Creditor Tips When a Customer Files Bankruptcy

The storm has been weathered, and businesses have stayed afloat for as long as possible in some cases. However, government assistance and other programs have run dry, placing businesses with a financial burden and a potential decision ahead. According to the American Bankruptcy Institute, commercial Chapter 11 bankruptcy filings increased 46% in November compared to November 2019. November 2020 data is also 19% above the previous month.

Lynnette Warman, Esq., with Culhane Meadows PLLC, presented a webinar, “How to Rapidly Assess a Bankruptcy Case Using 10 Key Points,” discussing the main factors credit professionals should take note of when a customer files for bankruptcy. The key points (some combined below) were broken down by the size of the bankruptcy as well as overall tips that credit departments must take into consideration when a customer files for bankruptcy.

Tip No. 1—Watch your customers for signs of distress.

Some obvious signs of distress include slow payments and nonpayment of invoices as they become due. Statements from customers such as, “Money is tight,” or promises to catch up on payments are also red flags moving forward. Other factors to watch out for are if the customer has been shut down or saw slowed business due to COVID-19 restrictions and if the lender has stopped providing funding; however, this can be tricky, noted Warman.

Tip No. 2—Get notice of bankruptcy filing as soon as you can.

How can credit departments be on top of their game with bankruptcy notices? Google alerts and internet searches are not foolproof, but they are a way to receive information directly. Warman also mentioned NACM industry trade groups as another place to learn about customer bankruptcies. An oral notice—this needs to be confirmed as customers may tell creditors of the filing but may not have actually filed—and a written notice from the customer are also potential information sources. Credit departments can ask their customer for a case number and the name of the court where the bankruptcy was filed. Creditors can also sign up for electronic notices through the bankruptcy noticing center through the U.S. Courts’ website.

Having documents in place as soon as possible is important as well. Most large cases will have a local website created and serviced by a servicing agent appointed by the bankruptcy court. “These websites are a goldmine for information,” said Warman. Often, in larger cases, the proof of claim will be filed through the servicing website rather than the court. These websites also provide general information including information on the U.S. Trustee, the case number and professionals employed by the debtor. “It’s a treasure chest of information that creditors can access, generally, immediately after the case is filed and without cost.”

Tip No. 3—Getting information from small cases…

…is never easy. Creditors can ask customers to send copies of documents or ask the customer’s attorney to send documents. Once a proof of claim is filed, direct that notices be sent to you. Once that is done, any motion in the case will come directly to you and avoid a lockbox situation. Hiring an attorney to represent you and get copies of documents is also an option, and recommended in complex cases.

Tips Nos. 4, 5, 6—Critical documents and information.

In a voluntary petition, look for the exact name of the filer—is it your customer? It might be another business within the same corporation. Warman suggested to check the EIN. For an involuntary petition, find out the exact name of the filer as well, and petitioning creditors, in smaller cases, sometimes have the largest claims in the case.

Despite previously being filed a couple weeks after the case is filed, it is now common for the filing of a schedule of claims and assets to be filed later in the case. This gives creditors an opportunity to see how much the company has in assets and liabilities and if they are listed as a creditor by the debtor, said Warman. The statement of affairs, also filed later in the case, gives information such as income in the year of the bankruptcy up until the petition date as well as the company's revenue the year before that.

Operating reports are filed every month starting with the month after the case is filed. This is a snap shot of all financial information of what happened in the last month—copies of bank statements are important here. In smaller cases, the debtor may tell you they have plenty of money and you should ship products, but looking at the operation report can show a different story. This could show that there might not be much hope you'll be paid for shipment if you make it, said Warman.

In medium to large cases, typically, you'll see a DIP financing motion because companies can't operate solely based on the cash they generate. Most of the time, they need a bit of a loan, noted Warman, who also mentioned to look out for a budget that the bankruptcy court provides on how the cash will be used. Creditors can review to see what the debtor is proposing to pay unsecured creditors. Benchmarks must also occur for the debtor to continue using the cash—file the plan by a certain date, sell assets by a certain date, etc. Failing to hit the benchmarks results in the loss of the ability to borrow money unless the lender agrees to an extension.

Small cases have the same problems as big cases just less money involved. Something new this year is the revision of the code with the Small Business Reorganization Act/Subchapter V of the Chapter 11 code. The passing of the CARES Act earlier this year also raised the debt ceiling under the new subchapter to $7.5 million. What this means is there will not be creditors' committees appointed and the disclosure statement and plan can be joined in one document and heard at one hearing, Warman said.

Tips Nos. 7, 8, 9—What to look for in documents.

Among the items to search for in a voluntary/involuntary petition is what chapter of the bankruptcy code is being followed. Also important is to confirm that the debtor or related filing entity is your customer. If the debtor is not the customer but rather a related company in the corporation, legal advice may be the best way to proceed. Warman's example of this was if you ship to one company but are being paid by another.

In medium to large cases, the declaration or affidavit will show the cause of filing and whether the business is still operating—creditors will need to know this before shipping. In smaller cases, creditors will want to look to see if the customer has any secured debt and how they are proposing to pay for goods or services delivered after the case is filed.

Tip No. 10—Calculate your claim and evaluate risk.

Gather all documents related to the claim and related contracts and make sure they are all in order. Review all outstanding invoices and reduce the claim by any agreed returns or credits. Determine whether the customer has disputed any part of the claim and determine whether you agree with the dispute. Identify whether the claim is secured by any lien or retainage as well.

Identify potential issues such as a preference claim. Do you have any unsecured claims, did you receive payment within 90 days of the petition date, was the payment made on an outstanding invoice or was it a payment in advance or at the time of delivery? These are all questions Warman said creditors need to ask themselves.

The top priority is to get your documents in order and analyze your claim. Large claims or problems with documents might require legal advice even before filing a proof of claim. If the debtor demands that you provide goods and services post-petition, demand to see copies of motions approving the use of cash collateral or DIP loan with the proposed budgets.

“Bankruptcy cases move a lot faster than most everything else. You have to be careful if pulled into a bankruptcy case,” Warman said. “Bankruptcy cases are now moving at warp speed; it’s not uncommon to see a case filed and on the first day there’s a motion to sell all assets…if you see a motion to approve bid procedures or a sale of assets, you have to act extremely quickly.”

-Michael Miller, managing editor