10 WAYS TO EFFECTIVELY MANAGE YOUR MONEY IN SOMEONE ELSE'S BANKRUPTCY

Submitted By:

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Attorney Bio

Matthew D. Ellison is a member of the Fowler Bell firm, practicing in the firm's Litigation, Bankruptcy, and Creditors' Rights Groups. Mr. Ellison also has significant experience in all forms of litigation arising out of insurance policies, including coverage disputes and suits over insurance claim handling.

Mr. Ellison also has experience in employment law, workers' compensation litigation, appellate practice, and complex collection matters. He represents local, regional, and national clients. His practice is a throwback to when attorneys learned in may disciplines and represented their clients in multiple matters, before the "specialization" era took hold.

As the child of a schoolteacher, Mr. Ellison always believes in educating his audience- whether that audience is a client, judge or jury. Because of that commitment to educating, Mr. Ellison builds strong relationships with his clients and knows how to provide them with the information they require to make important decisions.

Mr. Ellison is precise and focused in his practice and is dedicated to finding cost-effective solutions for his clients.

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"Make every dollar count."

As small- to medium-sized businesses face rising costs and wages, keeping control of unnecessary expenses and cash outlays is more important than ever. But when your company's key vendor or supplier suddenly closes its doors and files for bankruptcy protection, it becomes more important than ever to make every dollar count – often times, by "counting every dollar."

Bankruptcies – even when they're not your own – can stretch you financially. Your guiding principle should be to maximize your recovery, just as it would be in any other challenging time. Even though you don't control the financial health of your business partners, you can control whether or not you're prepared to maximize your recovery and minimize the financial harm to your business.

These are some tips to better position your business to do exactly that.

1. KNOW YOUR PRIORITY UNDER THE BANKRUPTCY CODE – AND SPEND YOUR LEGAL DOLLARS ACCORDINGLY.

I once had a client who wanted me to represent them as a creditor in a bankruptcy case, and go to every hearing, meeting of creditors, debtor examination, and so on. Before we settled on a course of representation, I asked them how much they were owed. They said about $3,000. Although lawyers take should always take great care to make sure their service rates are reasonable, even the lowest possible attorney rate would have turned this math problem upside down very quickly.

A key at the outset of any bankruptcy proceeding is to "know your priority." The Bankruptcy Code creates a de facto pecking order of those who are owed money, with secured creditors at the top of the list. If you are a secured creditor with a lot of money at stake, it may make sense to hire legal counsel to make sure that your rights remain unaffected by the bankruptcy filing. On the other hand, unsecured general trade creditors are often one of the lowest priority creditors and there are not many instances in which it makes a great deal of sense to fully "lawyer up."

At the outset of any bankruptcy case which may affect you, it's worth at least an initial consultation with your preferred legal counsel to evaluate whether it makes sense to even hire legal counsel. And by all means, be skeptical and ask tough questions of your attorney that make sure your economic interests – not the attorney's economic interests – are priority number one.

2. IF YOU ARE A SECURED CREDITOR, CHECK – AND DOUBLE CHECK – TO MAKE SURE YOUR LIENS ARE PROPERLY PERFECTED BEFORE A BANKRUPTCY CASE EVEN EXISTS.

When a bankrupt company is searching for every way they can to rehabilitate themselves, no stone will go unturned. That means checking every secured creditor's liens to make sure that they are "perfected," a term of art under state law which gives them full and superior validity against any other creditor. Provisions in the Bankruptcy Code allow a debtor to invalidate any lien which is not properly perfected as of the bankruptcy filing date.

For example, I once was involved in a case where a floorplan lender lent a dealership millions of dollars to fund sale inventory, which should have entitled it to a first-priority lien on this inventory. But it failed to follow a step in Kentucky's Uniform Commercial Code which required it to send a certified mailing notice of its lien to other creditors who had previously recorded a lien on the same collateral. Because it failed to "perfect" its lien, it lost its priority – and ultimately, a lot of money. Perfecting liens is easy if you're following the applicable law, so it pays to make sure on the front end so you don't get an unpleasant surprise on the back end.

