Oh No! The Buyer's Check Bounced After I Shipped the Next Truckload of Materials. What Do I Do Now?

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Legal Alert

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QUESTION: OH NO! THE BUYER'S CHECK BOUNCED AFTER I SHIPPED THE NEXT TRUCKLOAD OF MATERIALS. WHAT DO I DO NOW?

ANSWER: YOU MAY STOP DELIVERY OF GOODS IF YOU DISCOVER THE BUYER IS INSOLVENT.

You just sent two railroad carloads of lumber to the customer in another state when you learn that the last check from the customer has bounced. You know that you can demand reclamation of the goods after delivery because of your discovery of the buyer's insolvency. (UCC § 2-702.) Yet, you know that the customer's bank has a blanket lien on all of the customer's assets. Once the goods are actually delivered, your right to reclaim them will be defeated by the security interest of the bank in all of your customer's inventory. What do you do?

As seller, you may stop delivery of goods in the possession of a carrier or other bailee (for example, the airline, railroad or freight service) when you discover that your customer is insolvent. In fact, you may stop delivery of "carload, truckload, planeload or larger shipments of express or freight when the buyer repudiates or fails to make a payment due before delivery or if for any other reason, the seller has a right to withhold or reclaim the goods." (UCC § 2-702.A.)

So you immediately call, email, or otherwise notify the trucking company, railroad, or other carrier to stop delivery of the goods and return them to you. You can stop delivery until the buyer receives the goods. You can stop delivery until a warehouse or other bailee acknowledges to the buyer that it has the goods and is holding it for your customer. You also lose the right to stop delivery if the buyer has reshipped the goods during transit or put them into a warehouse. Finally, you lose the right to stop delivery upon negotiation to your customer of any negotiable document of title covering the goods.

In order to stop delivery, you must notify the holder of the goods (the "bailee") by reasonable diligence to prevent delivery. After the bailee receives such notification, it must hold and deliver the goods according to your directions, but you are liable to the bailee for any charges or damages it may incur as a result of your notification to stop delivery.

If a negotiable document of title has been issued for the goods, the bailee does not need to obey your notification to stop delivery unless there is a surrender of possession or control of the negotiable document. On the other hand, a carrier who has issued a non-

negotiable bill of lading is not obliged to obey a stop delivery notification received from anyone other than the consignor.

What?

What we are trying to tell you is that if you think your customer is insolvent or won't be able to pay you for the products being shipped, stop delivery as soon as possible. You have the right to stop delivery if you discover that your customer is insolvent. You may stop delivery of larger amounts such as carloads, truckloads or planeloads if your customer repudiates the deal or fails to make a payment due before delivery. (In other words, if the check that was the payment in advance bounces, stop delivery!)

Once the goods are actually delivered to your customer, you still have the right to demand reclamation under UCC § 2-702. Such a demand for reclamation may be a hollow remedy, however, where the bank has a blanket lien on all personal property of the debtor. As soon as the goods are delivered, they are subject to the bank's lien and you will not get your product returned. While you may have an administrative priority claim in the ensuing bankruptcy of your customer, that still won't be as good as simply stopping delivery and selling your goods to somebody who is able to pay for them.

If you have reason to stop delivery of goods, do it immediately. The case of *Butts v. Glendale Plywood Co.*, 710 F.2d 504 (9th Cir. 1983) illustrates the need to move quickly if you believe your customer is insolvent and the goods are still in transit. Summit Creek Plywood Company ("Summit Creek") bought two railroad carloads of lumber from Glendale Plywood Company ("Glendale Plywood") in March. On April 15, Glendale Plywood received shipping instructions. On April 17, Glendale Plywood shipped the two railroad carloads of lumber. On April 19, while the goods were in transit, Summit Creek sold the lumber to Davidson Lumber Sales and changed the railroad waybills to show Summit Creek as the shipper and Davidson Lumber Sales as the consignee. Summit Creek then sold the resulting account receivable from Davidson Lumber Sales to Walter E. Heller Western, a factoring agent.

The railroad followed Summit Creek's instructions and sent the railroad carloads of lumber to Davidson Lumber Sales. On April 28, Glendale Plywood figured out that Summit Creek could be insolvent and told the railroad to stop both cars. The railroad stopped both cars and Glendale Plywood then sold the lumber directly to Davidson Lumber Sales. The lumber was delivered to Davidson Lumber Sales on May 3.

Not surprisingly, Summit Creek went into bankruptcy on May 3. The bankruptcy trustee in the Summit Creek case sued Glendale Plywood saying it could not stop the shipment.

To cut through all the legal analysis, the issue was whether Glendale Plywood was going to get paid. If Glendale Plywood stopped delivery properly and then sold the lumber directly to Davidson Lumber Sales, then Davidson Lumber Sales would pay Glendale Plywood and Glendale Plywood would be happy.

If, on the other hand, the stoppage of delivery was ineffective and Summit Creek was still the seller of the plywood to Davidson Lumber Sales, then the payment by Davidson Lumber Sales would go to the bankruptcy trustee, rather than to Glendale Plywood.

The court found that the railroad's redirection of the carloads of lumber from Summit Creek to Davidson Lumber Sales at the direction of Summit Creek was a reshipment of the goods. The reshipment of the lumber cutoff Glendale Plywood's right to stop delivery under UCC § 2-705(2)(c). The court thought that "defining re-shipment as the point at which the seller's right to stop shipment ceases provides a time at which the rights of all parties are fixed." So when Summit Creek sold the goods in transit to Davidson Lumber Sales and directed the reshipment in transit to Davidson Lumber Sales, Glendale Plywood lost its rights to stop delivery. Rather than getting paid directly from Davidson Lumber Sales outside of the bankruptcy, Glendale Plywood was left with an unsecured claim in the Summit Creek bankruptcy.

The lesson to be learned is that if you determine that your buyer is insolvent or its check bounces while the goods are in transit, you need to stop delivery immediately. If the goods have been resold while in transit, your right to stop delivery will be defeated. Once the goods have been delivered, you may assert a demand to reclaim those goods, but you will lose the priority fight to the bank who is the secured creditor on all assets of your customer. While you are entitled to an administrative priority claim for all goods delivered to the debtor within the 20 days before the filing of the bankruptcy, that priority claim may not be paid for a long time, if ever.

If you would be interested in discussing ways to protect your business from the insolvency of your customers in advance of making shipments, please feel free to call me.