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BASIC PRINCIPLES OF BANKRUPTCY AND STATE RECLAMATION

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I. INTRODUCTION

Reclamation of goods is an isolated area of the law. It normally arises when goods have been delivered to a buyer on credit and it subsequently becomes known that the buyer is insolvent. In such an instance, prompt action is required in order to reserve the right to physically reclaim the goods. Issues such as the type of notice required, the method of delivery, the rights of the reclaiming seller against third parties, as well as a variety of others, typically have to be confronted. Additionally, in many instances, the insolvency of a buyer immediately precedes a bankruptcy filing. Different rules govern the reclamation of goods in a bankruptcy context, and alternative remedies are available in some circumstances. This Article attempts to address the nuts and bolts of both state and bankruptcy reclamation principles, providing an overview of the factors required to establish a right to reclamation, as well as a map through the existing pitfalls and snares that an attorney confronts in connection with reclamation.

There are two statutory provisions governing a seller's right to reclaim goods that are the focus of this Article. The first is found in the Uniform Commercial Code (hereinafter "U.C.C.") of most states. In Mississippi, it is located in Mississippi Code Annotated § 75-2-702.[1] That statute defines a seller's right to reclaim goods in a non-bankruptcy context and provides as follows:

> Seller's remedies on discovery of buyer's insolvency.
>
> (1) Where the seller discovers the buyer to be insolvent he may refuse delivery except for cash including payment for all goods theretofore delivered under the contract, and stop delivery under this chapter (Section 2-705) [Section 75-2-705].
>
> (2) Where the seller discovers that the buyer has received goods on credit while insolvent he may reclaim the goods upon demand made within ten (10) days after the receipt, but if misrepresentation of solvency has been made to the particular seller in writing within three (3) months before delivery the ten-day limitation does not apply. Except as provided in this subsection the seller may not base a right to reclaim goods on the buyer's fraudulent or innocent misrepresentation of solvency or of intent to pay.

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1. MISS. CODE ANN. § 75-2-702 is contained in Mississippi's enactment of the Uniform Commercial Code. Similar statutes have been enacted throughout the country, and interpretations of those statutes provide valuable guidance in interpreting Mississippi's provision and are referenced throughout this Article.

2. *Id.*

> (3) The seller's right to reclaim under subsection (2) is subject to the rights of the buyer in ordinary course or other good faith purchaser under this chapter Section 2-403) [Section 75-2-403]. Successful reclamation of goods excludes all other remedies with respect to them.[2]

The official comments to U.C.C. § 2-702 provide guidance as to the construction of the statute. The comments clarify that the seller's right to stop delivery is a remedy available to the seller, regardless of whether title has passed to the buyer. Additionally, the seller has the right to stop a bailee from delivering goods to the buyer. Interpreting subsection (2), the official comment indicates that any receipt of goods on credit is a tacit representation of solvency. Therefore, if goods have been received in the past on credit, that amounts to a tacit business misrepresentation as to solvency. In such an instance, the seller has ten days from the receipt of the goods by the buyer to exercise his rights of reclamation. The exception is when a written misrepresentation of solvency has been made to the particular seller. In such cases, the seller is not bound by the ten-day time period limitation.[3] These rules, as well as others, will be discussed and defined herein.

The second relevant statutory provision is found in the United States Bankruptcy Code (hereinafter "Bankruptcy Code"). The statute is 11 U.S.C. § 101 *et seq.*, specifically, 11 U.S.C. § 546, entitled "Limitation of Avoiding Power," which outlines the reclamation rights of a seller once bankruptcy has been filed by a buyer. The relevant provisions of that statute state that

> the rights and powers of a trustee . . . are subject to any statutory or common-law right of a seller of goods that has sold goods to the debtor, in the ordinary course of such seller's business, to reclaim such goods if the debtor has received such goods while insolvent, but--
>
> (1) such a seller may not reclaim any such goods unless such seller demands in writing reclamation of such goods--
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> (A) before 10 days after receipt of such goods by the debtor; or
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> (B) if such 10-day period expires after the commencement of the case, before 20 days after receipt of such goods by the debtor; and

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3. The Official Comment to § 2-702 of the Uniform Commercial Code provides as follows:
1. The seller's right to withhold the goods or to stop delivery except for cash when he discovers a buyer's insolvency is made explicit in subsection (1) regardless of the passage of title, and the concept of stoppage has been extended to include goods in the possession of any bailee who has not yet attorned to the buyer.
2. Subsection (2) takes as its base line the position that any receipt of goods on credit by an insolvent buyer amounts to a tacit business misrepresentation of solvency and therefore is fraudulent as against the particular seller. This Article makes discovery of the buyer's insolvency a demand within a ten day period a condition of the right to reclaim goods on this ground. The ten day limitation period operates from the time of receipt of the goods.
An exception to this time limitation is made when a written misrepresentation of solvency has been made to the particular seller within three months prior to the delivery. To fall within the exception the statement of solvency must be in writing, addressed to the particular seller and dated within three months of the delivery
3. Because the right of the seller to reclaim goods under this section constitutes preferential treatment as against the buyer's other creditors, subsection (3) provides that such reclamation bars all his other remedies as to the goods involved.

(2) the court may deny reclamation to a seller with such a right of reclamation that has made such a demand only if the court--

(A) grants the claim of such a seller priority as a claim of a kind specified in section 503(b) of this title; or

(B) secures such claim by a lien.[4]

Pursuant to this statute, the seller must establish, by a preponderance of the evidence, that: (1) the seller sold goods on credit to the buyer in the ordinary course of business; (2) the seller delivered those goods to the buyer at a time when the buyer was insolvent; (3) within ten (10) days after the goods were delivered to the buyer, or twenty (20) days in certain instances, the seller made written demand for the return of goods; (4) the buyer had possession of goods at the time of the reclamation demand; and (5) the goods were not in the hands of a buyer in the ordinary course of good faith purchase at the time of the demand.[5] An understanding of these factors, as well as the crucial interplay between § 546 of the Bankruptcy Code and § 2-702 of the U.C.C., are critical when confronted with a reclamation claim.

II. DISCUSSION

A seller of goods is confronted with three probable scenarios when seeking to reclaim goods pursuant to these statutes, all of which relate to where the goods are when the seller exercises his right of reclamation. Under the first possibility, the goods are still in the hands of the seller. Although the seller's rights are termed "reclamation," that term is actually somewhat of a misnomer at this stage. In this situation, as provided under U.C.C. § 2-702(1) and as one could reasonably expect, the seller may refuse to deliver the goods to the buyer unless he receives cash payment, even if the original contract called for credit terms. The contract terms shift from credit to "cash on delivery." A seller may also insist upon cash payment for all deliveries previously made under the existing contract, even though the credit terms have not expired, *i.e.,* payment is not due for those previous deliveries.

The second possibility is that the goods could be in transit to the buyer. In such a situation, the seller may stop delivery of any goods in transit, including goods in the possession of a carrier or other bailee, with certain exceptions discussed infra. It does not matter whether the goods are in the hands of a carrier or a warehouseman for shipment or for storage--the right of stoppage still exists as long as the buyer has not taken possession.[6]

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4. 11 U.S.C. § 546(c) (Supp. 1998). 11 U.S.C. § 546(d) governs reclamation by a farmer or fisherman and is not discussed in this Article.

