The Complexity of Bankruptcy

Business-to-business (B2B) credit is relatively simple to understand. One business provides services or a product on credit to another business with the promise to pay within a certain timeframe. Similar to consumer credit. However, there are factors that can cause B2B credit professionals to have headaches, including mechanic's liens and bankruptcies.

"Bankruptcy is an extremely complex area. … It's a complex preceding in the area of law," said Paul Hammer, senior attorney, with Texas-based firm Kane Russell Coleman Logan PC in an NACM webinar. "It's important to have a general understanding of what to expect when [creditors] receive a notification that a debtor has filed." In the webinar, Hammer discussed the different bankruptcy chapters as well as the creditors' meeting, proofs of claim and the automatic stay.

The Bankruptcy Code is designed to benefit honest, good-faith debtors, explained Hammer. Unsecured creditors will always be the last to collect, and on rare occasions, creditors will get a full payout—it happens more in complex Chapter 11 cases.

The automatic stay provides basic protection to a debtor since the creditor must cease all collection activity. This gives the debtor a break from creditors vying for priority and collecting debts. Creditors, on the other hand, need to make sure to follow the automatic stay to avoid losing important rights during the proceedings. "Regardless of how soon after the bankruptcy filing occurs, a creditor is in immediate danger of an automatic stay violation should any [collection] act be taken. Be aware and proceed with caution," said Hammer.

The automatic stay is a tricky proposition and slippery slope for creditors. "Don't send automatic monthly statements," warned Hammer. Many credit departments still do this after their debtor files for bankruptcy and include disclaimer language, such as, "this is not an attempt to collect debt." However, continuing to send these notices does not increase the chance of collection—the risk outweighs the reward. There is much conflicting case law and results from courts on the matter.

One of the first major things that occurs in a case is the creditors' meeting—usually within 60–90 days of the filing. This gives creditors the opportunity to attend and face the debtor in an informal proceeding similar to a deposition. At the meeting are the administering trustee and other interested parties, including the debtor and their attorney and the creditors. This is the best and often only chance for creditors to get a one-on-one meeting with the debtor after the bankruptcy filing, noted Hammer. "Creditors tend to have a much more active role in these sorts of cases because the Bankruptcy Code under Chapter 11 affords them much more flexibility and ways to creatively seek collections," said Hammer.

The proof of claim is another way that creditors, secured or unsecured, prove they are owed money in the bankruptcy case. For secured creditors, documents, such as mortgages, are submitted, while unsecured creditors can submit a statement of accounts or affidavits, but it usually comes down to getting the dollar amount correct, said Hammer.

While bankruptcies can put a hiccup in a creditor's daily workflow, they are common and growing in number. In 2019, commercial Chapter 11 filings increased 8% in May from April, according to a release from the American Bankruptcy Institute. Commercial Chapter 11s also jumped 7% in May year-over-year.

-Michael Miller, managing editor