

Protecting Your Interests When A Client/Customer Files For Bankruptcy

by Rebecca J. Price, Esquire

In the world of business, there are few things worse than working hard to provide an exemplary service or product to a client or customer only to receive that dreaded and unwelcome “Notice of Bankruptcy Filing” in the mail. Oh no! Your client or customer has filed for bankruptcy! And they owe you money! What now?

Unfortunately, many of us have become too familiar with these notices, as bankruptcy filings have steadily risen since 2006. But all hope is not lost; there are steps you can take to protect yourself, your business, and your receivables or products when your client or customer files for bankruptcy.

Types of bankruptcies

Although there are several types of bankruptcies, most often you will hear of Chapter 7 (typically a consumer bankruptcy resulting in the discharge of the majority of the debtor’s unsecured debts), Chapter 11 (typically a business bankruptcy that allows the debtor to restructure debts and pay a portion of the arrears over time) and Chapter 13 (typically a consumer bankruptcy that permits the debtor to restructure debts and pay a portion of the arrears over time). In each case, filing for bankruptcy gives the debtor a “breathing spell” from creditor pressure. Called the “automatic stay,” it stops all collection efforts and/or legal actions against the debtor.

What you can expect

Once your client or customer files, you will receive notice from the Bankruptcy Court, generally within two weeks of the commencement of the case. It is essential that all collection activity (including sending past due invoices and/or making collection calls) stop upon receipt of the notice.

Your next step is to ensure that the appropriate person in your office (or your attorney) is aware of the notice. That person should gather your outstanding invoices to prepare a “proof of claim” to be filed with the Court. At this time, determine if you provided any goods to the client/customer/debtor just before the debtor filed for bankruptcy; if so, you may be entitled to reclaim or be paid the full amount owed for those goods.

If you have a lease or existing contract with the debtor, determine whether the debtor plans to assume, assign or reject your agreement. Depending on how your agreement is treated, the debtor may be obligated to cure its outstanding obligations to you or return your equipment, goods, or real property. Also, while the case is pending, the debtor must pay its monthly obligation going forward.

In Chapter 11 or Chapter 13 bankruptcy, the debtor files a plan of reorganization outlining the debtor’s plan to restructure its debt. You will receive a copy of the plan and related documents so you can determine how your claim will be treated. If you are not satisfied, you may object to or vote against the plan.

During the bankruptcy process, you may also receive a letter advising that you received a “Preference Payment” from the debtor and demanding that you return the payment. Typically, any payment received from the debtor within ninety days prior to the bankruptcy may be deemed a preference. There are numerous defenses to preference payments, including payments made in the ordinary course of business and payments made in



exchange for new value. If you receive a preference letter, contact your attorney to determine what defenses are available to you.

Finally, the automatic stay applies only to the debtor. It does not apply to a non-debtor (except for a non-debtor spouse in a Chapter 13 case) or prohibit you from collecting payment from a personal guarantor. Therefore, if possible, obtain a personal guaranty before providing goods or services to a debtor.

There is no question that bankruptcy is complex and daunting. Notices are often ignored because we are not aware that anything can be done to collect from the “former” clients or customers. However, a few simple steps can go a long way to protect your interests and, perhaps, obtain payment following a client’s or customer’s bankruptcy.

This said, it is critically important to designate a person in your office to be responsible for the management of the bankruptcy process and be in contact with the bankruptcy court regarding your claim. If you do not have anyone in your office to handle that task, it may be time to speak with an attorney who is experienced in representing creditors, like you, in bankruptcy proceedings.

Rebecca J. Price, Esquire, is an associate at Norris McLaughlin & Marcus. Contact Rebecca at 484-765-2282 or rprice@nmmlaw.com.

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