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ARTICLES & INSIGHTS

ABOUT THE AUTHOR



[Byron Saintsing](#) leads a practice group focused on matters involving [construction law](#), commercial and business litigation, representation of [equipment lessors](#), charter schools, and education law, and commercial creditor bankruptcy. Byron has written and lectured on many topics pertaining to construction and equipment leasing, including editing materials on North Carolina's adoption of Article 2A of the Uniform Commercial Code.

Five Things to Keep in Mind When Your Customer Files Chapter 11

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It's rarely good news when your customer files a Chapter 11 bankruptcy. However, when it happens, you can prevent a bad situation from becoming worse by adhering to these five essential rules of the road for protecting your company's interests.

- 1. Stop Trying to Collect Your Debt from the Debtor.**
Once you receive notice of the bankruptcy, cease all demands for payment and do not continue to pursue your customer. Also, do not attempt to retake possession of your goods from the customer. Any of these actions constitutes a violation of the automatic stay of the Bankruptcy Code, and could land you in serious hot water with the Bankruptcy Court. Rather, ask your attorney to explain your options for collecting your account within the confines of the Bankruptcy Court rules.
- 2. File your Proof of Claim by the Deadline**
In bankruptcy cases, the Court assigns deadlines for filing proofs of claim. Make sure that you note this deadline on your calendar and communicate it to your attorney. Failure to file your proof of claim by the deadline could result in you waiving your right to receive any distributions issued to creditors in the bankruptcy case.
- 3. Leverage any Reclamation Claim**
If you are selling goods to your customer in the ordinary course of business, and the transaction occurred within 20 days of their bankruptcy, send them a notice of reclamation of those goods. This notice, while unlikely to result in actually receiving the goods back, may provide you with an administrative priority claim in the bankruptcy case for the value of the goods sold within the twenty (20) days preceding the bankruptcy. Administrative priority claims are paid ahead of most other claims, so this may help recover some of your loss. Note that a reclamation notice is not a violation of the automatic stay of the Bankruptcy Code (see above) and sending such a notice after the bankruptcy case has been filed is permissible.
- 4. If You Are a Lessor, Get Your Customer to Assume or Reject Your Lease(s) Pronto.**
True leases, (e.g. not leases that are in fact disguised security interests) get special treatment in bankruptcy. If you are leasing equipment to a customer, you are entitled to ask the Court to require that the customer either assume or reject your lease. Many times, bankrupt customers are content to use leased equipment for months or even years without assuming or rejecting the lease and/or without making monthly lease

payments. If your customer really needs the equipment you are leasing to them, they will assume your lease. In order to assume your lease, they must cure any defaults and keep it paid current.

5. Don't Ignore Demands to Return Preferential Payments.

You may receive a letter from your customer or your customer's attorney demanding that you return payments the customer made to you prior to filing bankruptcy. These are called preferential payments, or "preferences." Talk about rubbing salt in the wound! You are already out money still owed you, and now the customer wants to take back payments they made before the bankruptcy? If you encounter this situation, resist the urge to throw your hands up in the air. Don't ignore a demand for payment, as it may very well be an enforceable demand.

There are numerous defenses under the Bankruptcy Code against such demands for the return of preferences. Have your attorney explain these defenses to you, and advise you as to whether you may be able to take advantage of one or more of them to substantially limit any obligation to repay a preference.

If you would like to learn more about ways you can protect your company's interests in the event of a customer filing bankruptcy, please contact me at bsaintsing@smithdebnamlaw.com or 919.250.2118.

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