5. Toshiba Am., Inc. v. Video King, Inc. *(In re* Video King, Inc.), 100 B.R. 1008, 1013-14 (Bankr. N.D. Ill. 1989).

6. Valley Timber Sales, Inc. v. Midway Forest Prods., Inc., 563 So. 2d 612 (Ala. Civ. App. 1990); Haywin Textile Prods., Inc. v. Bill's Dollar Stores, Inc. *(In re* Bill's Dollar Stores, Inc.), 164 B.R. 471, 475-76 (Bankr. D.

If a seller opts to exercise the right of stoppage and the goods are in possession of a bailee, the seller must notify the bailee in sufficient time so the bailee can prevent delivery by exercising reasonable diligence. The seller should also notify the buyer of the stoppage.[7] After the receipt of notification, the bailee must hold the goods and deliver them according to the seller's directions. However, the seller is obligated for any charges or damages sustained by the bailee.

As noted previously, the seller loses the right of stoppage upon the occurrence of certain events. One, obviously, is when the buyer receives the goods. This receipt may be the actual receipt by the buyer or receipt by a third party on behalf of the buyer.[8] A buyer may also be deemed to have effectively received the goods. Under this theory, the right of stoppage may be lost when a bailee, other than a carrier, acknowledges that it is holding the goods on the buyer's account[9] or when the carrier acknowledges to the buyer that it holds the goods for him, either by re-shipping the goods according to the buyer's instructions or by the carrier's acknowledgment to the buyer that it is holding the goods as warehouseman for him.[10] If a negotiable document of title, such as a bill of lading or warehouse receipt, has been issued and is outstanding, the bailee does not have to obey a notification to stop delivery of the goods until the document has been surrendered.[11] The right is also lost when a negotiable document of title, such as a bill of lading or a warehouse receipt, is negotiated to the buyer[12] or when the goods are received by a subpurchaser from the buyer, and perhaps even when they are in transit to the subpurchaser.[13]

This leads us to the final reclamation possibility, which arises when the goods have been delivered to the buyer or the buyer has effectively taken possession of the goods. At this point, the interplay between bankruptcy and state reclamation principles becomes paramount since a buyer's insolvency and inability to pay often immediately preceed his filing of bankruptcy.

Before discussing this interplay, it is important to address the effect of a buyer's bankruptcy on a seller's ability to reclaim goods still in his possession or in transit, *i.e.,* the right of stoppage. Generally, a buyer's filing of bankruptcy has no effect on a seller's ability to reclaim in these situations, and a seller's right of stoppage under state law still exists.[14] The seller does not lose his right to stop in

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Del. 1994).

7. Indussa Corp. v. Reliable Stainless Steel Supply Co., 369 F. Supp. 976, 980 (E.D. Pa. 1974).

8. Donegal Steel Foundry, Co. v. Accurate Prods. Co., 516 F.2d 583, 590 (3d Cir. 1975); Marlow v. Oakland Gin Co. (*In re* Julien Co.), 128 B.R. 987, 997 (Bankr. W.D. Tenn. 1991), *aff'd*, 44 F.3d 426 (6th Cir. 1995).

9. Jimani Corp. v. S.L.T. Warehouse Co., 409 So. 2d 496, 500 (Fla. Dist. Ct. App. 1982), *cert. denied*, Metro Bank of Dallas v. S.L.T. Warehouse Co., 417 So. 2d 330 (Fla. 1982); C.F. Sales, Inc. v. Amfert, Inc., 344 N.W.2d 543, 552 (Iowa 1983).

10. Butts v. Glendale Plywood Co., 710 F.2d 504, 505 (9th Cir. 1983).

11. If a non-negotiable bill of lading has been issued by a carrier, the carrier is not required to recognize a stop notice from anyone other than the co-signor.

12. Marlow v. Oakland Gin Co. (*In re* Julien Co.), 128 B.R. 987, 1001 (Bankr. W.D. Tenn. 1991).

13. *See* Ceres, Inc. v. ACLI Metal & Ore Co., 451 F. Supp. 921 (N.D. Ill. 1978); Interlake, Inc. v. Kansas Power & Light Co., 398 N.E.2d 945, 949 (Ill. App. Ct. 1979); *c.f. Sales*, 344 N.W. 2d at 552; Morrison Indus. v. Hiross, Inc. (*In re* Morrison Indus., L.P.), 175 B.R. 5 (Bankr. W.D.N.Y. 1994).

transit shipments and, more importantly, stoppage does not violate the automatic stay of § 362(a) of the Bankruptcy Code. Additionally, the seller's right is not void under § 545 as a statutory lien.[15]

The remainder of this Article addresses a seller's right of reclamation under § 546 of the Bankruptcy Code and § 2-702 of the U.C.C. and the interplay between these provisions once the goods are actually or effectively received by the buyer. This interplay is important because, once bankruptcy has been filed, § 546(c) of the Bankruptcy Code is the exclusive remedy available to a reclamation seller.[16] However, the Bankruptcy Code does not create the right of reclamation for the seller of goods, but only recognizes that right to a *limited* extent. The Bankruptcy Code borrows from and narrows state reclamation rights by imposing additional procedural and substantive requirements before such rights will be recognized in a bankruptcy case.[17] Both the House and Senate reports on this statute state that "the purpose of the provision is to recognize *in part* the validity of Section 2-702 of the Uniform Commercial Code . . . ,"[18] not to provide a reclamation seller with all of the rights granted under § 2-702.[19] Thus, it is necessary that the seller has a right to reclaim goods under state law before he can establish rights to reclaim under § 546 of the Bankruptcy Code.[20] The interplay between state and bankruptcy reclamation statutes is critically important at this junction.[21]

Prior to the adoption of this section, trustees and debtors would frequently challenge a seller's reclamation rights in bankruptcy on a variety of grounds, including the argument that the trustee's rights as a hypothetical lien creditor under § 70(c) of the former Bankruptcy Act were superior to those of the reclaiming seller. Section 546(c) of the Bankruptcy Code was a legislative response to judicial confusion regarding the treatment of a claiming seller under § 2-702 of the U.C.C. By adopting § 546(c), Congress intended to grant a limited recognition of a seller's reclamation rights against the trustee or the debtor while protecting the potentially superior rights of other creditors.

With this preface, many of the same issues arise under both statutes. They include the following: (1) who bears the burden of proof; (2) what may be

14. *In re* Fabric Buys, 34 B.R. 471, 474 (Bankr. S.D.N.Y. 1983).

15. National Sugar Ref. Co. v. C. Czarnikow, Inc. (*In re* National Sugar Ref. Co.), 27 B.R. 565, 571-72 (S.D.N.Y. 1983).

16. *In re* Kentucky Flush Door Corp., 28 B.R. 808, 810 (Bankr. W.D. Ky. 1983); Energy Coop., Inc. v. Permian Corp. (*In re* Energy Coop., Inc.), 94 B.R. 975, 981 (N.D. Ill. 1988); *In re* Microwave Prods. of Am., Inc., 94 B.R. 967, 969 (Bankr. W.D. Tenn. 1989).

