COLLATERAL TRENDS

Bed, Bath, and Back to the Supplier:

A Supplier's Right to Reclaim Ownership of Inventory in the Netherlands

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In November of 2021, SFNet announced its first Cross-Border Finance Essay Contest, sponsored by Goldberg Kohn Ltd. Members of SFNet's International Finance and Development Committee judged the essay submissions on content, originality, clarity, structure and overall contribution to furthering and expanding understanding and discourse within the field of cross-border finance. This essay tied for third place.

The authors of the winning essays have been invited to participate on a panel at SFNet's 78th Annual Convention in Austin, TX, Nov. 9-11. The second place and first place winners will be published in the October and November issues of *TSL*, respectively.

Vroom & Dreesmann

Brothers-in-law Willem Vroom and Anton Dreesmann opened their first department store in 1887, in the heart of Amsterdam, the Netherlands. Over the years, Vroom & Dreesmann became an iconic Dutch chain of department stores. The stores were a huge success and Vroom & Dreesmann rapidly expanded in the 20th century, opening new stores in almost every city in the Netherlands. V&D, as it was officially rebranded in 2007, targeted a regular retail crowd, selling clothing, electronics and home accessories. It also had its own in-house travel agency and operated a chain of restaurants that were located both inside the department stores and externally, with locations even in New York City and Bali, Indonesia. A visit to V&D's School Campus, a special department set up in August for office and school supplies, traditionally marked the end of the summer for generations of high school students. Its long history and household name, however, did not last. V&D's story ended on December 31, 2015, when it was declared bankrupt by the Amsterdam court and bankruptcy trustees were appointed to liquidate V&D's assets.

In 2017, the trustees ended up in court in a dispute with one of V&D's suppliers. The dispute concerned the ownership of bedding materials and towels, more specifically. This dispute led to a decision from the Amsterdam court of first instance on November 8, 2017[1], concerning an element of Dutch law that is key to ABL professionals dealing with inventory in the Netherlands: the right of reclamation (in Dutch: recht van reclame). As this decision by the Amsterdam court has shown, the right of reclamation can have a significant impact on Dutch inventory and the position of ABL borrowers and ABL lenders.

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In this essay, I will discuss the right of reclamation in light of the proceedings between V&D's bankruptcy trustees and V&D's supplier and I will describe why you, as ABL professionals, should take good caution when working on ABL transactions involving Dutch inventory.

The Case of V&D Versus Its Bedding Supplier

Let's begin by introducing the two key players in this story. On the one hand, there is the wholesale textile company selling bedding materials and towels to V&D on an ongoing basis (the "Supplier"). On the other hand, there is the bankruptcy trustees of V&D, appointed by the Amsterdam court to administer and liquidate V&D's assets (the "Trustees").

Between September 29, 2014 and December 9, 2015, the Supplier sold and supplied different tranches of bedding materials and towels to V&D. Each tranche was based on a different purchase order and each purchase order constituted a separate purchase agreement. When V&D was declared bankrupt, it still owed the Supplier approximately EUR 376,000 for unpaid inventory. A large part of the unpaid inventory was still located at several storage centers and department stores of V&D.

In December 2015, news coverage on V&D's financial position and its imminent bankruptcy intensified and the Supplier sent a notice to V&D to dissolve the relevant purchase agreements between them and to reclaim the unpaid inventory that was still located at V&D locations. If the Supplier would not get paid for its inventory, it simply wanted its inventory back. Two days after this notice, however, V&D was declared bankrupt by the Amsterdam court.

When the Trustees challenged the Supplier's claims, the Supplier started legal proceedings against V&D's bankruptcy estate to reclaim the unpaid inventory through court order. During these legal proceedings, the Supplier claimed that (i) it retained ownership of the inventory on the basis of a retention-of-title provision and (ii) it reclaimed ownership of the inventory on the basis of its right of reclamation.

Retention of Title

The Supplier's first argument to reclaim possession of the inventory was based on a retention-of-title claim: the Supplier claimed that it had retained legal ownership of the inventory until the inventory was fully paid by V&D. Under Dutch law, a supplier of inventory can retain legal ownership of the inventory until the buyer has fully paid the purchase price for that inventory. Retention of title has to be agreed between a supplier and a buyer, for example in a sales contract or through general terms and conditions.[2]

According to the Supplier, the parties had agreed to a retention-of-title agreement included in the Supplier's general terms and conditions. However, the Amsterdam court ruled that the Supplier and V&D never agreed to the applicability thereof. Instead, they agreed to the applicability of V&D's general terms and conditions, which explicitly provided that legal ownership of the inventory transferred upon the transfer of possession of the inventory. The court ruled that the Supplier had lost the battle of the forms, and rejected the Supplier's claim on the basis that the parties had not agreed to any retention-of-title provisions.

