

When Your Customer Files Bankruptcy and Your Factor Has not Approved the Orders: Reclamation, Administrative Claims and Other Possibilities for Recovery

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Consider the plight of a manufacturer of women's blouses who sells to every major department store and specialty chain in the country. One of her highest volume customers is a 150 store chain of boutiques. Let's call the manufacturer "Better Blouses, Inc." and the boutique chain, "Le Boutique" (both names are fictitious and any resemblance to actual business names is purely coincidental). Better Blouses' New York salesman has taken orders from Le Boutique; \$3,000 per store. A nice order totaling \$450,000!

When Better Blouses received the order its credit manager advised her factor, who gave tentative approval of the credit. The goods were put into work and the complete order was ready to be shipped when the factor called and advised that credit approval had been withdrawn.

The credit manager called the CFO of Le Boutique and was given assurances that everything was fine; there was a temporary cash flow problem. "Don't worry. Ship the goods and you'll be paid." The credit manager phoned the New York salesman and was told, "They're as good as gold. Everyone's shipping!" Better Blouses' CEO decided to ship the orders without factor approval.

Two days after the goods were shipped the headlines in Women's Wear Daily were "Le Boutique Files Chapter 11." The goods were received by the Le Boutique, distribution center the day before the bankruptcy was filed.

What are Better Blouses options?

Reclamation

Bankruptcy Code Section 546(c) provides for the remedy known as reclamation. The over-used term "a trap for the unwary" is exemplified by the reclamation issues that can arise in a Chapter 11 reorganization case. Since Better Blouses shipped the goods in question two days prior to Le Boutique's Chapter 11 filing, and the presumption of Le

Boutique's insolvency exists due to the bankruptcy filing, a reclamation demand letter would appear to be an appropriate course of action.

A Priority Claim

Section 503 (b) (9) of the Bankruptcy Code provides that after notice and a hearing, there shall be allowed as an administrative expense the value of any goods received by the debtor within 20 days before the date of commencement of the case in which the goods have been sold to the debtor in the ordinary course of the debtor's business. That means that a qualifying creditor should get paid before general unsecured creditors as a priority expense. Procedures for asserting these claims are generally established early in the case.

Request for Notice

Although Better Blouses may be one of the 20 largest creditors who are ordinarily included on the list to receive notice of all court filings, the company should consider filing a "Request for Notice." It is a good idea to consult with a bankruptcy attorney to prepare the request in proper form. The request should be served on all of the individuals and entities shown on the master mailing list that the debtor has filed with the court.

Proof of Claim

Even though a reclamation demand has been made, a separate reclamation proof of claim should be prepared and filed with the clerk of the Bankruptcy Court. If money is owed to Better Blouses because of prior unpaid shipments that were not shipped with factor approval, a separate proof of claim should also be filed. The advice and assistance of a bankruptcy attorney is helpful to be certain that all of the required supporting documentation and information is included.

The Creditors' Committee

Service on the "Committee" can be an enlightening experience. The Committee may consult with the debtor

concerning the administration of the case to investigate the acts, conduct, assets, liabilities and financial condition of the debtor, Le Boutique; the operation of Le Boutique's business; the desirability of the continuance of such business; and any other matter relevant to the case or to the formulation of a plan of reorganization.

Preferences and Fraudulent Transfers

If Better Blouses received payment from Le Boutique on non-factored invoices within the 90 days preceding the commencement of Le Boutique's bankruptcy case, and such payment was for past due amounts, a claim against Better Blouses to recover the preferential amount may be available to Le Boutique. A bankruptcy attorney should be consulted so that an appropriate defense can be ready in the event the preference claim is filed.

A fraudulent transfer claim against Better Blouses, although highly unlikely, might also be brought under the appropriate circumstances.

Trademark Protection

If Better Blouses sold Le Boutique pursuant to a distribution or license agreement that provided certain protections for Better Blouses' trademarks, consideration should be given to Le Boutique's intentions regarding the liquidation of its inventory to raise money for operations.

Disclosure Statement and Plan of Reorganization

At some point in the Chapter 11 case, Le Boutique may prepare and file a Plan of Reorganization. If the plan provides for anything other than full payment to all creditors, a Disclosure Statement must be prepared and court approval of its provisions must be obtained before consents to the Plan can be solicited. The Disclosure Statement must contain sufficient information to enable a creditor to determine whether or not to vote in favor of the Plan.

Better Blouses should await the receipt of the Disclosure Statement and then decide whether to vote in favor of or against the plan.

Conclusion

In spite of what you may hear to the contrary, there are Chapter 11 cases where unsecured creditors receive payment in full. There are other cases in which unsecured creditors receive significant dividends because of the actions of Creditors' Committees. To do everything possible to maximize your recovery, consider the matters discussed in this article.



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