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Bankruptcy Reclamation—How a Seller Can Reclaim Its Goods From A Customer Going Bankrupt

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Big bankruptcies have been in the news a lot lately. Readers have likely heard about large corporations such as Borders, Circuit City and Eastman-Kodak (to name a few) going bust, and seeking help from the U.S. bankruptcy courts. While the U.S. is renowned for its sophisticated, flexible and fair bankruptcy laws, it is less known how expensive it is for a debtor to complete a Chapter 7 (liquidation) or Chapter 11 (reorganization) petition in bankruptcy. It might be shocking to know that millions and millions of dollars of a debtor's assets are spent on attorneys' and consultants' fees: for example, in the Borders bankruptcy, the tally for professional fees is currently \$16 million and counting.

These enormous professional fees are ostensibly necessary to achieve the underlying purpose of the bankruptcy laws: the fair treatment of all of a debtor's creditors in accordance with a statutorily prescribed priority status vis-a-vis the debtor's estate. Known as the "absolute priority rule," the Bankruptcy Code provides that creditors should be paid in the following order:

- (1) Secured creditors (banks and other institutions that have a security interest in certain of the debtor's assets),
- (2) Priority unsecured creditors (such as the I.R.S. and employees entitled to unpaid wages), and;
- (3) Unsecured creditors (all other creditors including trade creditors).

Unfortunately, because unsecured creditors are last in line to receive payments from the debtor's assets they often receive pennies on the dollar of what they are owed. Accurate statistics regarding average recoveries for general unsecured creditors are not readily available, but it is often discussed among members of the bankruptcy bar that unsecured creditors usually receive payouts on their claims of 0-15%. Again, in the Borders example, unsecured creditors are expected to receive a payout on their claim of 4-10% (the exact amount will be determined after the debtor has expended more assets sifting through the thousands of claims filed against the estate).

Such a low payout seems like a hard pill to swallow for unsecured creditors, many of whom are smaller businesses. But the Bankruptcy Code offers another kind of relief called "**the right of reclamation**" to those trade creditors who have sold goods to the debtor prior to its filing for bankruptcy. Codified in Section 546(c) of the Code, reclamation permits a seller to reclaim goods sold to the debtor if the debtor received the goods while insolvent and within 45 days of its filing a petition in bankruptcy. To assert its right of reclamation, the seller must make a written demand for the return of the goods either (1) within 45 days of the debtor receiving the goods, or (2) within 20 days of the commencement of the bankruptcy case if the debtor filed a bankruptcy petition and the 45 day period expires after the filing of the petition.

In addition, if the seller fails to make a written demand (or is unable to demonstrate the debtor's insolvency), then it can still make a request under Section 503(b)(9) to receive priority status for

the value of the goods received by the debtor within 20 days of the debtor's filing for bankruptcy. As discussed above, classification under Section 503(b)(9) would entitle the seller-creditor to receive a payment of its claim prior to the other unsecured creditors.

Although it is not possible to state categorically that a seller--who has delivered goods to a debtor within 45 days of a debtor's filing for bankruptcy--should always make a reclamation claim, in light of the notoriously low payouts for unsecured creditors, it is generally a good idea to consider the possibility if the seller has delivered a large amount of goods that can be easily resold for a value that will exceed what the seller is likely to recover as a creditor in the bankruptcy. Remember that time is of the essence: because of the strict time periods in which the seller must make a written demand, it is important to contact a qualified bankruptcy attorney to discuss the right of reclamation as soon as a seller learns of a buyer's bankruptcy.

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