bankruptcy Code requires that the seller make a written reclamation demand within ten days after the buyer's receipt of goods and if this 10-day period expires after the commencement of the buyer's bankruptcy case, then the reclaiming seller is entitled to an extra ten days to make its written reclamation demand. In other words, the reclaiming seller has a 20-day reclamation period for goods that the buyer received during the ten-day period prior to its bankruptcy filing. If the ten-day period expires prior to the commencement of the case, the

additional ten-day grace period does not apply and the seller's reclamation claim is limited to goods that the buyer received within ten days of the demand. Therefore, there is not an absolute twenty-day period for reclamation of goods in a case involving a bankruptcy filing.

COMPUTING THE RECLAMATION DEMAND TIME PERIOD – In computing the time period for making a reclamation demand, the seller must consider the following:

- 1) When did the buyer receive the goods?
- 2) What is the proper method for computing the time period for making the demand?
- 3) When is the reclamation demand deemed to be made?

The time period for making a reclamation demand is measured from the date the buyer received the goods. The Bankruptcy Code does not define the term "receipt." The UCC Section 2-103(1)(c) defines receipt of goods as "taking physical possession of them." Passage of title has no bearing on physical possession of the goods, which is what is required.

In calculating the time period for making a reclamation demand, the seller should begin counting forward on the day after the buyer received the goods. If the last day of the time period falls on a Saturday, Sunday or holiday the period in which the reclamation demand must be made is extended until the next business day. This may expand the period for making a demand by an additional day or two or more.

To compute the period for making a demand, the reclaiming seller must determine when it made the demand. The Uniform Commercial Code or Bankruptcy Section 546(c) defines when a reclamation demand is made. The courts have adopted the "Dispatch Rule" in which the reclamation period would be deemed made when the seller mails or otherwise dispatches the demand. Some state courts and some federal courts have adopted a "Receipt Rule" where the reclamation demand is deemed made on the date the buyer received the demand. If the "Dispatch Rule" is used, then the respective court may allow the creditor to reclaim only goods on hand on the date the buyer received the demand. Reclaiming sellers prefer the "Dispatch Rule" and the buyer, of course, prefers the "Receipt Rule" relative to the date recognized for the reclamation demand.

GOODS CLASSIFIED AS ESSENTIAL FOR THE CONTINUED OPERATION OF THE BANKRUPT – There are those situations whereby the goods would be considered essential for the continued operation of a debtor that has filed a Chapter 11 bankruptcy. Further, goods may be necessary to finish out a project to protect a receivable, etc. In the event this determination is made then this allows the seller to submit a Priority Claim in bankruptcy thereby elevating its claim to sold goods above other unsecured and secured claims.

BUYER'S POSSESSION OF RECLAMATION GOODS AT THE TIME OF DEMAND – A seller seeking to reclaim goods has the burden of proving that the buyer was in possession of the seller's identifiable goods when the seller made its reclamation demand. At the time of demand, if the buyer was not in possession of the goods or the goods were no longer identifiable then the seller will lose its reclamation rights. Since the buyer must be in possession of the goods that are subject to the seller's reclamation demand, the seller should send its demand as quickly as possible

and make every effort for expedited delivery of the demand to insure prompt receipt by the buyer. Accordingly, a fax transmittal that can be confirmed has been deemed acceptable, but the best way is physical delivery via courier with the next best choice being overnight Express Mail.

PRIORITY OF DEBTOR'S SECURED CREDITOR OVER RECLAIMING SELLER – The seller can lose its reclamation claim if the buyer's inventory is subject to a prior perfected security interest. This is because Section 2-702(3) of the Uniform Commercial Code subjects the seller's right of reclamation to the rights of a good faith purchaser. Since a creditor with a perfected security interest in inventory is considered a good faith purchaser, all court decisions have held that a secured creditor's interest in the buyer's inventory is superior to the seller's reclamation claim.

ENFORCEMENT OF A RECLAMATION CLAIM – A reclaiming seller will send a timely reclamation demand and satisfy all other requirements then sometimes take a wait and see attitude. This could result in the loss of a reclamation claim. It is recommended but not absolutely necessary that following the commencement of the buyer's bankruptcy case the seller can enforce its reclamation claim by commencing a lawsuit for reclamation of goods in the bankruptcy court. Also remember that a "motion" would have to be filed in the event the seller pursues the state action against the buyer, given that there was a false representation of written documentation submitted three months before delivery of the seller's product.

REMEDIES AVAILABLE FOR A SUCCESSFUL RECLAMATION CREDITOR – Where the seller has taken all the necessary steps to enforce its reclamation claim, the bankruptcy court may direct the buyer to return goods to the seller; direct the buyer to immediately pay for the goods; grant the seller a security interest in the buyer's assets to secure payment of the claim; or grant the seller an Administrative Claim or a Priority Claim.

OTHER INSOLVENT ACTIONS JUSTIFYING RECLAMATION OUTSIDE OF BANKRUPTCY PROCEEDINGS – Reclamation demands can be made resulting from any insolvency steps, which are not limited to bankruptcy. Other acts of insolvency include but are not limited to: Foreclosure Proceedings by secured lenders, GOB sales, filing of business entity Dissolutions, Assignment for the Benefit of Creditors, Receivership, non-compliance with COD transactions, and any other act committed by a buyer or creditor that would be considered "INSOLVENT."