17. Toshiba Am., Inc. v. Video King, Inc. (*In re* Video King, Inc.), 100 B.R. 1008, 1013 (Bankr. N.D. Ill. 1989).

18. H.R. REP. NO. 95-595, *reprinted in* 1978 U.S.C.C.A.N. (Supp. 11c; Dec.; 1978); S. REP. NO. 95-989, *reprinted in* 1978 U.S.C.C.A.N. (Supp. 11c; Dec.; 1978) (emphasis added).

19. *See* Ateco Equip., Inc. v. Columbia Gas (*In re* Ateco Equip., Inc.), 18 B.R. 917 (Bankr. W.D. Pa. 1982).

20. *See* 11 U.S.C. § 546(c) (Supp. 1998) (stating that bankruptcy trustee's powers are "subject to any statutory or common-law right of a seller of goods . . . to reclaim such goods . . .").

21. Though this paper addresses only the interplay between U.C.C. § 2-702 and § 546 of the Bankruptcy Code, § 2-507 of the U.C.C. may also be relevant in determining whether a seller can exercise rights of reclamation under Bankruptcy Code § 546(c). That section relates to cash sales and provides that when "payment is due on demand on delivery to the buyer of goods . . . [the buyer's] right as against the seller to retain or dispose of them is conditional upon [it] making the payment due." Collingwood Grain, Inc. v. Coast Trading Co. (*In re* Coast Trading Co.), 744 F.2d 686 (9th Cir. 1984); Plastic Distrib. Corp. v. Koro Corp. (*In re* Koro Corp.), 20 B.R. 241 (B.A.P. 1st Cir. 1982). However, reclamation typically arises in credit sale situations, which is the subject of U.C.C. § 2-702 and this Article.

reclaimed; (3) how to determine the insolvency of a buyer; (4) how to compute the time limit for demanding reclamation; (5) what type and form the demand should take; (6) what goods are covered by the demand; and (7) what are the rights of a good faith purchaser. On some of these points, the interpretation of the two reclamation statutes does not differ. On others, the Bankruptcy Code sharply curtails the relief which would otherwise be available under state law. In addition, the Bankruptcy Code allows a seller forms of relief other than physical repossession of the goods.

As an initial point, the burden of proving entitlement to relief, by a preponderance of the evidence under § 546(c), is on the reclaiming seller.[22] The same is true under U.C.C. § 2-702. Both statutes also only permit the reclamation of "goods." The following definition of "goods," as provided in the U.C.C., is applicable when interpreting both statutes:

> "Goods" means all things (including specially manufactured goods) which are movable at the time of identification to the contract for sale other than the money in which the price is to be paid, investment securities and things in action. "Goods" also includes the unborn young of animals and growing crops and other identified things attached to realty as described in the section on goods to be severed from realty (Section 2-107) [§ 75-2-107].[23]

Money is included in the definition of "goods" when it is the object of exchange, such as in a currency exchange contract.[24] However, a contract for work, or labor and material, is a contract for services, not a sale of goods.[25]

The next common issue concerns computation of the time in which to serve the demand for reclamation. Under both statutes, the seller may reclaim his goods upon discovery of the insolvency of the buyer who received goods on credit if demand for the goods is made within ten days after the goods were received. Section 546 of the Bankruptcy Code was amended in 1994 to provide that if the ten (10) day period has not run prior to the time that a bankruptcy is filed, the reclaiming seller will have twenty (20) days after the goods are delivered to make the reclamation demand.[26] Also, § 2-702(2) of the U.C.C., which addresses the time limit to reclaim goods under state law, does not apply if there has been a written misrepresentation of solvency. This provision will be discussed extensively infra. Under each statute, if the seller fails to make demand for reclamation within the applicable period, the right is forever lost.

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22. Flav-O-Rich, Inc. v. Rawson Food Serv., Inc. (*In re* Rawson Food Serv., Inc.), 846 F.2d 1343, 1344 (11th Cir. 1988); *Video King*, 100 B.R. at 1013; *In re* Penthouse Travelers of Aripeka, Inc., 120 B.R. 226 (Bankr. M.D. Fla. 1990).

23. MISS. CODE ANN. § 75-2-105(1) (1972).

24. Koreag, Controle Et Revision S.A. v. Refco F/X Assocs., Inc. (*In re* Koreag, Controle Et Revision S.A.), 961 F.2d 341, 355 (2d Cir. 1992), *cert. denied*, 506 U.S. 865 (1992).

25. North Am. Leisure Corp. v. A & B Duplicators, Ltd., 468 F.2d 695, 697 (2d Cir. 1972); 11 U.S.C. § 546(c)(1) (Supp. 1998).

26. Chicago Limousine Serv., Inc. v. Hartigan Cadillac, Inc., 548 N.E.2d 386 (Ill. App. Ct. 1989).

The U.C.C. and Bankruptcy Code are silent on how to compute the time to serve the demand. The most logical approach is to exclude the day the goods are received and give the seller until the end of the tenth day. If the last day is on a Sunday, most courts, applying their states' common or statutory law, would probably allow service of the demand on Monday, the eleventh day.[27] The same rule should apply whether the period is ten days or twenty days.

Also, under each statute, the applicable period does not begin until the goods are received by the buyer. Goods are received when the buyer "take[s] physical control of them."[28] When the goods are shipped free on board ("F.O.B.") seller's place of business, the goods are not considered received by the buyer until actual delivery.[29]

As noted above, under § 2-702(2) of the U.C.C., if a buyer has misrepresented his solvency within three months prior to the delivery of the goods subject to be reclaimed, the ten day period is not applicable. The form of the written document is not spelled out in the U.C.C. The misrepresentation of solvency must be in writing, but there is no requirement that the document be signed by the buyer. Any form of writing relied on by the seller, such as a balance sheet or other type of financial statement, or perhaps a letter signed by the buyer and transmitted to the seller, is acceptable for this purpose under the U.C.C.[30] However, the misrepresentation must be made directly to the seller. A general misrepresentation to a trade or credit association, rather than the seller, would probably not qualify unless there was proof established by the seller that the misrepresentation was made with full knowledge that it would be received and relied upon by the seller. The misrepresentation must also have been made to the seller within the three-month period prior to the time of delivery of the goods to the buyer. In calculating the time period, the three months commences from the date the writing is presented to the seller and not the date on the document.[31] The U.C.C. does not have a time limit within which the seller must make the demand, although the longer the seller waits, the fewer the goods that will be left to reclaim.

One of the important differences between the U.C.C. and Bankruptcy Code reclamation statutes is that § 546(c) of the Bankruptcy Code eliminates the spe-

27. Action Indus., Inc. v. Dixie Enters., Inc. (*In re* Dixie Enters., Inc.), 22 B.R. 855, 858 (Bankr. S.D. Ohio 1982); *In re* Behring & Behring, 5 U.C.C. Rep. Serv. (CBC) 600 (Bankr. N.D. Tex. 1968); McCain Foods, Inc. v. Flagstaff Foodservice Co. New England (*In re* Flagstaff Enters., Inc.), 14 B.R. 462 (Bankr. S.D.N.Y. 1981); Steinberg v. American Chicle (*In re* Meyer-Midway, Inc.), 68 B.R. 181 (N.D. Ill. 1986); *see also* BANKRUPTCY RULE 9006(a) and MISS. R. CIV. P. 6(a) (outlining standards for computation of time).

