
Managing Business Bankruptcies

Disclaimer: The following material should not be considered legal advice. When you have a legal question, contact competent legal counsel. Comments are based on a few decades of experience and specialized training provided by NACM and various attorneys relating to FDCPA and collection practices.

This summary takes **the perspective of the Trade Creditor**, which is a company with an unsecured open account the bankrupt debtor has used for purchases. Lenders, lessors, or members of certain industries have special rights, and the following may be modified or not apply.

Generally, the trade creditor's process of managing bankruptcy accounts involves

- establishing the amount currently at risk (account balance plus orders in process);
- placing unshipped orders on hold and stopping shipments in transit;
- using reclamation rights or administrative claim rights to reduce the amount at risk;
- establishing the risk exposure for prepetition debtor payments on account that might be recalled as preferential; and,
- reviewing how similar situations might be avoided in the future.

Step 1: Notification

Received from the Debtor, an Industry Group, a Credit Reporting Agency, the Bankruptcy Court Creditor rights in bankruptcy are firmly bound to a timetable. Without timely notice of the filing, the creditor clearly is disadvantaged in trying to mitigate potential loss.

Use early warning systems:

- Know your customers, and develop contacts with financial executives, owners in SMEs;
- Use a watch list to monitor high risk accounts;
- Know competitors and, if possible, belong to an industry group;
- Use credit reporting resources and industry credit group alert systems.

Step 2: Confirmation

Confirm the debtor, filing date, bankruptcy chapter, and case number for tracking the case. PACER (Public Access to Court Electronic Records) may be used or the case may be confirmed directly with the court.

Step 3: Internal Notice

- Publish an internal notice of the filing to
 - Advise those involved in the order-to-cash cycle of the bankruptcy filing;
 - Place unshipped orders on hold;
 - Determine if there are orders in process that haven't been entered in the online system;
 - Advise management.

Step 4: Stop shipments in transit

Make demand on the carrier, warehouseman, or other bailee (holder) of the goods before the buyer receives possession or control of the goods. Have the bailee isolate the goods until you and the buyer come to an agreement or a decision is made to have the goods returned.

Step 5: If the Supplier decides to continue to sell

Set up a new account and clearly discriminate between pre-petition and post-petition debt. Attempts to collect pre-petition debt without a court order may be considered by the court to be a violation of the bankruptcy "stay", and the creditor may be held in contempt.

Some of the **issues** to be considered in deciding to sell a bankrupt Buyer:

"What are the issues or problems that brought the debtor to this point?"

These may include liquidity, profitability, changes in management, bank relationship. The intent of this question is to determine the likelihood of survival.

"Who brought us to the party?"

This involves an appraisal of the management of a Debtor in Possession.

"Will I get paid for post-petition shipments?"

Payment for post-petition shipment claims as administrative expenses are more likely but are not assured. Non-payment of administrative expenses most often occurs when cases are converted from Ch. 11 reorganization to Ch. 7 liquidation.

"Am I required to sell a bankrupt debtor?"

Unless the court orders you to sell, you may decline to sell any prospective Buyer.

"Do I have to give usual terms of sale?"

You may use special terms to reduce your exposure without violating antitrust laws. For example, a trade creditor normally selling on thirty-day terms requires payment in seven days by electronic transfer (wire).

When in doubt, consult an insolvency lawyer!

Step 6: 503(b)(9) Administrative Claim

Creditors may file an administrative claim covering shipments received by the debtor within twenty days of the filing date. This means such claims receive a priority and may get paid at a later time in the case.

Step 7: Reclamation

Rights under the Uniform Commercial Code: Four requirements – sale on credit, demand within ten days of receipt, buyer must still have possession, buyer insolvent when goods received.

Rights under the Bankruptcy Code: Four UCC requirements, sale in ordinary course, expands the reach-back period to 45 days, written demand.

A demand letter must be sent, addressed to Controller / CFO / CEO, cc: Owner or President and Atty and Trustee, if appointed.

If you have reclamation rights, you must make timely demand. You should ask that the goods be segregated under lock and key.

Confirm receipt of the demand, and confirm the buyer still has goods. Ideally, have a person go to the facility and take pictures!

Recovery, if granted by the court, may include return of goods, security interest, an administrative claim, or payment.