The Right of Reclamation

The Supplier's second argument to reclaim possession of the inventory was based on its right of reclamation. The right of reclamation is the right of a supplier of inventory to reclaim legal ownership and possession of inventory from its buyer, if the following four conditions are met:

(a) the inventory was brought in the possession of the buyer;

(b) the buyer failed to pay the purchase price and consequently, the supplier is authorized to dissolve the purchase contract;

(c) the inventory is in the same state as when it was brought in the possession of the buyer; and

(d) no more than (i) six weeks have passed since the supplier's claim to demand payment of the purchase price became due and payable, and (ii) sixty days have passed since the buyer obtained possession of the inventory.[3]

The right of reclamation is a statutory right, arising by operation of Dutch law. It does not have to be specifically agreed between a supplier and a buyer. The supplier can waive its right of reclamation, for example in a purchase agreement, through applicable general terms and conditions, or in a one-sided statement from the supplier.

If a supplier successfully exercises its right of reclamation, the purchase agreement terminates and legal ownership of the unpaid inventory automatically transfers back from the buyer to the supplier, without any further action being required. In addition, legal ownership of the inventory will transfer back to the supplier free from any third-party security interests. A secured third party will only be protected if (i) the secured party has taken possession of the inventory (a possessory pledge), and (ii) there was no reasonable ground for that secured party to expect that the supplier would exercise a right of reclamation.[4]

The Amsterdam Court Proceedings

The debate between the Supplier and the Trustees focused on two specific conditions of the right of reclamation: (i) the timing-condition and (ii) the same state-condition.

Timing of exercising the right of reclamation

A key element of the right of reclamation is that it is a time-sensitive right. A supplier can exercise its right of reclamation by delivery of a written notice addressed to the buyer.[5] But the supplier has to act quickly: it has to exercise its right before both (i) six weeks have passed since the supplier's claim to demand payment of the purchase price became due and payable, and (ii) sixty days have passed since the buyer obtained possession of the inventory. In V&D's case, the Supplier sent written notice that, among others, it was exercising its right of reclamation to V&D on December 29, 2015.

As described earlier, the Supplier had provided different tranches of inventory to V&D, based on different purchase orders that each constituted a separate purchase agreement. Consequently, the court had to determine, for each different tranche of inventory separately, if the Supplier sent the notice on time, to be able to exercise its right of reclamation.

As a matter of Dutch law, a claim for payment of the purchase price generally becomes due and payable upon the transfer of possession of the relevant asset, from the supplier to the buyer.[6] However, parties to a purchase agreement are free to negotiate a different payment term. For example, they can agree that the purchase price becomes due and payable only after a certain period of time after the transfer of possession, say 30, 60 or 120 days thereafter. Parties with a strong market position generally tend to include longer payment terms in their contracts with suppliers. And so did V&D: its general terms and conditions provided that the purchase price would only become due and payable 90 days after the possession of the purchased inventory had transferred from the Supplier to V&D. Consequently, the Amsterdam court ordered that all inventory that was supplied by the Supplier within the 90-day period before December 29, 2015 (the date of the Supplier's written notice) could be made subject to the Supplier's right of reclamation. The Supplier could not reclaim any inventory supplied before that 90-day period, because the statutory term to exercise the right of reclamation for that inventory had lapsed.

This meant that V&D had two types of inventory in its possession: inventory that was eligible for reclamation, described by the court as Unpaid and supplied Within term for Reclamation-inventory (UWR inventory), and inventory that was not eligible for reclamation (non-UWR inventory). And this is

where the second condition to exercise a right of reclamation comes into play: the same-state condition.

Inventory Remains In the Same State

The right of reclamation lapses if the supplied inventory is longer in the same state as when it was transferred to the buyer, for example because the inventory was comingled (vermenging) with other assets, manufactured into other products (zaaksvorming) or became part of another product (natrekking).[7]

Because of the court's decision that V&D and the Supplier agreed to a 90-day payment term, the inventory could be divided into UWR inventory and non-UWR inventory. Both categories, however, consisted of exactly the same products: bedding materials and towels. These products were not individually marked or numbered and therefore it was impossible to identify individual products belonging to either category.

This brings us to the essence of this case: because the Supplier exercised its right of reclamation with respect to the UWR inventory, legal ownership of the UWR inventory transferred back from V&D to the Supplier, while legal ownership of the non-UWR inventory remained with V&D. In each case, both the UWR inventory and the non-UWR inventory remained in the possession of V&D. But, because it was impossible to distinguish UWR inventory from non-UWR inventory, inventory legally owned by the Supplier had comingled with inventory legally owned by V&D.

The Trustees argued that the Supplier could only exercise its right of reclamation if the Supplier could identify specifically which individual products were UWR inventory. Because that was impossible, the Supplier could not exercise its right of reclamation at all.

The court did not agree to the Trustees' argument. It ruled that there was co-ownership of the inventory, with the Supplier having right to a share equal to the UWR inventory. As a consequence, the Supplier was not required to prove exactly which specific individual products were UWR inventory. If the Supplier was able to prove what number of products consisted of UWR inventory, the Supplier could reclaim that same number of products, without the need to prove exactly what individual products were UWR inventory. Requiring the Supplier to provide further evidence as to the individual products qualifying as UWR inventory would not be reasonable and fair, according to the court.

