CONTRACT FORMATION: COMMON LAW

- Contract Created by Offer and Acceptance
- Mirror Image Rule
- Acceptance at Variance With Offer = Rejection/Counteroffer
- Last Document Controls Terms

UNIFORM COMMERCIAL CODE
ARTICLE 2 – SALES

- Applies to Domestic Sales of Goods
- Contains uniform provisions for:
  - Formation of contracts
  - Terms
  - Warranties – protection for buyer
  - Remedies
  - State not Federal law
  - May vary by state
UNIFORM COMMERCIAL CODE
ARTICLE 2 – SALES
CONTRACT FORMATION

- Offer
  - Purchase order
  - E-mail
  - Telephone call
  - Supply agreement

UNIFORM COMMERCIAL CODE
ARTICLE 2 – SALES CONTRACT FORMATION

- Acceptance
  - Performance – e.g., shipment
  - Promise to perform (e.g., ship) by certain date
  - Confirmation/terms and conditions
  - Signed credit application/terms and conditions
  - Other action evidencing acceptance
  - By electronic medium

BATTLE OF THE FORMS

- Contract May be Created Even if Variance Between Offer and Acceptance
- If both parties are merchants, different or additional terms may become part of sales contract unless:
  - They are a material alteration;
  - Counterparty objects; or
  - Offer limits acceptance terms
- Conduct May Signal Acceptance of Additional Terms
BATTLE OF FORMS EXAMPLES OF PROVISION LIMITING NEW TERMS

- **Buyer’s Side**
  - “Any acceptance of this order that contains terms inconsistent with or in addition to the terms of this order is not binding unless agreed to by buyer in writing.”

- **Seller’s Side**
  - “Buyer shall not change any of the terms and conditions contained in this Credit Application, unless seller agrees in writing.”

MODIFICATION OF SALE CONTRACTS

- **Agreement of Parties**
- **One Exception: Prior Agreements May be Changed by:**
  - Course of performance, course of dealing, or usage of trade; and
  - Consistent additional terms
  - Unless the court finds the prior written agreement was intended as a complete and exclusive statement of the terms of the agreement

TITLE AND RISK OF LOSS

- **Shipment Contract**
  - Seller delivers goods to carrier for delivery to the buyer
  - Unless otherwise agreed, both title and risk of loss pass to buyer when carrier receives the goods

- **Terms**
  - FOB (Free on Board) place of shipment
  - FAS (Free Alongside) at a named port
  - CIF (price includes Cost of the Goods, Insurance and Freight)
  - C&F (price includes Cost of the Goods, and Freight)
TITLE AND RISK OF LOSS

- Destination Contract
  - Requires seller to guarantee delivery of goods to specific destination
  - Unless otherwise agreed, title and risk of loss pass to buyer when goods arrive at destination
  - Seller responsible for delivery expense to destination

- Terms
  - FOB destination
  - Ex-ship
  - No arrival, no sale

WARRANTIES

- Protections to Persons Purchasing Goods
- Express Warranties
  - Seller promises regarding quality, character and suitability of goods
  - Example: Goods will conform to description or sample
- Implied Warranties
  - Imposed by law
  - Merchantability
  - Fitness for particular purposes

WARRANTIES

- Warranties Can be Limited or Excluded
  - “As-is” “where is”
  - With all faults
  - Waiver of warranty of merchantability must mention merchantability and be conspicuous

- Liability – Damage Limitations
- Limited Period for Buyer to Assert Claims
**UNIFORM COMMERCIAL CODE**

**REMEDIES – ADEQUATE ASSURANCE DEMAND**

- **UCC 2-609 Governs**
- **Upon Reasonable Grounds for Insecurity, a Contract Party Can Demand Adequate Assurance of Due Performance From Financially Distressed Party**
  - Form of Adequate Assurance Demand – Supp. Tab 1 at p. 1
- **Pending Receipt of Such Performance, the Contract Party Can Suspend Performance**
- **Financially Distressed Party's Failure to Provide Such Performance Within Reasonable Time Not Exceeding 30 Days Results in Repudiation of Contract**

---

**UNIFORM COMMERCIAL CODE**

**REMEDIES – ADEQUATE ASSURANCE DEMAND**

- **Reasonable Grounds for Insecurity**
  - Determined by “commercial standards” as between merchants
  - Customer past due
    - With the seller
    - With other vendors

