

Covering Credit Bulletin

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Bankruptcy Reclamation

Disclaimer: This article is not legal advice, nor is it a substitute for legal advice provided by an attorney on the subject of reclamation claims in bankruptcy. It is a primer for credit professionals.

Introduction: Under certain circumstances, creditors can file reclamation notices on merchandise shipped to a debtor that subsequently files for bankruptcy protection. This reclamation notice will contain a demand for the return of the creditor's product delivered to the debtor within a specific statutory time period. The demand must be detailed. It must be specific enough that the merchandise that the creditor is attempting to reclaim is easily identified by the debtor. For example, it may be appropriate to include with the demand a list of invoice numbers, purchasing numbers, proofs of delivery, lot numbers or serial numbers, and product descriptions.

Reclamation rights are often misunderstood. To reclaim goods, a creditor must send notice to the debtor company demanding reclamation of goods in a manner consistent with the requirements of the U.S. Bankruptcy code. For example, the description of the goods must be sufficiently specific that the goods will be readily identified, otherwise the reclamation demand may be considered ineffective by the Court. The creditor's demand will typically be faxed, sent by overnight delivery, and sent by mail to the debtor with return receipt requested. It should contain specific language, including instructions that the debtor must set aside and

safeguard any of the creditor's merchandise in its inventory for which reclamation is demanded.

Here is a sample demand letter:

Date
Debtor Name
Address

Dear _____:

This letter constitutes a notice of demand for the return of certain goods purchased by your company ("Debtor") from _____ (insert your company's name) as the Seller. Pursuant to provisions made in 11 U.S.C. section 546 (c), and by virtue of your company's bankruptcy filing and insolvency, the Seller hereby demands the return of all the merchandise currently in your possession and delivered to you on or after _____ (insert the delivery date). The specific invoices are _____ (insert invoice number, date and amount or make reference to an attachment including the invoices for which the reclamation notice has been issued). All goods subject to this reclamation notice should be protected and segregated and not used for any purpose whatsoever except those specifically authorized by the Bankruptcy Court.

Please contact me immediately upon receipt of this notice to make arrangements to allow us to reclaim the merchandise in your possession referenced above. Unless you do so, we will take further action as required to enforce this reclamation demand. My telephone number is _____ (insert telephone number) and my email address is _____. I look forward to hearing from you shortly.

Thank you

Company Name

Etc.

A seller generally has only ten days to make its written reclamation demand. However, if the ten-day period expires after the bankruptcy has been filed; the seller can make its reclamation demand up to twenty days of the buyer's receipt of the goods. A seller may make a demand at any time but reclamation rights are likely only to apply if all of these conditions are met:

1. The seller delivered the goods to the buyer;
2. The goods were sold to the buyer in the ordinary course of business

- 3. The buyer has possession of the goods at the time the demand is received and
 - 4. The buyer was insolvent when it received the goods.

A creditor's right to reclamation of *its* inventory under the Bankruptcy Code may be subordinate to the rights of another creditor with a perfected security interest in the bankrupt debtor's inventory. The Courts seem divided about which claim has precedence – a preexisting and perfected security interest in inventory such as might be held by a bank or other creditor, or the reclamation rights of a creditor in bankruptcy. A secured creditor will generally oppose an unsecured creditor's reclamation demand since the return of inventory would reduce the value of its collateral.

To be enforceable, the creditor's goods must be in the possession of the debtor when reclamation demand is received. If the debtor has transferred the goods in the ordinary course of business to a third party purchasing them in good faith before the reclamation demand is received, the creditor/supplier has no reclamation rights to enforce.

The manner in which a general trade creditor files a Proof of Claim will be impacted by a preference claim. If the preference demand is denied by the Court, their claim typically will involve only an unsecured, non-priority claim. If the preference demand is acknowledged by the Court but the goods are not returned, the creditor would normally be permitted list an administrative or secured or priority claim for the amount of the preference claim, and an unsecured claim for the remainder of the balance due at the time of the bankruptcy filing.

One additional point: The seller must reduce its pre-petition claim by an amount equal to the invoice value of any merchandise returned pursuant to a reclamation notice.