28. U.C.C. § 2-103(1)(c) (defining "receipt"); *see also* Montello Oil Corp. v. Marin Motor Oil, Inc. (*In re* Marin Motor Oil, Inc.), 740 F.2d 220 (3d Cir. 1984); Conveyco, Inc. v. First Software Corp. (*In re* First Software Corp.), 72 B.R. 403 (Bankr. D. Mass. 1987); Haywin Textile Prods., Inc. v. Bill's Dollar Stores, Inc. (*In re* Bill's Dollar Stores, Inc.), 164 B.R. 471, 475 (Bankr. D. Del. 1994); Morrison Indus. v. Hiross, Inc. (*In re* Morrison Indus., L.P.), 175 B.R. 5 (Bankr. W.D.N.Y. 1994).

29. Aventura Sportswear, Ltd. v. Maloney Enters., Inc. (*In re* Maloney Enters., Inc.), 37 B.R. 290, 292 (Bankr. E.D. Ky. 1983); *see also* Official Comment 2 to U.C.C. § 2-103 (emphasizing difference between shipment of goods and receipt of goods).

30. The courts have held that a check returned for insufficient funds does not constitute a sufficient writing. Mullen v. Sweetheart Cup Corp. (*In re* Bar-Wood, Inc.), 15 U.C.C. Rep. Serv. (CBC) 828 (Bankr. S.D. Fla. 1974); *but see* Theo. Hamm Brewing Co. v. First Trust & Sav. Bank, 242 N.E.2d 911, 915 (Ill. App. Ct. 1968).

31. Potts v. Mand Carpet Mills (*In re* Bel Air Carpets, Inc.), 452 F.2d 1210, 1212 (9th Cir. 1971).

cial provision in U.C.C. § 2-702 pertaining to misrepresentation of solvency. The requirement for written demand, *i.e.*, ten or twenty days, is an *absolute* requirement. The seller must establish that within ten (10) days after the goods were delivered to the buyer, or if such ten (10) day period expires after the commencement of the bankruptcy case, before twenty (20) days after receipt of such goods by the buyer, the seller made written demand for return of the goods, or he forfeits his common law or statutory cause of action.[32] In order to satisfy these requirements, the seller must show which of his goods were received by the buyer and on what dates. Only those goods which were received within the applicable period are potentially subject to reclamation. The reclaiming seller must then show that he submitted the appropriate notice to the buyer within the specified time period.

The next common issue involves the question of the buyer's solvency. Before any right of reclamation under either the Bankruptcy Code or the U.C.C. can be exercised, the buyer must be shown to be insolvent. The test of insolvency under the Bankruptcy Code (the "balance sheet" test) may be more difficult to meet than the test under the U.C.C. (not paying debts as they become due). Section 1-201 of the U.C.C. defines an insolvent person as one who "has ceased to pay his debts in the ordinary course of business or cannot pay his debts as they become due *or* is insolvent within the meaning of the federal bankruptcy law."[33]

Under § 546(c) of the Bankruptcy Code, the first part of the definition of insolvency under the U.C.C. is irrelevant. The only relevant definition of insolvency is contained in § 101(32) of the Bankruptcy Code and provides as follows:

> financial condition such that the sum of such entity's debts is greater than all of such entity's property, at fair valuation, exclusive of--
>
> (i) property transferred, concealed, or removed with intent to hinder, delay or defraud such entity's creditors; and
>
> (ii) property that may be exempted from property of the estate under Section 522 of this title.[34]

This is a balance sheet definition. Under this section, a debtor is insolvent only if his debts are greater than his assets, at a fair evaluation, exclusive of property

32. Haynie v. Gibson Distrib. Co. (*In re* Gibson Distrib. Co.), 40 B.R. 767, 769 (Bankr. W.D. Tex. 1984) (citing American Druggists' Ins. Co. v. Jeanes Mechanical Contractors, Inc. (*In re* Jeanes Mechanical Contractors, Inc.), 32 B.R. 657 (Bankr. W.D. Ky. 1983)); Crown Quilt Corp. v. HRT Indus., Inc. (*In re* HRT Indus., Inc.), 29 B.R. 861, 864 (Bankr. S.D.N.Y. 1983); Ecolotec, Inc. v. Deephouse Equip. Co. (*In re* Deephouse Equip. Co.), 22 B.R. 255, 257 (Bankr. D. Conn. 1982); *In re* Leads Bldg. Prods., Inc., 141 B.R. 265, 267 (Bankr. N.D. Ga. 1992); Flav-O-Rich, Inc. v. Rawson Food Serv., Inc. (*In re* Rawson Food Serv., Inc.), 846 F.2d 1343, 1346 (11th Cir. 1988); CAM/RPC Elecs. v. Robertson (*In re* MGS Mktg.), 111 B.R. 264, 267 (B.A.P. 9th Cir. 1990); Chemical-Ways Corp. v. Hales Mach. Tool, Inc. (*In re* Dynamic Techs. Corp.), 106 B.R. 994 (Bankr. D. Minn. 1989); Pratt Oil Operations v. Charter Int'l Oil Co. (*In re* Charter Co.), 52 B.R. 263, 265 (Bankr. M.D. Fla. 1985).

33. *See* MISS. CODE ANN. § 75-1-201(23) (1972).

34. 11 U.S.C. § 101(32)(A) (1993).

exempted or fraudulently transferred.[35] The balance sheet test concentrates on estimating what can be realized from the sale of the assets within a reasonable time.[36]

Another common thread in statutes is the determination of the type of demand to be made. Section 546(c) of the Bankruptcy Code clearly mandates a written demand.[37] However, U.C.C. § 2-702 is unclear as to whether an oral or written demand is required. There is a diversity of opinion among commentators and courts on this subject. Those who feel that an oral demand is adequate admit the difficulty of proving the demand, but feel it is the seller's problem when it is time to prove the existence of the demand.[38] Yet, the acceptance of oral demand by all courts remains uncertain. Hence, it is suggested that written demand always be issued.

Other characteristics of the demand are particularly important, such as its form and effectiveness. In determining the effectiveness of the demand, the overwhelming majority of courts use the date the demand is mailed.[39] The most effective method of delivering the demand is by facsimile or hand-delivery. Although service of the demand upon the debtor is normally required, service upon the debtor's attorney has been held effective.[40] Telegrams and mailgrams are other methods, but the seller should insist upon a confirmation of time and date of delivery. Making the demand by regular, certified, or registered mail is also a possibility, but it is not recommended due to the typical delays. Delays in receipt of such demand create the possibility that the goods will be disposed of before the demand is received by the buyer.

