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# Are You "Betting the Company" Through Your Handling of Customer Funds or By Virtue of Transfer of Title Provisions Related to Acquisition of Goods?

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Two common types of arrangements between contracting parties can create excessive financial risk for a party. The first is a company serving as a middleman or payment agent by accepting funds from a customer and then disbursing funds received to pay for goods or services that benefit the customer, not the agent. Examples include ad agencies accepting customer funds and paying for ad creation and placement, and logistics companies paying freight bills of their customers from customer funds.

The doomsday scenario is as follows. Big Retail Co. incurred $3 million of shipping bills over a 90-day period. Freight Agent Co. received funds from Big Retail to pay the shipping bills, but the funds were not paid timely to Freight Agent and then Big Retail filed bankruptcy at the end of the 90-day period.

Several years later, the trustee for the Big Retail's bankruptcy estate filed suit against Freight Agent to recover the $3 million in payments as "preferential transfers" even though Freight Agent's fee tied to the payments at issue was only $30,000. Suddenly Freight Agent had exposure 100 times greater than its profit on the "job", possibly threatening its ability to operate. Even if Freight Agent had a legal right to recover from the ultimate recipients of Big Retail funds, filing multiple suits could be costly and generate substantial ill will with critical suppliers.

What could Freight Agent have done to avoid this scenario? It could have agreed in writing with Big Retail that Freight Agent would hold all funds received from Big Retail in a restricted account or accounts solely for the benefit of the intended recipients. These accounts would have been established so that they could not receive deposits of Freight Agent, general funds or fees tied to such payments. Had Freight Agent done so, it would have likely faced no suit or prevailed in any suit to recover funds from Big Retail Co.

The second situation relates to the timing of transfer of title to purchased goods. An acquirer of goods could suffer substantial harm should the "seller" file bankruptcy prior to transfer of title to the goods, particularly if the acquirer has already paid for the goods and/or the goods are not easily or timely replaceable. The goods would become part of seller's bankruptcy estate, any action to obtain them would be "automatically stayed" and the bankruptcy court may not agree to lift the stay, at least not in a timely manner. Further, claims for damages resulting from failure to timely deliver and/or to recover payments made could be worth only pennies on the dollar. The acquirer could be liable to other parties for failure to deliver the "acquired" (but not timely delivered) goods to those other parties.

How is this potential debacle best addressed? Applicable agreements could provide one or more of the following:

- The title to the goods transfers from an "upstream" supplier of the seller directly to the acquirer thus leaving the seller out of chain of title.

- The acquirer pays the "upstream supplier" directly thus taking the seller out of the payment chain.

- The title passes to the acquirer upon the earlier of payment for, or delivery of the goods. Further, the goods, if they must remain in the seller's possession for any period, could be segregated and clearly marked as belonging to the acquirer. Credit protections could be requested from the seller as well.

The best take-away is that when substantial sums are in play, it's worth consulting a lawyer with experience structuring financial terms and title transfer provisions. The survival of your company may depend upon having done so. Perhaps 99 times out of 100, Big Retail or a seller does not file bankruptcy, but that hundredth time, you surely want to have avoided unknowingly and inadvertently having "bet the company."