

UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA
THIRD DIVISION

IN RE: Chapter 11 Case
Youth Fair, Inc., BKY Case no. 3-89-3935
Debtor, ADV no. 3-90-191
Plaintiff,

v. MEMORANDUM ORDER

The Schwab Company, a
division of S. Schwab Company,
Inc., a Maryland Corporation,

Defendant.

This matter came before the Court on cross-motions for summary judgment. Plaintiff claims that as a matter of law, its cash payment to the defendant was an impermissible post petition transfer under 11 U.S.C. 549(a). The defendant cross-moved, claiming that the cash payment was a proper satisfaction of its reclamation demand under 11 U.S.C. 546(c). Plaintiff is represented by Darrell B. Johnson. Defendant is represented by William Douglas White.

This is a core proceeding under 28 U.S.C. Sections 1334 and 157 (a). The Court has jurisdiction to determine this matter under 28 U.S.C. Section 157(b)(2)(F). Based upon all the files and records

in

this case, being fully advised in the premises, the Court now makes the following Order pursuant to the Federal and Local Rules of Bankruptcy.

I.

FACTS

The Plaintiff and defendant have stipulated to the following facts. On October 10, 1989, Schwab, the defendant, shipped goods to Youth Fair, the plaintiff, in the ordinary course of business. Youth Fair received these goods on October 13, 1989 along with the invoice, No. 3839 dated October 10, 1989, in the amount of \$724.55.

Youth Fair filed a petition for relief under Chapter 11 of the United States Bankruptcy Code on October 17, 1989. On this same day, Schwab shipped more goods to Youth Fair on three different invoices, Nos. 6710, 6711, 6712, totalling \$3819.54. Youth Fair received these goods on October 20, 1989. At this time, National City Bank of Minneapolis had a valid perfected security interest in all of the inventory of Youth Fair to secure a debt in the amount of \$2,600,000.00.

On October 20, 1989, Schwab sent a written demand to reclaim those goods sent to Youth Fair on the above invoices. Youth Fair was in possession of the goods at the time of receipt of the reclamation demand. After Schwab made the reclamation demand, Youth Fair and Schwab discussed Youth Fair's desire to pay for the goods rather than returning and reordering similar goods. On October 27, 1989, Schwab entered a credit in the amount of the above invoices and re-invoiced the goods on invoice nos. 18985, 18986, 18987, and 18988.

On October 30, 1989, Youth fair returned some goods totalling \$792.00 to Schwab upon agreement by the two parties. One day later, Youth Fair drew a check in the amount of \$3,752.12--the amount of the above four invoices less the credits for the returned goods. The memorandum on this check read "[w]ith this check, reclamation notice dated 10/20/89 has been satisfied." The check was sent to Schwab at an undetermined date. Schwab claims that it was entitled to reclamation under 11 U.S.C. Section 546(C) and thus the cash payment was a proper transfer of property of the estate. The plaintiff argues that the cash payment was an improper transfer under 11 U.S.C. Section 549(a).

After the payment, Youth Fair marked the goods, distributed them to their stores and sold them in the ordinary course of business. On August 1, 1990, all of Youth Fair's inventory was sold free and clear of liens pursuant to an Order of this Court approving the sale of Youth Fair's assets. The agreement for the sale of Youth Fair's assets satisfied National City Bank's security interest in full.

ISSUES

Whether the cash payment by Youth Fair to Schwab, instead of the return of goods upon Schwab's reclamation demand, was an impermissible post-petition transaction under 11 U.S.C. Section 549(a)?

DISCUSSION

1. Standard for Summary Judgment

Rule 56(c) of the Federal Rules of Civil Procedure provides that summary judgment:

shall be rendered forthwith if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law.

A moving party must meet this standard to prevail in a motion for summary judgment. Summary judgment is proper under Rule 56(c) if the pleadings, depositions, answers to interrogatories and admissions on file together with the affidavits, if any, show that there is no genuine issue of material fact and that the

moving party is entitled to judgment as a matter of law. Celotex Corp. v. Catrett, 477 U.S. 317, 322 (1986).

The existence, however, of a material factual dispute is sufficient only if the disputed fact is determinative of the outcome under the applicable law. Egger v. Phillips, 710 F.2d 292, 296 (7th Cir.) (en banc), cert denied, 464 U.S. 918 (1983). On a motion for summary judgment, the inferences to be drawn from the underlying facts must be viewed in the light most favorable to the party opposing the motion. Anderson v. Liberty Lobby, Inc., 477 U.S. 242 (1986).

The parties in the present case have stipulated to all the relevant facts. Thus, there are no genuine issues of material facts. This case is ripe for summary judgment.

2. Cash payments in lieu of goods received by Youth Fair on October 13 and 17, 1989, under 11 U.S.C. 546(c).(FN1) To succeed under Section 546(c), the seller must prove these elements:

- 1) That it sold goods on credit to the debtor in the ordinary course of business;
- 2) That the debtor was insolvent, as defined by the Bankruptcy Code, at the time it received the goods;
- 3) That it made a written demand for the return of goods within ten days after the debtor received the goods; and
- 4) The debtor was in possession of the goods at the time of the demand.

In Re Video King of Illinois, Inc., 100 B.R. 1008, 1013-14(Bankr. N.D.Ill. 1989).

It is undisputed by the parties that the Schwab sold the goods to Youth Fair on credit in the ordinary course of business, that Youth Fair was insolvent when it received the goods, that Schwab sent Youth Fair a written reclamation demand, and that Youth Fair was in possession of the goods at the time it received the demand. Thus, Schwab has met each of the above elements and had a right to reclaim the goods under 11 U.S.C. Section 546(c).