As to the form, it is recommended that it be general in nature so that it will encompass deliveries by all of the divisions of large corporations. Sellers risk omitting certain invoices when they make specific references to invoices. The most advisable approach is to make a general demand and then follow up with other letters citing specific invoices. This will enable the buyer to identify immediately the goods sought to be reclaimed without running the risk of omitting goods which might be reclaimable.[41]

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35. *See In re* Furniture Distrib., Inc., 45 B.R. 38 (Bankr. D. Mass. 1984) (applying § 101(32) insolvency definition); *In re* Best Buy Drugs, Inc., 89 B.R. 997 (Bankr. S.D. Fla. 1988) (same); Mayer Pollock Steel Corp. v. London Salvage Trading Co. (*In re* Mayer Pollock Steel Corp.), 157 B.R. 952, 960 (Bankr. E.D. Pa. 1993) (same).

36. *In re* Storage Tech. Corp., 48 B.R. 862 (Bankr. D. Colo. 1985); *Mayer Pollock*, 57 B.R. at 961.

37. 11 U.S.C. § 546(c)(1) (1993).

38. United Beef Packers v. Lee (*In re* A.G.S. Food Sys., Inc.), 14 B.R. 27 (Bankr. D.S.C. 1980) (holding an oral demand to be sufficient); Farmers Rice Milling Co. v. Hawkins (*In re* Bearhouse, Inc.), 84 B.R. 552, 558-60 (Bankr. W.D. Ark. 1988) (same); *see also In re* Behring & Behring, 5 U.C.C. Rep. Serv. (CBC) 600 (Bankr. N.D. Tex. 1968) (implying oral demand will be sufficient if the seller followed with an immediate reclamation suit).

39. Montello Oil Corp. v. Marin Motor Oil, Inc. (*In re* Marin Motor Oil, Inc.), 740 F.2d 220, 228-29 (3d Cir. 1984) (holding that demand was effective upon mailing); McCain Foods, Inc. v. Flagstaff Foodservice Co. New England (*In re* Flagstaff Foodservice Corp.), 14 B.R. 462 (Bankr. S.D.N.Y. 1981); Haywin Textile Prods., Inc. v. Bill's Dollar Stores, Inc. (*In re* Bill's Dollar Stores, Inc.), 164 B.R. 471, 473 (Bankr. D. Del. 1994).

40. *Flagstaff Foodservice Corp.*, 14 B.R. at 462.

41. However, it is important to note that the court in *Conoco, Inc. v. Braniff, Inc. (In re Braniff, Inc.)*, 113 B.R. 745, 752 (Bankr. M.D. Fla. 1990) held that "the demand must identify the goods as to which reclamation is sought so as to permit their return . . . ." This court was dealing with fungible goods, and it may be argued that this holding is limited to such goods.

The parent/subsidiary situation creates problems in addressing the form of the demand. Although a demand by a corporation includes deliveries by all of its divisions, it is unlikely that a demand by a parent will include deliveries by subsidiary corporations. Subsidiaries are separate entities, and the sellers must make separate demands. Also, when the seller has sold to a parent and its subsidiaries, separate demands should be made upon each.

Under each statute, it is important to understand which goods are subject to reclamation. A demand is effective to reclaim only the goods on hand at the time of the service of the demand and does not cover the proceeds of goods already sold.[42] To confirm what is on hand, a seller should send a representative to the premises to determine which portion of the seller's goods are on hand at the time of the service of the demand or obtain an acknowledged inventory from the buyer regarding same. If the goods have been processed before the demand, they are non-identifiable and are not subject to reclamation.[43] Fungible goods can be reclaimed if they can be traced to an identifiable mass.[44] If raw goods have been processed, sold to a buyer in the ordinary course of business, or sold to a good faith purchaser, they are not subject to reclamation.[45] If the debtor sells the goods after the demand, the majority of bankruptcy cases have awarded administrative priorities or liens, rather than unenforceable reclamation rights.[46] This last point will be discussed in greater depth infra.

One of the most important issues which arises in the determination of which goods are subject to reclamation under either statute involves the rights as between the reclaiming seller and a good faith purchaser. The rights of a reclaiming seller under U.C.C. § 2-702(3) are subject to the rights of a buyer in the ordinary course of business or other good faith purchaser.[47] In almost every reported decision, a secured creditor with a perfected security interest in after-

42. Flav-O-Rich, Inc. v. Rawson Food Serv., Inc. (*In re* Rawson Food Serv., Inc.), 846 F.2d 1343, 1347 (11th Cir. 1988); Collingwood Grain, Inc. v. Coast Trading Co. (*In re* Coast Trading Co.), 744 F.2d 686, 691 (9th Cir. 1984); U.S. Billiards Co. v. Greenberger (*In re* Bensar Co.), 36 B.R. 699, 702 (Bankr. S.D. Ohio 1984); Champion Int'l Corp. v. Davidson Lumber Co. (*In re* Davidson Lumber Co.), 22 B.R. 775, 776 (Bankr. S.D. Fla. 1982); *In re* Furniture Distribs., Inc., 45 B.R. 38, 45 (Bankr. D. Mass. 1984); Dukseung of Am., Inc. v. New York Wholesale Distrib. Corp. (*In re* New York Wholesale Distrib. Corp.), 58 B.R. 497, 500 (Bankr. S.D.N.Y. 1986); Archer Daniels Midland Co. v. Charter Int'l Oil Co., 60 B.R. 854, 856 (M.D. Fla. 1986); Bethlehem Steel Corp. v. Wheeling-Pittsburgh Steel Corp. (*In re* Wheeling Pittsburgh Steel Corp.), 74 B.R. 656 (Bankr. W.D. Pa. 1987); Coupon Carriers Co. v. J.L. Marsh Mfg. Co. (*In re* Coupon Carriers Co.), 77 B.R. 650, 652 (N.D. Ill. 1987); Jones Oil Co. v. Intercity Oil Co. (*In re* Intercity Oil Co.), 122 B.R. 358 (Bankr. W.D. Wis. 1990).

43. Party Packing Corp. v. Rosenberg (*In re* Landy Beef Co.), 30 B.R. 19, 21 (Bankr. D. Mass. 1983); *Wheeling-Pittsburgh*, 74 B.R. at 657; Monfort, Inc. v. Kunkel (*In re* Morken), 182 B.R. 1007, 1016 (Bankr. D. Minn. 1995).

44. *Braniff*, 113 B.R. at 755.

45. Toshiba Am., Inc. v. Video King, Inc. (*In re* Video King, Inc.), 100 B.R. 1008, 1014 (Bankr. N.D. Ill. 1989).

46. *Davidson Lumber Co.*, 22 B.R. at 776; Western Farmers Ass'n v. Ciba Geigy, 6 B.R. 432 (Bankr. W.D. Wash. 1980); Oliver Rubber Co. v. Griffin Retreading Co., 56 B.R. 239, 240 (D. Minn. 1985), *aff'd*, 795 F.2d 676 (8th Cir. 1986); and Eagle Indus. Truck Mfg., Inc. v. Continental Airlines, Inc. (*In re* Continental Airlines), 125 B.R. 415, 417 (Bankr. D. Del. 1991); *see also* United States v. Westside Bank, 732 F.2d 1258 (5th Cir. 1984) (granting reclaiming seller priority claim to the excess proceeds of a foreclosure sale); *but see* Action Indus., Inc. v. Dixie Enters., Inc. (*In re* Dixie Enters., Inc.), 22 B.R. 855 (Bankr. S.D. Ohio 1982).