---

**UNIFORM COMMERCIAL CODE**

**REMEDIES – ADEQUATE ASSURANCE DEMAND**

- **Additional Reasonable Grounds for Insecurity**
  - Default under Debtor's loan facility
  - Concern over Debtor's ability to pay upcoming principal and/or interest installment on bond debt
  - Downgrade by credit rating agency to unacceptably low level
  - Continued poor financial results
  - Threats of customer bankruptcy
UNIFORM COMMERCIAL CODE
REMEDIES – ADEQUATE ASSURANCE
OF PERFORMANCE

• What constitutes adequate assurance of performance?
  • Revoke credit terms and switch to cash in advance
  • Collateral security
  • Letter of credit

STOPPAGE OF DELIVERY

• Creditor's Right to Stop Delivery of Goods to Customer Due to Insolvency or Breach Governed by UCC 2-702, 2-703 and 2-705
  • Debtor's insolvency
    • Balance Sheet: Liabilities exceed assets
    • Equity: Failure to pay debts as they mature

STOPPAGE OF DELIVERY

• Withholding Delivery of Goods in Creditor's Possession and Switching to Cash Terms Going Forward
• Stopping Delivery of Goods in Possession of Carrier/Warehouse/Other Third Party
STOPPAGE OF DELIVERY

- Notice Must be Given to Carrier/Warehouse and Debtor
  - Form of Stoppage of Delivery Notice – Supp. Tab 2 at p. 2
- Following Notice, Carrier, Warehouse/Other Third Party Must Hold and Deliver Goods According to Seller’s Direction
  - Seller liable for charges or damages

STOPPAGE OF DELIVERY

- Right of Stoppage of Delivery Cut Off by Any of the Following:
  - Debtor’s receipt of goods
  - Acknowledgment by warehouse that it is holding goods for Debtor
  - Acknowledgment by carrier that is holding goods for Debtor by reshipping/holding
  - Negotiation to Debtor of negotiable bill of lading or warehouse receipt

STOPPAGE OF DELIVERY RIGHTS VS. SECURED INVENTORY LENDER

- Stoppage of Delivery Rights Superior to Secured Inventory Lender’s Rights
- In Contrast, Reclamation Rights are Subordinate to Secured Inventory Lender’s Rights
STOPPAGE OF DELIVERY—AFTER BANKRUPTCY FILING

- Seller Retains Rights Under UCC to Stop Delivery
- Not Precluded by Automatic Stay
- Debtor Usually Ends up Paying for Stopped Goods
- Must Seek Automatic Stay Relief in Bankruptcy Court to Obtain Return of Goods
- Be Prepared to Incur Charges of Carrier/Warehouser Holding Goods Prior to Release to Debtor or Return to Creditor

STATE LAW RECLAMATION

Uniform Commercial Code Section 2-702

Requirements for Reclamation
- Credit terms/cash terms
- Debtor insolvent
  - Balance Sheet: Liabilities exceed assets
  - Equity: Failure to pay debts as they mature

STATE LAW RECLAMATION – REQUIREMENTS

- Reclamation Demand Describing Goods
  - Written demand not required but recommended
    - Form of State Law Reclamation Demand – Supp. Tab 3 at p. 3
    - Preference risk arising from return of goods within 90 days of customer bankruptcy in response to oral reclamation demand
- Demand Sent Within 10 Days of Debtor’s Receipt of Goods
  - Written misrepresentation of solvency exception
STATE LAW RECLAMATION

- **Defenses**
  - Sale of goods to good faith/bona fide purchaser prior to demand
    - Includes a creditor with a blanket security interest in inventory
  - Goods processed prior to demand
  - Goods commingled, cannot be traced prior to demand

---

STATE LAW RECLAMATION

- **Remedy:**
  - Recovery of goods
  - Replevin action in state court to obtain possession
    - Multiple replevin actions when goods are in multiple jurisdictions

---

BANKRUPTCY RECLAMATION

- **Avoidance Powers of Trustee**
  Subject to Rights of Seller of Goods That has Sold Goods to Debtor in Ordinary Course of Seller's Business to Reclaim Such Goods if Debtor has Received Such Goods While Insolvent, Within 45 Days Before Commencement of Bankruptcy Case
BANKRUPTCY RECLAMATION

- Deadline to Reclaim Goods
  Extended From 10 Days to 45 Days
  After Debtor's Receipt of Goods (or
  20 days After Bankruptcy Filing)
- Written Reclamation Demand
  - Form of Bankruptcy Reclamation
    Demand – Supp. Tab 4 at p. 4

BANKRUPTCY RECLAMATION

- State Law Reclamation Defenses Apply
  in Bankruptcy Cases. In re Dana
  Corp. (Bankruptcy Court,
  Southern District of New York –
  2007)
- Reclamation Rights Limited to
  Identifiable Goods in Debtor's
  Possession
- Debtor's Insolvency – Balance Sheet

BANKRUPTCY RECLAMATION REMEDIES

- Return of Goods
- No Other Statutory Remedies
- Courts May Create Remedies in the Future
  - Payment?
  - Administrative Claim?
  - Other?
**WARNING!!!** Seller’s Reclamation Rights Still Subject to Prior Rights of a Creditor With a Security Interest in Such Goods

- Are reclamation claims rendered valueless by Debtor’s pre-petition secured inventory lender?

