

WHAT TO DO WHEN YOUR CUSTOMER BECOMES INSOLVENT

BY RYAN K. KAUFFMAN

A business can fail or encounter financial distress for any number of reasons, including the financial difficulties of the business' customers. For companies that supply or sell goods and equipment, the financial health of their business customers, and their ability to pay for their orders, is obviously an important concern. While not every late invoice payment is a cause for alarm, when a business customer becomes insolvent or unexpectedly files for bankruptcy (either voluntarily or involuntarily), the seller who has provided goods to that customer on credit stands to lose a great deal. By acting quickly, however, a seller/creditor in such a position can take steps to minimize any loss.

The two statutory schemes that affect a seller/creditor's rights in such a situation, including the right of reclamation, are the Uniform Commercial Code ("UCC"), as it has been adopted in Michigan, and the federal bankruptcy code. Under the UCC, a seller of goods has a number of alternatives upon discovery that the buyer is insolvent, which is defined as a person who has ceased paying, or is unable to pay, his or her debts as they become due, or whose debts are greater than his or her assets at fair valuation.

First, 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. Consequently, the sale is transformed from one based on credit to a "cash on delivery" sale. This alternative obviously offers the greatest protection to the seller/creditor, because the seller either receives full payment or stops delivery and maintains control of the goods. The seller/creditor should not accept a "cash on delivery"

payment by check that has not been certified by the bank, due to the risk that the check will be returned due to insufficient funds.

Moreover, assuming the buyer is able to make payment upon delivery, there is no danger that the payment will later be considered an avoidable preferential transfer should the buyer subsequently declare bankruptcy. The bankruptcy code allows the trustee to recover certain payments made by the bankrupt to its creditors in the 90 days before the filing of a bankruptcy petition if those payments are considered

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"preferential transfers." Under such circumstances, the creditor is required to return the payment to the bankruptcy estate. However, in order to be considered "preferential" the transfer must be "for or on account of antecedent debt owed by the debtor before such

transfer is made." With a cash on delivery sale, the goods and payment are exchanged simultaneously. Thus, there is no payment on an antecedent (previous) debt, and the payment can never be considered "preferential transfer" that may be recovered.

The seller/creditor also has the general ability to stop the delivery of goods that are in transit. This right to reclaim goods in transit upon discovery that the buyer is insolvent or has filed a bankruptcy petition exists whether the goods are in possession of a carrier or in possession of a bailee for storage. The seller, however, must notify the bailee in sufficient time so that the delivery can be prevented through the exercise of reasonable diligence. The seller should also notify the buyer/debtor of the stoppage at the same time. A wise

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seller/creditor will have adequate procedures in place to allow it to quickly identify and notify the appropriate agents or employees of the carrier company or bailee in case the need should arise. With delivery stopped, the seller may then transform the sale to a cash sale, or arrange for the return of the goods. Importantly, the seller/creditor's right to stop the delivery of goods in transit does not violate the automatic stay that is issued by the bankruptcy court upon the filing of a petition. However, it must be remembered that the seller/creditor's right to automatically reclaim the goods that are in transit does not exist if any negotiable document of title covering the goods has been negotiated by the buyer/creditor.

Of course, depending on the exact timing of events, it is quite likely that the buyer/debtor will already

“Importantly, the seller/creditor’s right to stop the delivery of goods in transit does not violate the automatic stay that is issued by the bankruptcy court upon the filing of a petition.”

be in possession of the goods or equipment, when the seller discovers that the buyer is insolvent or has filed a bankruptcy petition. Still, even under this circumstance, the seller/creditor has a remedy. The seller/creditor may reclaim its goods upon discovery of the insolvency of a buyer who received the goods on credit, if demand is made within ten (10) days after the goods were received. While the UCC does not specifically require that the demand for reclamation of goods be in writing, it could be risky to rely solely on an oral demand. The most effective method of demand would likely be facsimile or hand-delivery, to minimize any delay in communicating the demand. The demand should sufficiently identify the goods for which reclamation is sought in order to permit their return. If the exact nature of the goods is initially unknown, the best course of action is to make an immediate general demand and then follow up with a more specific demand as information becomes available. Further, the seller/creditor should make a demand for reclamation if the buyer/creditor's insolvency is discovered within ten (10) days of the buyer's receipt of goods if payment was made by check to guard against the contingency that the check will be

returned due to insufficient funds. If the check is returned, it may very well be returned after the ten-day reclamation period has lapsed.

