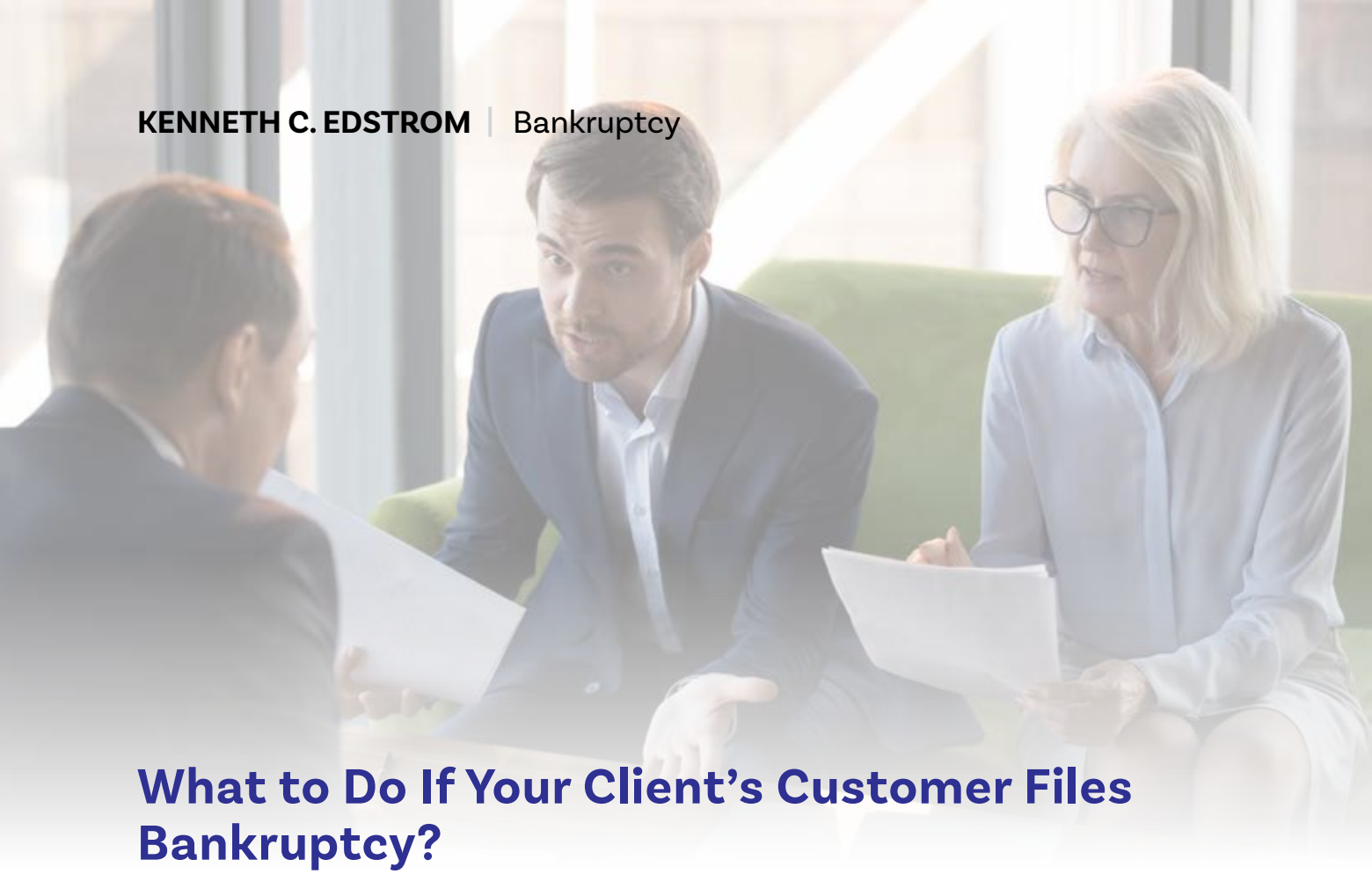

What to Do If Your Client's Customer Files Bankruptcy?