**Recent Court Decisions Continue Trend of Rendering Reclamation Rights Valueless as a Result of Pre-Petition Lender Secured by Inventory**

- **Exception:** 6th Circuit Court of Appeals Decision in *Phar Mor Case*

**6th Circuit Rejected Other Court Holdings That Reclamation Rights are Wiped Out if Proceeds of Goods Paid Down Secured Claims**

- U.S. Bankruptcy Court, Northern District of Texas – 2009, in *Pilgrim’s Pride*, – Denied Reclamation in Light of Floating Pre-Petition Inventory Lien
BANKRUPTCY RECLAMATION UNDER BAPCPA – A HOLLOW REMEDY?

- Sounds Great on Paper
- Recovery Prospects Uncertain, But Possible!
- Send Reclamation Demand and Don’t Ignore this Remedy!

BANKRUPTCY “20 DAY” ADMINISTRATIVE CLAIM

- Administrative Claim for the Value of Goods Received by the Debtor Within 20 Days Prior to Bankruptcy
- 20 Day Goods Must be Sold to the Debtor in the Ordinary Course of Debtor’s Business
- Reclamation Rights Still Relevant for Goods Received by Debtor From 21–45 Days Before Bankruptcy

BANKRUPTCY “20 DAY” ADMINISTRATIVE CLAIM

- Safety Net for Trade Creditors that Supply Goods Not Services!
- Disregards More Onerous Requirements for Successful Reclamation
  - No written reclamation demand required
  - No secured inventory lender defense
  - No goods on hand requirement
  - No solvency defense
BULK SALE UCC ARTICLE 6

- Designed to Protect Creditors From Risk of Merchants Selling All Their Inventory for Less Than Fair Value
- Bulk Transfer is a Transfer of Majority of Inventory
- Many States Have Repealed Their Bulk Transfer Statutes
  - Other statutory remedies, such as fraudulent transfer claims, are available to protect trade creditors

BULK TRANSFER UCC ARTICLE 6

- Remaining States Have Either Original or Revised UCC Article 6
- Original Article 6
  - Bulk sale occurs if there is a sale “of a major part of the materials, supplies, merchandise and other inventory” outside of the ordinary course of business
  - 10-day bulk sale notice requirement to all creditors of seller
  - Buyer must maintain list of seller's creditors and schedule of property obtained in bulk sale
  - Creditors can void non-compliant bulk sale
  - Very short 6 month statute of limitations
  - Concealed sales toll statute of limitations

BULK TRANSFER REVISED UCC ARTICLE 6

- Lessens The Burdens On Bulk Sale Buyers
- Includes Newly Defined Terms, such as “bulk sale,” “date of bulk sale” etc. Which Increase Certainty
- Bulk Sale is a Sale of More Than Half of Seller's Inventory Outside the Ordinary Course of Business and Under Conditions In Which “Buyer has Notice... that Seller will Not Continue To Operate the Same or Similar Kind of Business After the Sale.”
- Excepts any Asset Sales that Fall Below a Net Value of $10,000, or that Exceed $25 Million
- 45-Day Notice Requirement
- Where Seller has more than 200 creditors, notice requirement can be satisfied by filing the notice with the Secretary of State, rather than giving notice to all creditors
BULK TRANSFER
UCC ARTICLE 6

- Information Retained for Creditors Differs from that Required Under Original Article 6
  - Buyer and Seller Must Agree on Net Contract Price to be Distributed and include in “Written Schedule of Distribution” to accompany notice to Creditors
- Remedy
  - Money damages for non-compliance equal to creditor's claim reduced by any amount the creditor would not have realized if the buyer had complied
  - Buyer has good faith defense
  - Extends statute of limitations from 6 months to 1 year from date of bulk sale

CONSENSUAL SECURITY INTEREST – GOVERNING LAW

- Governing Law Article 9 – Uniform Commercial Code
  - State not federal law
  - May vary by state

TRANSACTIONS NOT SUBJECT TO UCC ARTICLE 9

- Mechanic's Liens
- Aircraft, Ships and Motor Vehicles
- Wages
- Insurance Contracts, Except for:
  - Healthcare insurance receivables
  - Proceeds of UCC collateral
CONSENSUAL SECURITY INTEREST – CREATION