Michael Dennis

For more information about bankruptcies, you may want to purchase "*The Credit and Collection Manager's Concise Desk Reference*" published by the Institute of Credit Management and written by Michael C. Dennis. Retailing for \$44.95, this book is on sale for \$19.95 including shipping and handling. Terms are open account or credit card. For more information, or to order please contact me at:

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Questions and Answers

Question: Why do U.S. regulations governing exports make it so difficult to export?

Answer: The U.S. government does not consider exporting to be a right. Export regulations are intended to support U.S. foreign policy.

Q. We apparently made a mistake in a UCC filing and a court has decided that our security agreement / security interest is invalid? Is this commonplace?

A. Yes. In my experience, some of the most common mistakes made when preparing and filing UCC1 Financing Statements are:

- Failing to list the debtor's correct business name
- Using the debtor company's DBA
- Failing to file with the proper State agencies or agencies
- Failing to provide an adequate description of the collateral
- Failing to amend the filing if and when the collateral is moved, especially from one State to another
- Failing to file continuation statements before the expiration of the security interest
- Shipping goods prior to perfection of a security interest

Q. Management is pushing me to approve more applicants for open account terms or larger credit limits. I am concerned about the additional risk of default and the inevitable problem of slow payment associated with selling to marginal customers. What are your thoughts?

A. The first thing that occurs to me is that every credit manager's job is to make certain that she or he provides the type of assistance that senior management expects. In other words, senior management establishes the overarching goals for the credit function and the credit manager's job is to make certain that these goals are met. That being said, I would certainly look for options and alternatives to mitigate risk such as the use of security interests, standby letters of credit, or personal guarantees.

Q. How do you feel about friendly reminder letters?

A. I feel that they are not particularly effective. I don't recommend their use, but I believe that a certain percent of the time they may be effective in reminding good customers that they have inadvertently skipped an invoice.

Q. Our new CFO does not like bad news. Her style is to "shoot the messenger." What would you suggest?

A. Leaders manage problems. They look for root causes. They make appropriate adjustments. They are proactive. Some managers are not good leaders, and when a problem is presented, their first thought is to assign blame or allocate responsibility. Shooting the messenger is a great way to discourage people from telling you bad news – which means it is a lousy way to manage or lead the credit function. I doubt you will be able to change the CFO's management style. There is an old saying: "When the going gets tough, the tough get going." If you find this and other aspects of the CFO's management style to be unacceptable, you may want to consider looking for a new job.

Q. I attended a recent presentation in which you said that you follow up on a final demand with a final call to the customer. Can you explain your rationale?

A. Sure. I send a final written demand to the President or owner of the debtor company. A day or two before the final demand expires, I try to reach the company President by phone. I guess you might consider this optimistic, but I hope that by speaking directly to the debtor company President that I can avoid having to place the account for collection and losing xx% of my company's money in contingent collection fees. If this final appeal works *only* once a year, I think it is worth my time.

Q. I know the think is the most important characteristic of a successful credit professional?

A. Focus. The best credit people I know are focused on what they do. The less effective are unfocused, or unfortunately are focused on the wrong thing. For example, they are focused on the quantity of collection calls made rather than on the negotiation process that should occur once a debtor company has been contacted.

Q. We sell equipment used in construction of commercial buildings. Are mechanics lien rights enforceable when a customer files for bankruptcy?

A. I will make this general comment, and then encourage you to discuss this issue with your attorney: Lien rights generally are enforceable in a bankruptcy. However, there may be competing claims for the same asset and the Court would need to determine which claim is superior.

Q. [This is a follow up]. How soon do we have to file a lien?

A. Lien laws vary from State to State. Generally speaking, creditors must file notices fairly quickly; usually within 60 days of the date the last goods or services were provided to the site in order to preserve their rights.

Q. What is an MBE as it relates to a customer?

A. I assume the acronym refers to a minority business enterprise meaning a for profit enterprise located in the United States that is at least 51 percent owned by African Americans, Hispanic Americans, Native Americans, Asian-Indian Americans and Asian-Pacific Americans. These individuals must be involved in the day-to-day management of the business to qualify as a "MBE" business.

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