47. Secured creditors, under UCC § 1-201(32) and (33), are good faith purchasers; therefore, a seller's reclamation rights are subject to secured creditors' rights. *See* MISS. CODE ANN. § 75-1-201(32) and (33).

acquired inventory (as a good faith purchaser) has been held to have superior rights to a reclaiming seller.[48] For example, under § 2-702, if a creditor has a perfected security interest in after-acquired property, *i.e.,* a floating lien, and the seller of goods attempts to reclaim goods in the buyer's possession, the seller's reclamation attempts would fail due to the creditor's security interest in after-acquired property which attached to the goods upon delivery to the buyer.

The principles of U.C.C. § 2-702(3) apply with equal force when interpreting § 546 of the Bankruptcy Code. Hence, a good faith purchaser, *i.e.,* a secured creditor, has rights superior to a reclaiming seller asserting a claim under § 546(c).[49] However, the fact that a secured creditor has rights superior to those of a seller does not extinguish the seller's right to reclamation. Those rights are merely subject to the rights of a good faith purchaser. Under state law, the seller may still be able to reclaim the goods if he pays the secured creditor the value of his lien prior to obtaining possession. Alternatively, after the goods are sold, the seller may be entitled to the proceeds from the goods after the satisfaction of the secured creditor's claims.[50]

However, in the case of reorganization, because of a debtor's need for both inventory and cash in the earlier stages, it is highly unlikely that the court will award reclamation or require the payment of cash. In the event that the sellers are capable of proving their alleged claims of reclamation, even though they are not entitled to reclaim the goods due to superior interests of a secured party, the reclaiming sellers may nevertheless be entitled to a second lien or an administrative expense claim on the goods still in the buyer's possession under § 546(c)(2)

48. The following cases hold that the good faith purchaser wins against the reclaiming seller: *In re* Haywood Woolen Co., 3 U.C.C. Rep. Serv. (CBC) 1107 (Bankr. D. Mass. 1967); Stowers v. Mahon (*In re* Samuels & Co.), 526 F.2d 1238, 1242 (5th Cir. 1976), *cert. denied*, 429 U.S. 834 (1976); House of Stainless, Inc. v. Marshall & Ilsley Bank, 249 N.W.2d 561, 567 (Wis. 1977); R.J. Reynolds Tobacco Co. v. Friedewald (*In re* Bowman), 25 U.C.C. Rep. Serv. (CBC) 738 (Bankr. N.D. Ga. 1978); Kennet-Murray & Co. v. Pawnee Nat. Bank, 598 P.2d 274, 277 (Okla. Ct. App. 1979); Los Angeles Paper Bag Co. v. James Talcott, Inc., 604 F.2d 38, 39 (9th Cir. 1979); *Western Farmers Assoc.*, 6 B.R. at 436; Petroleum Specialities, Inc. v. McLouth Steel Corp. (*In re* McLouth Steel Corp.), 22 B.R. 722 (Bankr. E.D. Mich. 1982); Harris Trust and Sav. Bank v. Wathen's Elevators, Inc. (*In re* Wathen's Elevators, Inc.), 32 B.R. 912, 922 (Bankr. W.D. Ky. 1983); Kerr Pac. Milling Corp. v. Coast Trading Co. (*In re* Coast Trading Co.), 31 B.R. 663, 664-65 (Bankr. D. Or. 1982); Butts v. Bendix Forest Prods. Corp. (*In re* Summit Creek Plywood Co.), 27 B.R. 209 (Bankr. D. Or. 1982); Ohio Farmers Grain and Supply Ass'n v. Melvin Liquid Fertilizer Co. (*In re* Melvin Liquid Fertilizer Co.), 37 B.R. 587, 589 (Bankr. W.D. Ohio 1984); *Westside Bank,* 732 F.2d at 1262; *In re* Misco Supply Co., 42 U.C.C. Rep. Serv. (CBC) 1662 (D. Kan. 1986); Griffin Retreading Co. v. Oliver Rubber Co. (*In re* Griffin Retreading Co.), 795 F.2d 676, 680 (8th Cir. 1986); A.V. Beebe v. MacMillan Petroleum, Inc. (*In re* MacMillan Petroleum, Inc.), 115 B.R. 175, 180 (Bankr. W.D. Ark. 1990); Shell Oil Co. v. Mills Oil Co., 717 F.2d 208, 212-13 (5th Cir. 1983); *but see In re* American Food Purveyors, Inc., 17 U.C.C. Rep. Serv. (CBC) 436 (N.D. Ga. 1974).

49. *Griffin Retreading Co.,* 795 F.2d at 678; *MacMillan Petroleum, Inc.,* 115 B.R. at 180; *In re* Roberts Hardware Co., 103 B.R. 396, 399 (Bankr. N.D.N.Y. 1988); *In re* Diversified Food Serv. Distribs., Inc., 130 B.R. 427 (Bankr. S.D.N.Y. 1991); *In re* Leads Bldg. Prods., Inc., 141 B.R. 265, 268 (Bankr. N.D. Ga. 1992).

50. 15 MYRON M. SHEINFIELD ET AL., COLLIER ON BANKRUPTCY ¶ 546.04[2][a] (Lawrence P. King ed., 15th ed., 1997).

of the Bankruptcy Code.[51] The alternative remedies are available to the seller only if he otherwise has a valid reclamation right under § 546(c).[52] Whether the court grants a lien or an administrative claim is within the sole discretion of the court.[53] But, if reclamation is denied, one of these alternative forms of relief must be afforded. The relief most often granted by the courts is the granting of an administrative expense claim, which will give the seller a § 507(a)(1) administrative expense priority. This is a very unsatisfactory remedy if the case is converted to Chapter 7 and there are not enough assets to pay all administrative priority creditors. The reclaiming seller, therefore, should negotiate with the buyer for a junior lien on all of the property of the estate or attempt to obtain payment of cash on a deferred basis during administration of the case.[54]

This brings us to a disputed and confusing area under § 546 of the Bankruptcy Code. It involves the amount of an administrative claim or lien to be awarded to a seller in the event there is a superior claim of a secured creditor. As a preface, when there is not a secured creditor with an interest superior to those of the reclaiming seller, but the bankruptcy court nevertheless determines that physical repossession should be denied (since the goods are necessary to the reorganization of the estate), an administrative priority claim or a junior lien is normally granted for the full amount of the value or the full invoice price of the goods in the possession of the debtor when the reclamation was demanded.[55]

However, the amount of the administrative claim or junior lien becomes a more difficult question when the valid right of reclamation is denied not only because the goods are needed in reorganization, but also because a good faith purchaser has an interest in those goods. In this instance, the appropriate course of action would seem to be that any lien or other priority claim granted to a seller should

