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## LEGAL INFORMATION FOR THE CONSTRUCTION INDUSTRY

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## Protecting Yourself in the Face of Bankrupt Customers

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Knowing your rights when it comes to dealing with bankrupt customers has become crucial for many business owners in recent times in getting paid for goods and services. Understanding the basics of “reclamation rights” and “critical vendor” status is a good place to start in protecting your business while still moving forward in this economy.

### RECLAMATION RIGHTS: defined:

Reclamation permits a vendor to take back a certain amount of goods that it sold to a customer who is unable to pay, either before or after filing for bankruptcy.

### **Before filing Bankruptcy:**

If the customer has not yet filed, the vendor shall look to the Uniform Commercial Code (UCC) for the required reclamation guidelines. The UCC allows for a vendor to reclaim goods bought on credit “while insolvent” if the demand is made within 10 days after the customer received the goods, and is limited to only those goods received during the prior 10 days.

The written demand must be:

- in writing
- identify the specific goods, and
- served on the vendor (i.e. certified mail, or some other method that allows for delivery confirmation).

### **After Filing Bankruptcy:**

Reclamation after the debtor has filed for bankruptcy is governed by the Bankruptcy Code.

A vendor has 45 days to demand reclamation of the goods, given the transaction(s) fall within certain guidelines:

- first, the goods must have been sold during the “ordinary course” of the vendor’s business;
- second, the goods must have been received while the debtor was insolvent.
- The demand must also be in writing and served within 45 days of receipt of the goods by the debtor. If the 45 day period expires after the bankruptcy is filed, the vendor must make the reclamation demand within 20 days after the filing.

Any creditors of the company in bankruptcy will be notified by the bankruptcy court. It is always in the best interest of the creditor to make the reclamation demand as early as possible.

However, the Bankruptcy Code has provided a section that allows for an administrative priority claim for the value of any goods received by the debtor within 20 days prior to the filing for those goods sold in the “ordinary course” of business.

### CRITICAL VENDOR STATUS: defined:

“Critical Vendor” status applies when certain vendors are “critical” to the ongoing business of the debtor after the bankruptcy filing as it applies to reorganization.

Typically, under the Bankruptcy Code, a debtor is **not permitted** to pay any of the amounts that were owed prior to the filing.

However, the courts have created an exception for certain vendors who prove to be essential to the ongoing business.

The vendor must demonstrate to the debtor, and eventually to the court, that they will only continue to provide said goods and/or services if:

- They are paid for their pre-petition claim, and
- that without the vendor’s continued business, reorganization would be exceedingly difficult, if not impossible

Obtaining “critical vendor” status is never guaranteed and should not be relied upon.

Rather, a vendor is better off acting quickly in exercising its reclamation rights, while pursuing a parallel path towards becoming a critical vendor.

The hiring of a lawyer is an important decision that should not be based solely upon advertisements. Before you decide, ask us to send you free written information about our qualifications and experience. Additionally, the information above is not intended to be legal advice. Please consult with an experienced lawyer if you have a specific issue or dispute.