Note: Most often, secured creditors are granted rights to inventory and suppliers' reclamation rights are secondary, if allowed at all.

Step 8: Preference Analysis

Purpose of bankruptcy preference law: To provide for more equitable distribution to creditors through return of payments to estate deemed to be preferential.

Six required elements of a preferential payment: transfer of property of the debtor, to or for the benefit of a creditor, that occurs within 90 days before filing (one year for an insider), because of a preexisting debt, that allows the creditor to receive more than it would have received in a Ch. 7 liquidation, and the debtor was insolvent at the time the transfer was made.

When the trustee demands payment be disgorged, trade creditors have three common defenses:
Payment in the ordinary course of business – historical transactions and industry practice
New value provided – shipped new merchandise after payment
A contemporaneous exchange – COD or other form of cash sale

Evaluating Exposure:

Review payments and sales within the 90-day period preceding the filing date; identify payments according to stated terms (objective) and pattern of payment (subjective) for at least the last two years.

Identify as **contemporaneous** any cash sales; **new value** for any payments followed by equal or larger amounts of new sales; **ordinary course** for any payments within terms or within the historical pattern of payment. Identify all other payments as subject to possible preference attack by the DIP or a trustee.

Preferences less than \$6,225 (2018) may not be pursued. Preferences less than \$10,000 (plus annual increases) must be pursued in locality of the creditor.

What are potential issues with preference claims?

Must be filed within two years of the bankruptcy filing or the appointment of trustee. Often, preferences are claimed after the plan acceptance and confirmation, and then the named creditors will not be paid until the preference matter is resolved.

Confirm your claim is not contingent, disputed, or unliquidated, and know if you have a preference exposure.

Watch for the trustee just "throwing it against the wall" to see what sticks.

When the trustee notices the unsecured creditor, it should **never pay the initial preference demand**. The trustee should be advised of defenses available, with an effort to settle the demand for less than the claimed amount.

Step 9: Post Mortem for the Bankrupt Debtor

A post mortem should be prepared and should answer (at least) the following questions:
How much does the creditor have at risk from the filing?
How much will the creditor recover (and when) on reclamation?

How much will the creditor recover on an administrative claim?
How much exposure does the creditor have to a preference claim?
What caused the filing?
In the most recent credit line review, were relevant factors missed or discounted?
What should the creditor do to reduce the risk of similar problems in the future?

Step 10: Filing the proof of claim

In Ch. 7 cases, creditors must file within 90 days of the first scheduled meeting of creditors.

In Ch. 11 cases, if the creditor is listed on the debtor’s schedules, it need not file; however, it’s not unusual for the debtor’s schedule to be incorrect.

Contingent, disputed, or unliquidated debts – The issue in such claims need to be resolved and may take a substantial amount of time.

“No-asset” cases – The Court may tell creditors not to file a claim in a no-asset case; however, sometimes assets are discovered at later dates, and all creditors may not be included or their listing may be inaccurate.

Watch for the “bar date”. Late proofs of claim are almost always declined.

If a preference is paid, this will affect the amount of claim, and a new claim should be filed.

Increasing the dividend

Focus on the debtor and the accuracy of schedules: assets, liabilities, secured debt, ownership.

Carefully review the actions of secured parties: Does the security agreement correctly identify collateral; is the security agreement properly perfected; has the financing statement lapsed; has the secured party been preferred in payments, property transfers, or improved position?

Look hard for and at insiders: Potential preferences and fraudulent conveyances

Look to other third parties: Potential preferences

Serving on the creditors committee.

Larger creditors are usually invited to participate; however, any creditor may serve and can request appointment.

Why serve? Provision of insider information; input on treatment of various matters of interest to creditors, such as preferences; potential of increasing the unsecured creditors’ dividend.

Downside?

Time and effort; reimbursement only for expenses; exposure to fiduciary risk

The Bottom-line

A significant amount of money may slip through trade creditor’s hands in bankruptcy losses. The amount of immediate loss and potential future risk may be reduced and recovery affected in bankruptcy cases by carefully evaluating the situation at the time of a filing, using rights to stop shipments and to reclaim, properly filing administrative claims, becoming aware of potential preference exposure, and learning from any prior oversights or mistakes.