51. 11 U.S.C. § 546(c)(2) (1993); Pester Ref. Co. v. Ethyl Corp. (*In re* Pester Ref. Co.), 964 F.2d 842 (8th Cir. 1992); Sandoz Pharm. Corp. v. Blinn Wholesale Drug Co. (*In re* Blinn Wholesale Drug Co.), 164 B.R. 440, 444 (Bankr. E.D.N.Y. 1994); *In re* Reliable Drug Stores, Inc., 70 F.3d 948, 951 (7th Cir. 1995); *Melvin Liquid Fertilizer,* 37 B.R. at 589; *Westside Bank*, 732 F.2d at 1265; *In re* Misco Supply Co., 42 U.C.C. Rep. Serv. (CBC) 1662 (D. Kan. 1986); *Griffin Retreading Co.,* 795 F.2d at 679; *Wathen's Elevators,* 32 B.R. at 923; *Davidson Lumber Co.,* 22 B.R. at 776; *Western Farmers Ass'n,* 6 B.R. at 435-36; *In re* Roberts Hardware Co., 103 B.R. 396, 399 (Bankr. N.D.N.Y. 1988); Toshiba Am., Inc. v. Video King, Inc. (*In re* Video King, Inc.), 100 B.R. 1008, 1016 (Bankr. N.D. Ill. 1989); *Leeds Bldg. Prods., Inc.,* 141 B.R. at 269; Isaly Klondike Co. v. Sunstate Dairy & Food Prods. Co. (*In re* Sunstate Dairy & Food Prods. Co.), 145 B.R. 341, 345 (Bankr. M.D. Fla. 1992).

52. *Griffin Retreading Co.,* 795 F.2d at 679-80 (holding that an Alabama reclamation claim requires alternative remedy); Collingwood Grain, Inc. v. Coast Trading Co. (*In re* Coast Trading Co.), 744 F.2d 686, 692 (9th Cir. 1984) (holding that a "right of administrative priority is in lieu of, not in addition to, right to reclaim").

53. *Leeds Bldg. Prods., Inc.,* 141 B.R. at 268-69 (citing Eagle Indus. Truck Mfg., Inc. v. Continental Airlines, Inc. (*In re* Continental Airlines, Inc.), 125 B.R. 415 (Bankr. D. Del. 1991)); and Conoco, Inc. v. Braniff, Inc. (*In re* Braniff, Inc.), 113 B.R. 745, 757 (Bankr. M.D. Fla. 1990).

54. *See generally In re* Buyer's Club Mkts., Inc., 100 B.R. 37 (Bankr. D. Colo. 1989) (allowing reclaiming seller to reclaim its goods because the grant of administrative expense claim would require creditor to continue to monitor case to insure its administrative claim was not in jeopardy).

55. Coupon Carriers Co. v. J.L. Marsh Mfg. Co. (*In re* Coupon Carriers Co.), 77 B.R. 650, 652 (N.D. Ill. 1987) (valuing of goods); McCain Foods, Inc. v. Flagstaff Foodservice Co. New England (*In re* Flagstaff Foodservice Corp.), 14 B.R. 462 (Bankr. S.D.N.Y. 1981) (valuing of goods); *but see* Performance Papers, Inc. v. Georgia-Pacific Corp. (*In re* Performance Papers, Inc.), 119 B.R. 127 (Bankr. W.D. Mich. 1990) (concluding that amount of priority or junior liens should be for invoiced amount of goods in possession of debtor when reclamation demanded). The more logical of the two approaches would be to base the administrative claim or the junior lien on the value of the goods when reclamation was demanded and allow the reclaiming seller to assert an unsecured lien against the estate for the invoice amount in excess of that figure.

be limited to the value, if any, of the reclamation seller's claim under state law and not the full value of the goods delivered to the buyer.[56] As explained earlier, "§ 546 does not enhance the rights of a seller, or give value to rights that had no value outside of bankruptcy, but only protects [some of] the rights that it may have under state law."[57] "If [the] [c]ourt granted a lien or administrative claim to a seller whose right to reclamation was worthless outside of bankruptcy, the seller would, in essence, be given more rights than it would otherwise have under state law . . . ."[58] In a non-bankruptcy context, if a seller asserted a right of reclamation, but there was a prior perfected secured creditor who was undersecured (its collateral was worth less than its debt), the reclamation seller would receive nothing. The reason is that if the goods were sold, the secured creditor would have the first right to the proceeds from the sale, and all of the proceeds would be needed to satisfy his undersecured claim. Only if the secured creditor is oversecured (his collateral is worth more than his debt) would the reclaiming seller be entitled to proceeds from the sale of the goods and only for that oversecured portion.

Following this logic, the Seventh Circuit Court of Appeals has held that in the undersecured instance, the reclaiming seller's claim has no value (and therefore the administrative expense claim of the reclaiming seller is zero).[59] Presumably, if a reclaiming seller sought to reclaim goods encumbered by a security interest and the secured party was oversecured, the seller would only have rights to the oversecured amount. For example, if a reclaiming seller sought to reclaim goods worth $1,000, but a secured creditor had a $700 security interest in those goods, under the theory enunciated under the Seventh Circuit, the bankruptcy court should grant an administrative claim or lien in the amount of $300, *i.e.,* the oversecured portion of the value of the goods.

Although this appears to be the logical result (due to the case law allowing an administrative claim or lien for the full value or invoice price of goods), in practice, sellers often argue that they should be entitled to an administrative claim or lien in that amount, regardless of the secured party's interest.[60] The seller might make the argument that he should be awarded the full value of the goods and be allowed to wait until the conclusion of the case to see what proceeds are actually available to him after satisfaction of the secured creditor's interests. However,

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56. Bindley Western Indus. v. Reliable Drug Stores, Inc., 181 B.R. 374, 378 (S.D. Ind. 1995), *aff'd,* 70 F.3d 948 (7th Cir.); *Blinn Wholesale Drug Co.,* 164 B.R. at 447-49; *see also Leeds Bldg. Prods., Inc.,* 141 B.R. at 269-270 (holding that reclamation lien has no value if lien holder's interest exceeds value of security); Pillsbury Co. v. FCX, Inc. (*In re* FCX, Inc.), 62 B.R. 315, 323 (Bankr. E.D.N.C. 1986); *Video King,* 100 B.R. at 1017.

57. *Leeds Bldg. Prods., Inc.,* 141 B.R. at 269.

58. *Id.*

59. *Reliable Drug Stores, Inc.,* 181 B.R. at 378-79; *see also Blinn Wholesale Co.,* 164 B.R. at 443-44.