The number of bankruptcies in the United States, both for businesses and individuals has decreased steadily since the Great Recession of 2008-09. According to the American Bankruptcy Institute, the last business bankruptcy peak was in 2009 when 60,837 business-related bankruptcy cases were filed. By 2018 that number had decreased by nearly two-thirds to 22,232 cases. The COVID-19 virus will undoubtedly reverse that trend for 2020 and perhaps for the years that follow. It is probable therefore that the question is not whether your client's customer will file for bankruptcy, but rather, when. It is important, therefore for a business to know something about what happens when a customer files for bankruptcy and some of the rights and responsibilities a business seller has when a paying customer stops paying and files for bankruptcy protection.

Stop any collection activities such as a lawsuit, threatening letters, etc. Under 11 USC § 362 an automatic stay is put in place halting all collection actions as of the time of the filing of the bankruptcy.

File any Mechanic's Liens allowed under state Law. Somewhat contradictorily, filing a mechanic's lien is not prohibited during the bankruptcy proceedings, however, attempting to collect on such a lien is covered by the automatic stay.

Make a demand on the bankrupt debtor for an administrative claim or a reclamation claim. There are short timelines for making a claim in a bankruptcy where you sold goods to a bankrupt debtor during the period leading up to a bankruptcy. The seller should of course call their lawyer as soon as they hear about the bankruptcy to talk about any claims that they can make that will put them ahead of other creditors who are all trying to get paid as much as possible from the bankruptcy estate.

File a proof of claim as soon as possible. In order to get paid from the bankruptcy estate, a seller must file a proof of claim within a deadline specified in the bankruptcy notice. Best to do that as soon as possible.

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If the court notice says that they will let you know when a proof of claim should be filed, the seller will receive a notice from either the bankruptcy debtor or bankruptcy trustee to file a claim sometime later. However, there is no penalty for filing a proof of claim as soon as the bankruptcy is filed even if the official period for filing proofs of claim doesn't start until later in the case. Filing a claim immediately ends the possibility that the seller will not recognize the importance of a notice to file a bankruptcy that they receive months later.

If the customer is seeking to re-organize under Chapter 11, they need to decide whether they want to keep selling to the customer and under what terms. There is no law that says a seller has to keep selling to a customer who is now operating in Chapter 11. They can decide to stop all sales, sell on COD or pre-payment or continue to provide terms to the debtor. While the usual rule is that no debt owed at the time of the filing of the bankruptcy can be paid during the course of the bankruptcy, there may be a chance to get paid some or even all of what the seller is owed if they agree to keep selling to the customer when they continue to operate in bankruptcy. These agreements are called "Critical Vendor Agreements" and they have specific and sometimes complicated obligations for sellers. Although they are not always allowed or approved by the bankruptcy courts, when they are the seller needs to consider the pros and cons of such arrangements carefully.

Attend the Meeting of Creditors. A meeting of creditors will be scheduled about a month after the case is called. It may be in person or via teleconference only. The customer will be under oath and the creditor will have the chance to ask questions about the assets of the customer and what is going to happen to the customer's business in the future.

Save all records of transaction with the Debtor for the past two years. I advise my clients to print out all invoices, ledgers and records of payment for the two years prior to the customer's bankruptcy filing. A bankruptcy trustee or the debtor has the right to go after certain payments made from the now bankrupt creditor for various time periods prior to the filing of the bankruptcy. These "preference actions" can be started for two years after the filing of the bankruptcy case. Any defense to those claims will be found in the evidence of the course of dealing of the seller and the customer. The seller should not depend on having the information available to them in two years. Computers crash, software changes, accounts receivable personnel come and go. Print the documents out now and keep them in a safe place for future use if needed.

There are other things that sellers can and should do. Not surprisingly the best advice if they or you have questions is to call a qualified bankruptcy practitioner who can walk you or them through the entire bankruptcy process.