This decision by the court, specifically the way it handled the issue on comingled inventory, can be considered both innovative and pragmatic. It does justice to the fact that clearly at least some part of inventory consisted of UWR inventory that belonged to the Supplier.

The supplier regains ownership free from any security interests, so the supplier's right of reclamation takes priority over the ABL lender's security interest. The ABL lender, which may have already provided financing for the inventory, will not be able to enforce its security interest against the supplier. The ABL lender will most likely remain empty-handed.

Dealing with the Right of Reclamation in ABL Transactions

The case between V&D and its Supplier shows that the right of reclamation is an important right to take into account in the relationship between a supplier and a buyer. But this case also shows the importance of the right of reclamation for ABL lenders. An ABL lender with a security interest over Dutch inventory will in any event not be protected from a Supplier's right of reclamation as long as the ABL lender does not have the secured inventory in its possession.

Now in practice, this could work out as follows. Imagine that the buyer acts as borrower under an asset-based inventory credit facility and intends to include its Dutch inventory in the borrowing base. Generally, once the borrower has obtained legal title to the inventory and the inventory is subject to a valid security interest in favor of the ABL lender, the borrower will be able to include the inventory in its borrowing base. However, if the borrower has not yet fully paid for the inventory, the supplier may be able to exercise its right of reclamation. Legal ownership of the inventory, that was already included

in the borrowing base, will then fall back to the supplier. The supplier regains ownership free from any security interests, so the supplier's right of reclamation takes priority over the ABL lender's security interest. The ABL lender, which may have already provided financing for the inventory, will not be able to enforce its security interest against the supplier. The ABL lender will most likely remain empty-handed.

In order to mitigate the risk described above, ABL lenders lending on Dutch inventory can take certain actions, which can be divided into four steps:

- It starts with analyzing whether the right of reclamation could become relevant in your transaction. The right of reclamation arises by operation of Dutch law. Consequently, the borrower's purchase contracts may not contain any references thereto, as opposed to retention-of-title arrangements that should contractually be agreed. Due diligence may show that the borrower processes the inventory or uses the inventory to manufacture other products, which may cause the right of reclamation to lapse;
- Second, determine whether it will be feasible for the borrower to have its suppliers waive their right of reclamation, for example in specific purchase contracts, in general terms and conditions applied by the borrower and accepted by the supplier, or in separate statements provided by the suppliers;
- Third, consider excluding inventory that may become subject to a right of reclamation from the borrowing base by including eligibility criteria in the ABL loan documents, or apply a reserve for the value of the inventory that is not, or not yet fully, paid for, depending on the type of inventory; and
- Fourth, closely monitor the borrower's payment terms with its suppliers, its overdue payments, and the dates on which the borrower acquired possession of the inventory, to be able to timely identify and address potential right-of-reclamation issues.

Since the decision of the Amsterdam court in 2017 as described above, ABL loan documents increasingly include eligibility criteria and reserves to address the right of reclamation. For example, a provision stating that Dutch inventory can only qualify as eligible inventory if it is fully paid for by the borrower, or otherwise if the supplier has explicitly and unconditionally waived its right of reclamation, is becoming more and more accepted in Dutch ABL inventory transactions.

It may sound strict to exclude all (partially) unpaid Dutch inventory from the borrowing base, and this may not always be desirable from an ABL lender's commercial perspective. However, against that view, there is an economic question to be asked: why should an ABL lender be required to provide financing for inventory that is basically already financed by someone else, the supplier? The borrower should not need additional financing for the same inventory, unless it intends to refinance the existing debt, meaning that it will pay the supplier. Otherwise, if the ABL lender allows the borrower to borrow based on unpaid inventory, the borrower financed its unpaid inventory with both the supplier and the ABL lender. That means that the borrower has excess cash, against an increased risk for the ABL lender.

Conclusion

The right of reclamation is an important feature of Dutch law that should be taken into account if Dutch inventory is part of an ABL inventory financing, especially from an ABL lender's perspective. Suppliers have to act fast to be able to exercise their right of reclamation, but when they do, their right may have priority over an ABL lender's security interest. ABL loan documents therefore increasingly contain provisions to address the risk that a supplier of inventory exercises its right of reclamation, and my expectation is that such provisions will become even more widely accepted in the future.

And for V&D, did it really all end in 2015? Not exactly. Some well-known Dutch entrepreneurs eventually bought V&D's intellectual property rights from V&D's bankruptcy estate. They currently use the V&D name to operate a webshop, selling basically the same products as the original V&D department stores, including bedding materials and towels. Only time will tell if these products will now find their way to the beds and baths of loyal V&D customers, or eventually also will go back to the supplier.

1. The Amsterdam court decision is referenced ECLI:NL:RBAMS:2017:8185.
2. Art. 3:92 Dutch Civil Code.
3. Art. 7:39 Dutch Civil Code.
4. Art. 7:42 Dutch Civil Code.
5. Art. 7:39 sub 1 Dutch Civil Code.
6. Art. 7:26 sub 2 Dutch Civil Code.
7. Art. 7:41 Dutch Civil Code.

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