Youth Fair claims, however, that Schwab's reclamation rights were subject to the security interest of National City Bank and thus, Youth Fair could not return the goods upon demand. The court need not address this issue since the bank's security interest was satisfied in full.

The question now becomes whether Youth Fair's cash payment to Schwab, to satisfy the reclamation demand, was an impermissible transaction under 11 U.S.C. Section 549(a).

Youth fair argues that the cash payment was a post-petition transfer which was made to satisfy a pre-petition debt. It claims that the trustee may avoid such transactions under 11 U.S.C. 549(a).(FN2) Schwab argues that the trustee's powers to

(FN1) 11 U.S.C. Section 546(c) reads:

Except as provided in subsection (d) of this section, the rights and powers of a trustee under sections 544(a), 545, 547, and 549 of this title are subject to any statutory or common-law right of a seller of goods that has sold goods to the debtor, in the ordinary course of such seller's business, to reclaim such goods if the debtor has received such goods while insolvent, but--

(1) such a seller may not reclaim any such goods unless such seller demands in writing reclamation of such goods before ten days after receipt of such goods by the debtor; and

(2) the court may deny reclamation to a seller with such a right of reclamation that has made such a demand only if the court--

(A) grants the claim of such a seller priority as a claim of a kind specified in section 503(b) of this title; or

(B) secures such a claim by a lien.

(FN2) 11 U.S.C. 549(a) provides in part:

Except as provided in subsection (b) or (c) of this section, the trustee may avoid a transfer of the property of the estate --

(1) that occurs after the commencement of the case; and

(B) that is not authorized under this title or by the court.

avoid the transfer are subject to its reclamation rights under Section 546(c) and that these rights extend to the cash payment.

Section 546(c) subjects the powers of the trustee under Section 549 only to any statutory or common-law right of the seller to reclaim goods. It requires "as a premise that the reclaiming seller have an independent right of reclamation under applicable nonbankruptcy law." In re Video King of Illinois, Inc., 100 B.R. 1008, 1013 (Bankr. N.D.Ill. 1989). Section 546(c) is a narrow exception to the rule that all of the debtor's post petition transactions are frozen. In re Dynamic Technologies Corp., 106 B.R. 994, 1004 (Bankr. D.Minn. 1989). It provides only limited protection to sellers attempting to reclaim their goods. Id.

The seller's independent right of reclamation in this case derives from Minn. Stat. Ann. Section 336.2-702.(FN3) Section 336.2-702 provides only for the return of goods. It does not provide for cash payments in lieu of goods. See Minn. Stat. Ann. Section 336.2-702. Although Schwab had a statutory right to reclaim the goods, it did not have a statutory right to cash

payment. Thus, Section 546(c) does not extend protection to the cash payment. The trustee's power to avoid the post petition

(FN3) Minn.Stat. Ann. 336.2-702 provides in part:

(2) Where the seller discovers that the buyer has received goods on credit while insolvent the seller may reclaim the goods upon demand made within ten days after the receipt, but if misrepresentation of solvency has been made to the particular seller in writing within three months before delivery the ten day limitation does not apply. . . . (emphasis added).

transfer under Section 549(a) is not subject to whatever rights that Schwab may have to the cash payment.

Schwab cites *In re Bearhouse, Inc.*, 84 B.R. 552 (Bankr. W.D.Ark. 1988) for the proposition that cash payments can be substituted for the goods upon a reclamation demand. See *Id.* at 559. The passage that Schwab quotes is merely dictum. The Court found that the seller had rights to the proceeds from the sale of the reclaimed goods on a theory grounded in Arkansas state law. *Id.* at 561.

Schwab also cites *Oliver Rubber Co. v. Griffin Retreading Co. Inc.*, 56 B.R. 239 (D.Minn. 1985), *aff'd*, 795 F.2d 676 (1986) and *In re Western Farmers Ass'n*, 6 B.R. 432 (Bankr. W.D. Wash 1980) for a similar proposition. Schwab's reliance on these case is misplaced. In both cases, the debtor had ignored the seller's reclamation demand. *Oliver Rubber*, 56 B.R. at 240; *In re Western Farmers Ass'n*, 6 B.R. at 434. Consequently, neither court held that the seller was entitled to cash payment in lieu of the goods. The *Oliver Rubber* court held that the appropriate remedy was an administrative expense claim, *Oliver Rubber*, 56 B.R. at 241, and the *In re Western Farmers Ass'n* court granted a lien on the debtor's assets. *In re Western Farmers Ass'n*, 6 B.R. at 436.

CONCLUSION

Although Schwab had a right to reclaim the goods under 11 U.S.C. Section 546(c), it was not entitled to cash payment in lieu of the goods. The trustee may recover the transfer under Section 549(a). In this case, the debtor in possession has the rights of the trustee to recover the transfer from the defendant. 11 U.S.C. Section 1107.

Since reclamation is impossible because the goods are no longer available, the appropriate action in this case would be to deny reclamation and proceed to the other statutory alternatives of Section 546(c). *Matter of Griffin Retreading Co.*, 795 F.2d 676 (8th Cir. 1986). Schwab will be granted an administrative expense priority claim under 11 U.S.C. Section 546(c)(2)(A). The plaintiff's motion for summary judgment is granted and defendant's motion is denied.

NOW, THEREFORE, IT IS ORDERED:

1. The debtor, Youth Fair may recover the post-petition cash transfer of \$3,752.12 under 11 U.S.C. Sections 549(a) and 1107.

2. The defendant is entitled to an administrative expense claim in the amount of \$3,752.12 under 11 U.S.C. Sections 546(c)(2)(A) and 503(b).

LET JUDGMENT BE ENTERED ACCORDINGLY.

Dated: February 14, 1991.

Dennis D. O'Brien
U.S. Bankruptcy Judge