The seller/creditor's right to reclamation is not perfect, and it is often subject to perfected security interest on the buyer's after-acquired inventory or the rights of bona fide purchasers who bought the goods from the buyer in good faith. Other considerations arise where the buyer files a petition for bankruptcy during the seller/creditor's ten-day reclamation period. Service of a demand for reclamation does not violate the automatic stay, and after serving the demand, the seller/creditor should also file a complaint for reclamation of goods in the bankruptcy court.

In the end, dealing with customers who might default on credit purchases is a risk of doing business. However, if the seller/creditor is diligent and aware of his rights, the adverse affects arising from customer defaults may be reduced. If you learn that a major customer has filed for bankruptcy, you should immediately contact legal counsel to walk you through the available strategies to improve your position in the bankruptcy.



Mr. Kauffman is a member of the Litigation Department at Fraser Trebilcock Davis & Dunlap, P.C. in the Lansing office. Mr. Kauffman's areas of practice include Real Estate Law, General and Commercial Litigation and Utility Law. He can be reached at 517/377-0881 or rkauffman@fraserlawfirm.com.

DOS AND DON'TS OF PROTECTING YOUR IDEAS AND INVENTIONS

BY: TONI L. HARRIS

The purpose of obtaining a patent is to prevent others from making, using, selling, offering for sale, or importing the patented invention. Your patentable invention is a valuable asset that must be protected, although applying for and prosecuting a patent is not an inexpensive endeavor. Furthermore, if you are willing to spend the time and money to patent your intellectual property, then you should be prepared to enforce your rights to maintain its economic value.

Litigation of a patentable idea or invention should be a top concern for an inventor during the initial development phase of the invention, and also while applying for a patent and marketing the invention. When enforcing your patent rights, there are various tactics employed by alleged infringers to invalidate or narrow the scope of your patent and avoid liability for infringement. As an inventor and patentee, there are steps you can take early to minimize the risk:

Do:

- 1) Contact an attorney registered to practice before the United States Patent & Trademark Office (USPTO) as soon as possible to review your idea/invention;
- 2) Document a timeline of the development of the idea/invention and provide a copy to your attorney;
- 3) Identify any co-inventors and their contributions to the invention, as they may be identified in the patent application;
- 4) Request a patentability search of the prior art related to your idea or invention;
- 5) Provide to your attorney a description of the invention, with as much detail as possible, and drawings or photographs; and
- 6) Consider filing a provisional patent application with the USPTO during the development phase of, and prior to marketing, your invention.

Don't:

- 1) DON'T share your idea/invention with anyone without a signed confidentiality agreement prepared by counsel;
- 2) DON'T solicit help from a third party to develop or test your idea or invention without a signed confidentiality agreement prepared by counsel;
- 3) DON'T wait more than one year after first publicly disclosing your invention to file a patent application in the United States – patent protection is time-barred even if your invention would otherwise be patentable (in many foreign countries, public disclosure instantly precludes obtaining patent protection);

4) DON'T wait more than one year after first offering your invention for sale to file a patent application in the United States – patent protection is time-barred even if your invention would otherwise be patentable (in many foreign countries, an offer for sale instantly precludes obtaining patent protection); and

5) DON'T prepare and file a patent application without the assistance of a patent agent or attorney licensed to practice before the USPTO.



Ms. Harris is a member of the Litigation Department at Fraser Trebilcock Davis & Dunlap, P.C. She practices Intellectual Property Law and Litigation and is licensed to practice in front of the U.S. Patent and Trademark Office. Ms. Harris can be reached at 517/377-0839 or tharris@fraserlawfirm.com.

ATTORNEY ACTIVITIES OF NOTE

■ Peter L. Dunlap delivered a lecture on product liability to the Michigan State University School of Engineering's Senior Engineering Design Course on April 2, 2007. Mr. Dunlap has provided this service to the Engineering School every term for ten years.

■ Robert B. Nelson, Ryan K. Kauffman, and Nickki L. Proulx represented AARP in a case before the Michigan Public Service Commission (MPSC). A settlement was reached with AT&T and other parties wherein all customers receiving primary basic local exchange service will receive a 9.5% discount in the rate AT&T had asked for (and is currently charging) through the end of 2008. AT&T also agreed, at the attorneys' recommendation, to publicize the discount on their web site and have a link from their site to the MPSC web site, in order to allow more customers to sign up for the service. The settlement was approved on April 3, 2007.

■ Peter D. Houk spoke at the ICLE Annual Advanced Negotiation and Alternative Dispute Resolution Institute (ANDRI) on March 22, 2007. On March 26, 2007, Mr. Houk served on a panel of four presenters to the Michigan Attorney General's staff. The topic of the panel was Alternative Dispute Resolution.

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