- Security Agreement Granting Security Interest in Collateral
  - Identifies Debtor and secured party
  - Must be signed or authenticated by Debtor
  - Must properly describe collateral by asset category
- Debtor has Interest in Collateral
- Value Extended to Debtor
  - Trade credit extension
  - Forbearance from collection

CONSENSUAL SECURITY INTEREST – CREATION

- Name of Debtor
  - Correct legal name
  - How to verify?
- Authority of Signer

CONSENSUAL SECURITY INTEREST – CLASSIFICATION OF COLLATERAL

- Accounts
- Goods
  - Inventory
  - Equipment
- Instruments
- Chattel paper
- General intangibles
- Investment property, such as securities and brokerage accounts
- Deposit accounts
- Letters of credit rights
- Commercial tort claims
- Supporting obligations
- Proceeds
CONSENSUAL SECURITY INTEREST – PERFECTION

• Perfection
  • Usually by filing UCC Financing Statement
    - See UCC Financing Statement – Supp. Tab 5 at pp. 5-6
    - Does not require Debtor's signature
    - File by Debtor's correct legal name
      • Impact of filing against wrong name?
      • Impact of filing against trade name!

CONSENSUAL SECURITY INTEREST – PERFECTION

• Where to file UCC
  • State of Debtor's location
    - State of registration for corporation or limited liability company
    - State of principal place of business for unregistered entity – general partnership
    - State of residence for individual
  • Usually with Secretary of State, but check!
    - Couple of states provide for local UCC filing

CONSENSUAL SECURITY INTEREST – PERFECTION

• Longevity of UCC Financing Statement
  • Not perpetual
  • General rule: 5 years
    - May vary by state
  • UCC Continued by Filing Continuation
    • Must be filed within 6 months prior to expiration
    • See UCC Amendment – Supp. Tab 6 at p. 7
CONSENSUAL SECURITY INTEREST – PERFECTION

- Amending UCC
  - Debtor name change
    - Old name seriously misleading
  - Adding/deleting collateral
  - Address changes
- UCC Amendment Form
  - For name changes, must file within 4 months to relate back
  - See UCC Amendment – Supp. Tab 6 at p. 7

CONSENSUAL SECURITY INTEREST – PERFECTION

- Other Means of Perfection
  - Possession of collateral
  - Control of collateral

PERFECTION METHODS BY TYPE OF COLLATERAL
CONSENSUAL SECURITY INTEREST – PRIORITY

How to Find Competing Security Interests/Liens
- Do UCC/Lien Search
- Where?
  - State of Debtor's location
  - State where Debtor's physical assets are located
  - State of Debtor's principal place of business

Priority Rules
- General rule: first to perfect wins
- Exceptions with Priority Over First to Perfect
  - Purchase Money Security Interests
  - Consignments
  - IRS and Certain Other Statutory Liens

Purchase Money Security Interest (“PMSI”)
- Security interest granted to seller of goods to secure purchase price
- Requires compliance with UCC Article 9
- Priority over prior perfected security interest in inventory by following UCC Article 9 rules for PMSI superpriority status
CONSENSUAL SECURITY INTEREST – PURCHASE MONEY SECURITY INTEREST

- UCC Article 9 Rules for Superpriority Status
  - PMSI Security Agreement signed or authenticated by Debtor
  - Equipment
    - UCC filing within 20 days of receipt by Debtor
  - Inventory
    - UCC Filing before Debtor's receipt of goods
    - Authenticated written notification to prior secured inventory creditors
    - See PMSI Notice – Supp. Tab 7 at p. 8
    - Good for 5 years

CONSIGNMENT

- Consignment
  - Delivery of goods having a value of at least $1,000 to merchant for sale provided:
    - No security interest created in consigned goods
    - Goods not consumer goods prior to delivery; and
    - Merchant deals in goods of that kind under name other than that of consigner, is not auctioneer and is not generally not known by creditors to be substantially engaged in selling goods of others

CONSIGNMENT (cont'd)

- Consignment (cont'd)
  - Requires UCC filing and compliance with UCC Article 9 – Supp. Tab 8 at p. 9
  - Priority over prior perfected security interest in inventory by following UCC Article 9 PMSI rules for superpriority status – Supp. Tab 9 at p. 11
## UCC ARTICLE 9 REMEDIES

- **Default is Condition to Debtor's Exercise of Article 9 Remedies**
- **Not Defined in UCC Article 9**
- **Governed by Contract**
  - Nonpayment
  - Other events of default