3. IF YOU DON'T HIRE LEGAL COUNSEL, DON'T BE AFRAID – OR TOO LAZY – TO READ YOUR MAIL.

If you choose to not have legal counsel enter an appearance in the case, then most important notices will come by regular mail (or in some cases, electronic mail). Resist the temptation to throw away things that might look like mass junk mailings; often important notices of deadlines, objections to claims, or Chapter 11 plan documents are sent via mass mailings. Ignorance is often no excuse for a missed deadline. Make sure that whoever processes or routes mail is aware of the bankruptcy case, and knows how to identify or properly route case-related mailings. And read the mailings; failure to act in a timely fashion can often mean a forfeiture of certain legal rights.

4. DON'T BE AFRAID TO CONTINUE DOING BUSINESS WITH A DEBTOR AFTER IT FILES FOR BANKRUPTCY. IT MIGHT BE YOUR PATH TO GETTING MADE WHOLE.

Many provisions of the Bankruptcy Code are intended to encourage vendors to continue doing business with debtors. This may be the last thing on your mind if you're sitting on dozens of unpaid accounts receivable from that debtor. And generally speaking, it is your right to say "enough is enough" and move in a different direction. (Unless you have an in force "executory contract" – stay tuned for more on that.)

If your trade vendor is seeking a reorganization, then you may benefit from having a claim for an "administrative expense." Provided that your goods or services being provided to the debtor are enabling it to continue operating as a business, you will have a claim against the debtor's estate that must be paid in full as part of any successful reorganization.

Additionally, a recent trend in bankruptcy reorganizations is to allow debtors to pay some – or all – of their pre-petition debts to certain vendors who they regard as "critical." While the Bankruptcy Code does not favor paying pre-petition debts out of the Code's prescribed order of priority, some judges will allow it if the debtor makes a convincing case that you are so critical to the debtor's chances of rehabilitation, that you must be "kept happy" and therefore need to be paid. By making yourselves useful and invaluable to the debtor before they file bankruptcy, you can raise the odds that you might be treated in this fashion after the reorganization process begins.

5. DON'T ACCEPT "UNUSUAL ARRANGEMENTS" WITH BUSINESS PARTNERS WHO MIGHT ONE DAY BECOME DEBTORS.

A client of mine once was owed $11,000 in unpaid service invoices. They were none too thrilled to get a demand letter from a Chapter 11 liquidating trustee demanding that they pay an additional $20,000 to settle an "avoidance" action.

Under Chapter 5 of the Bankruptcy Code, a debtor can pull certain pre-bankruptcy payments (within a limited time prior to the bankruptcy) back into the debtor's estate for the benefit of all creditors. If a debtor makes certain payments that are for either a) less than reasonably equivalent value; or b) the preference of one creditor over another, then the recipient of those payments can be required to cough those payments back over. Talk about unfair!

Fortunately, there are steps that a business can take in order to protect themselves against such threats. Make sure the debtor's payment timing is well documented, so you can easily prove when you were paid and for what. Know the industry standard for receiving payments, and make sure your terms (and the debtor's habits) are within the industry norms. Even if it may benefit you financially at the time, don't "fleece" the debtor, who is in a vulnerable economic position, into paying much more for something than its reasonable value.

6. SUGGEST A SECURITY DEPOSIT AT THE OUTSET OF YOUR BUSINESS RELATIONSHIP – AND THEN MAKE SURE YOU HAVE ITS EXISTENCE AND PURPOSE DOCUMENTED.

If you know that you're going to be in a transactional relationship for the long haul, then consider asking for a "security deposit" to guard against unpaid invoices. That way, if you get left holding the bag upon a bankruptcy filing, you at least have something to show for it. A security deposit converts you into at least a partially secured creditor – and something is better than nothing.