60. *Performance Papers, Inc.,* 119 B.R. at 129 (invoicing price of goods used); *but see Flagstaff Foodservice Corp.,* 14 B.R. at 462 (holding the administrative claim to the value of the goods in the debtor's possession on the date demand was made); Coupon Carriers Co. v. J.L. Marsh Mfg. Co. (*In re* Coupon Carriers Co.), 77 B.R. 650, 652 (N.D. Ill. 1987) (holding that an administrative claim was limited to the actual proceeds of the sale of the inventory involved in the goods to be reclaimed); *In re* Marko Electronics, Inc., 145 B.R. 25, 29 (Bankr. N.D. Ohio 1992) (holding that an administrative claim was limited to the actual proceeds of the sale of the inventory involved in the goods to be reclaimed); *see generally Leeds Bldg. Prods.,* 141 B.R. at 269 (citations omitted) (stating, "[o]ne line of cases seemingly supports the proposition that once a valid right to reclaim is established, a seller should receive a lien or administrative claim for the full amount of the goods sought to be reclaimed[]").

this argument is flawed. Under state law, the amount of the reclamation claim is normally determined soon after the request for reclamation is filed. The reason is simple. The longer you wait, the more likely the goods are to be disposed of and the more unlikely it would be for the parties to come to an agreement as to the appropriate amount of a reclamation claim. The same is true in the bankruptcy context. Furthermore, in a bankruptcy case, settlements are often reached with secured parties whereby they take less than the value of their secured interest, particularly if their secured interest is in dispute. In such a case, the secured party's claim could disappear or be diminished, and the seller would arguably then be entitled to an increased or full administrative claim. This would work to the detriment of the unsecured creditors, which is not the logical or equitable result.

Therefore, it would seem that the value of the administrative claim or lien should be established as soon as practicably possible after the reclamation demand is asserted. The amount of the administrative claim should be computed by looking at the records, as of the date of the demand, showing the amount of inventory on hand and comparing those with the financial records which demonstrate the amount of the secured party's interest on that date. Any other approach risks allowing a seller rights which he would not otherwise be entitled to under state law and jeopardizing the rights of the unsecured creditors.

Although the Fifth Circuit has not specifically addressed the issue, existing case law construing U.C.C. § 2-702 seems to indicate that it would rule that a lien or administrative claim should only be granted to the extent a secured creditor is oversecured. In *United States v. Westside Bank*, which construes U.C.C. § 2-702, the court recognized that a seller's right of reclamation is subordinate to a pre-existing perfected security interest in the buyer's after-acquired property.[61] After the prior perfected security interest holders' interests are satisfied, *Westside* provides that the reclamation seller is entitled to priority over the general unsecured creditors as to the remaining traceable proceeds from the sale of the goods trapped by the reclamation demand.[62] In *Westside*, after the reclamation demand was delivered, the goods were sold at a foreclosure sale.[63] Thereafter, the after-acquired property security interest holder's interests were satisfied and proceeds remained from the sale of those goods.[64] The Court ruled that the reclamation seller had a priority interest in the remaining proceeds after the senior liens had been satisfied.[65]

The point which was not specifically addressed, but implied by this opinion, is if the proceeds from the foreclosure sale had been insufficient to satisfy the debt owed to the security interest holder in after-acquired property, the reclamation seller would have received nothing. Only if there are proceeds left after the sale of the property does the reclamation seller receive a benefit. Hence, only to the

61. United States v. Westside Bank, 732 F.2d 1258, 1261 (5th Cir. 1984).
62. *Id.* at 1263.
63. *Id.* at 1261.
64. *Id.*
65. *Id.*

extent that the secured creditor is oversecured does the reclamation claimant benefit under the state reclamation statute and, by logical extension, § 546 of the Bankruptcy Code.

Several other issues are particularly relevant under § 546. First, goods delivered after the date of bankruptcy filing (post-petition) are not subject to reclamation because they are delivered in the ordinary course of business to a debtor-in-possession and have already been afforded administrative expense priority status.[66] The delivery of goods on the date of the bankruptcy filing will be treated as a potential reclamation claim if delivered *prior* to the time of filing and a post-petition delivery if delivered after the time of the filing. All of the courts considering the issue have held that the filing date will be fractionalized for purposes of classifying the status of goods delivered.[67] However, from a practical viewpoint, most buyers treat all deliveries on the date of filing as post-petition deliveries.

Additionally, service of the demand after the filing of the bankruptcy petition does not violate the automatic stay.[68] Once a written demand is served, the seller should immediately file a complaint for the reclamation of goods. This should be an adversary proceeding under the Bankruptcy Rules, not a contested matter.[69] The seller might also consider obtaining a temporary restraining order, preventing the disposition of the goods until a hearing can be held on the adversarial matter. This is important since some courts have held that a seller who fails to diligently assert his reclamation rights can lose the right of reclamation and the right to obtain an administrative expense priority claim or junior lien.[70]

III. CONCLUSION

In conclusion, both sellers and buyers in either a non-bankruptcy or a bankruptcy context should be familiar with the principles of reclamation set forth in § 2-702 of the U.C.C. and § 546 of the Bankruptcy Code. Under § 2-702, a seller may stop the goods in transit to a buyer under a variety of circumstances. There are some risks to the seller when he attempts to stop goods in transit, including liability to the bailee or transit carrier for damages and/or transportation fees. The right of stoppage, however, is not affected by the filing of bankruptcy by a buyer and continues even after the buyer has filed for bankruptcy protection.

Once the goods are actually or effectively received by the buyer, the interplay between § 2-702 and § 546(c) often becomes important. Indeed, a buyer's inabil-

66. 11 U.S.C. § 507(a) (1993).

67. *See* Bojaland and Co. v. Breakstone (*In re* Holiday Meat Packing Inc.), 30 B.R. 737, 740 (Bankr. W.D. Pa. 1983); Ducker v. Fairmeadows II (*In re* Bridges Enters., Inc.), 62 B.R. 300, 302 (Bankr. S.D. Ohio 1986); and Vanco Trading, Inc. v. Monheit (*In re* K Chem. Corp.), 188 B.R. 89, 95-96 (Bankr. D. Conn. 1995).

68. Cowles Tool Co. v. Production Steel, Inc. (*In re* Production Steel, Inc.), 21 B.R. 951, 954 (Bankr. N.D. Tenn. 1982); *In re Flagstaff Foodservice Corp.*, 14 B.R. at 462; and *In re Julien Co.*, 128 B.R. at 1001; *see also* Patrick A. Murphy, *Creditor's Rights in Bankruptcy,* 140.5 Note .5, at p. 14 (1988).

69. *See* BANKR. RULE 7001; *In re* Buyers Club Mkts., Inc., 100 B.R. 37, 38 (Bankr. D. Colo. 1989).

70. Tate Cheese Co. v. Crofton & Sons, Inc. (*In re* Crawford and Sons, Inc.), 139 B.R. 567, 569 (Bankr. M.D. Fla. 1992); *see also In re* Adventist Living Ctr., Inc., 171 B.R. 310, 313 (N.D. Ill. 1994), *aff'd*, 52 F.3d 159 (7th Cir. 1995) (holding that it is reasonable for seller to rely on debtors' attorney's promise to take inventory without any further action).

ity to pay for goods, in many instances, immediately precedes his filing of bankruptcy. Once bankruptcy has been filed, § 546(c) is the exclusive remedy available to the reclaiming seller. Under § 546, the seller may reclaim the goods only if (1) he is entitled to reclaim under state law, and (2) he is entitled to reclaim under the relevant provisions of § 546(c). There are numerous points that are relevant in determining whether a seller may, in fact, validly assert a reclamation claim. These points include, but are not limited to, evaluating the buyer's insolvency, complying with the time periods, issuing the proper demand and asserting it properly to attach to all goods, and evaluating and dealing with the superior rights of a good faith purchaser. This Article is intended to serve as a guide to buyers and sellers in dealing with these issues.