

# Bankruptcy & Restructuring Law Monitor

PROVIDING COMMENTARY AND THE LATEST UPDATES ON BANKRUPTCY & RESTRUCTURING LAW

PUBLISHED BY



## All Hope May Not Be Lost For a Seller of Goods to an Insolvent Buyer

Posted at 4:24 PM on August 3, 2009 by Kenneth L. Baum

In these days of economic uncertainty and write-offs, sellers should be aware of their right under Section 2-705 of the Uniform Commercial Code (UCC) to stop the delivery of goods in transit to an insolvent buyer who has not taken physical possession of the goods. “Insolvent,” within the meaning of the UCC, means that a buyer has “...generally ceased to pay debts in the ordinary course of business other than as a result of bona fide dispute ...” In some cases, litigation may be necessary to determine the issue of insolvency. Additionally, a buyer may refuse or defeat a demand to stop goods in transit where (a) it has actually received the goods in question, (b) a bailee of the goods (other than a carrier) acknowledges it is holding the goods for the buyer, (c) a carrier, through reshipment or warehousing, makes such acknowledgment to the buyer, or (d) the buyer has negotiated a negotiable document of title to the goods.

A seller’s right to stop in transit exists even where the buyer has filed for bankruptcy protection, as courts have held that a seller is not required to seek relief from the automatic stay provisions of the Bankruptcy Code before exercising its right to stop delivery. Moreover, because an effective stoppage of delivery divests the buyer of title to the goods at issue, goods purchased, but never received, by a buyer who has filed for bankruptcy protection, never become part of the bankruptcy estate.

Cole Schotz recently represented a client who stopped goods in transit to Fortunoff’s, which purchased a substantial amount of furniture and other merchandise on credit from various overseas sellers shortly before filing a Chapter 11 bankruptcy petition. In many cases, the bill of lading issued

by the carrier provided that title to the goods passed to Fortunoff's when they were loaded for delivery to New York. Upon learning of Fortunoff's bankruptcy filing, many sellers (including our client), whose shipments had not yet arrived at Fortunoff's New York warehouse facility, issued notices that they were stopping the shipments in transit pursuant to Section 2-705 of the UCC. The bankruptcy court in Fortunoff's Chapter 11 case rejected Fortunoff's argument that the passage of title and the application of the automatic stay rendered the sellers' demands ineffective, and held that any goods that were the subject of a valid stop in transit demand were not property of Fortunoff's bankruptcy estate.

As the Fortunoff's example illustrates, a seller of goods to an insolvent buyer, including a buyer who has filed for bankruptcy protection, who seeks to minimize its losses should consider the stop in transit provisions of the UCC and seek relief in the bankruptcy court to ratify its actions.

Cole, Schotz, Meisel, Forman & Leonard, P.A.

Court Plaza North  
25 Main Street  
Hackensack, NJ 07601  
Phone:  
(201) 489-3000

900 Third Avenue  
16th Floor  
New York, NY 10022  
Phone:  
(212) 752-8000

500 Delaware Avenue  
Suite 1410  
Wilmington, DE 19801  
Phone:  
(302) 652-3131

300 East Lombard Street Suite 2000  
Baltimore, MD 21202  
Phone:  
(410) 230-0660