But make sure that you have this arrangement documented. A security deposit without evidence as to why it exists and under what conditions it can be drawn on, is really no security deposit at all. At least, it's not one which will stand up under the harsh examination of a debtor's financial practices while in bankruptcy. An undocumented security deposit runs the

risk of being voided in bankruptcy proceedings, which means that you lose the benefit of your bargain. Take the extra few minutes to write things up and avoid headaches and heartburn that might come later.

7. CONSIDER WHETHER YOU HAVE AN "EXECUTORY CONTRACT" WITH THE DEBTOR – AND IF YOU DO, KEEP PERFORMING!

An "executory contract" is one where performances remain due and owing by both contracting parties. An example is an unexpired contract where you agree to supply the debtor with 100 products per month and the debtor agrees to pay for them. If you have an executory contract with the debtor that has not been terminated as of the petition date, you must keep performing your obligations under the contract. Importantly, this obligation to perform continues, even if the debtor was in default at the time the case was filed. The debtor is given time to determine whether to keep performing these contracts ("assume" them), or reject them.

Pending the debtor's decision on assumption or rejection, creditors are entitled to be paid for what they supply post-petition but cannot terminate the contract based on a pre-petition default. If there is a default prior to bankruptcy which gives you the option to terminate the contract, but you fail to do so, then you are stuck with performance (as is the debtor) until the "accept or reject" deadline.

A creditor who keeps doing business with the debtor after bankruptcy may receive a higher priority for the debt owed to them. But a creditor who walks away may not, and might have to answer to a judge as to why they have done so.

8. IF A DEBTOR WANTS TO ASSUME YOUR EXECUTORY CONTRACT, MAKE SURE YOU GET EVERY DEFAULT CURED.

A debtor who wishes to assume an executory contract doesn't just get to check a box that says "yes" – they have to make sure that all prior defaults in the contract are cured at or near the time the contract is to be assumed. You are entitled to be compensated for all pecuniary loss that has resulted from any prior debtor default. That means document your losses and be capable of proving them when the time comes.

Often, a debtor will understate the extent of defaults (and their monetary significance) in order to make the cure easier on them. If you aren't prepared to come forward with evidence of what is actually needed to fully make you whole again, this is a battle you can lose. And let's face it: debtors don't always have the best record-keeping system themselves.

Document every default. Send timely written notices of default to the debtor, and state what is necessary to cure the default. If your arrangement calls for interest and late charges on unpaid invoices, add them up and don't voluntarily waive them in the interest of being a good sport.

And consider whether the default resulted in pecuniary harm that isn't specifically addressed in the financial terms of your executory contract. Don't let the debtor get off easy if they want to continue doing business with you under the existing contract.

9. THINK BEYOND JUST WHAT YOUR LEGAL RIGHTS ARE – THINK WITH (DOLLARS AND) CENTS.

I have seen cases before where a creditor had a very compelling case for putting forth issues that could have resulted in the dismissal of the bankruptcy case. However, just because you can do something doesn't mean you should do something. What happens if a debtor has their bankruptcy case dismissed? It's a free for all – and that means more money that you'll have to spend on other court fights. Therefore, you (or your bankruptcy counsel) should also think about the long game, instead of just whether you can win a specific battle.

10. KNOW THAT THE BANKRUPTCY CODE FAVORS DEBTOR REHABILITATION, AND PICK YOUR FIGHTS ACCORDINGLY.

I enjoy a hard-fought, challenging legal battle just as much as the next lawyer. But my obligation is always to render advice that is in the best interest of my client's rights and objectives. The Bankruptcy Code generally favors giving debtors at least a chance at rehabilitation if they are choosing that path, and most bankruptcy judges favor giving debtors a chance too. That means that certain legal tactics and fights often aren't worth picking, especially when such represents an existential challenge to the debtor's chance at success. An aggressive, heavy-handed legal strategy that tries to stop a case dead in its tracks often represents an unwise use of your time and resources. Save your precious and limited resources for what really counts, so you don't become a financial casualty of someone else's bankruptcy.