## UCC ARTICLE 9 REMEDIES FOLLOWING DEFAULT

- **Collection Rights re Accounts**
- **Repossession of Collateral (Inventory/Equipment)**
- **Disposition of Collateral**
  - Public vs. private sale
  - Notice requirements
    - Debtor
    - Guarantor/Secondary Obligor
    - Other creditors with security interest in same assets
  - Commercial reasonableness
  - Discharges creditor's security interest and subordinate liens and security interests

## UCC ARTICLE 9 REMEDIES FOLLOWING DEFAULT

- **Strict foreclosure**
- **Secured party acquires collateral in full or partial satisfaction of secured claim**

**Requirements**
- Debtor's consent
- Notice to
  - Guarantor/secondary obligor
  - Other secured creditors
- No timely objection
Bruce S. Nathan is a member of the firm's Bankruptcy, Financial Reorganization & Creditors' Rights Group. Mr. Nathan concentrates on all aspects of bankruptcy law, including avoidance actions, Plan confirmation, asset sales, asset purchases, executive compensation, reorganization, reorganization creditors, recovery creditors, an

Affiliations

• New York State Bar Association
• American Bankruptcy Institute
• National Association of Credit Management
• Member of FCIB, an Association of Executives in Finance, Credit and International Business. Presented at Law Institute on Commercial Loan Workouts & UCC Issues, December 13, 2007, on key provisions of People’s Claims: At Last, A Court Speaks,

E-mail: bnathan@lowenstein.com

Institute of Management Accountants Member, Board of Directors

Primer - “Last in Line”

Effective Seller Remedies When Confronting a Financially Distressed Buyer

Demystifying Chapter 15 of the Bankruptcy Code,

Credit Card Payments as Preferences: The Sixth Circuit Joins the

Claims: At Last, A Court Speaks,

E-mail: bnathan@lowenstein.com
The Refco Blueprint!,
Bruce Nathan,
American Bankruptcy Institute Journal, May 2005

Are Reclamation Claims Heading for Oblivion Where the Debtor Has a
Critical Vendor?,
Bruce Nathan,
Business Credit, September 2005

Critical Vendor Status Is No Escape From PREFERENCE Risk,
Bruce Nathan,
Business Credit, May 2005

Be Toxic to Collectibility,
Bruce Nathan,
Business Credit, November/December 2003

Consignment the Right Way: File a UCC Financing Statement,
Bruce Nathan,
Lowenstein Sandler Bankruptcy Alert, May 6, 2005

Extra, From the Appellate Corner - Hot Off the Presses: Delaware
Critical Vendor Payments Denied by Kmart Ruling - Part 1,
Bruce Nathan,
American Bankruptcy Institute Journal, May 2004

 humanoid

preferences, reclamation and paca in one case: a three-ring circus,
Bruce Nathan,
American Bankruptcy Institute Journal, November 2004

preferences, reclamation and paca in one case: a three-ring circus,
Bruce Nathan,
American Bankruptcy Institute Journal, November 2004

preferences, reclamation and paca in one case: a three-ring circus,
Bruce Nathan,
American Bankruptcy Institute Journal, November 2004

preferences, reclamation and paca in one case: a three-ring circus,
Bruce Nathan,
American Bankruptcy Institute Journal, November 2004

preferences, reclamation and paca in one case: a three-ring circus,
Bruce Nathan,
American Bankruptcy Institute Journal, November 2004

preferences, reclamation and paca in one case: a three-ring circus,
Bruce Nathan,
American Bankruptcy Institute Journal, November 2004

preferences, reclamation and paca in one case: a three-ring circus,
Bruce Nathan,
American Bankruptcy Institute Journal, November 2004

preferences, reclamation and paca in one case: a three-ring circus,
Bruce Nathan,
American Bankruptcy Institute Journal, November 2004

preferences, reclamation and paca in one case: a three-ring circus,
Bruce Nathan,
American Bankruptcy Institute Journal, November 2004

preferences, reclamation and paca in one case: a three-ring circus,
Bruce Nathan,
American Bankruptcy Institute Journal, November 2004

preferences, reclamation and paca in one case: a three-ring circus,
Bruce Nathan,
American Bankruptcy Institute Journal, November 2004

preferences, reclamation and paca in one case: a three-ring circus,
Bruce Nathan,
American Bankruptcy Institute Journal, November 2004

preferences, reclamation and paca in one case: a three-ring circus,
Bruce Nathan,
American Bankruptcy Institute Journal, November 2004

preferences, reclamation and paca in one case: a three-ring circus,
Bruce Nathan,