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Dealing with bankruptcy

Tough times can force your customers to seek legal protection. **Interviewed by Curt Harler**

Perhaps the only thing worse than a customer whose payments are 60 days overdue is one who notifies you that it is declaring bankruptcy. What you do in the days after a debtor declares bankruptcy has a major effect on what, if anything, you collect.

“It is important to have a general understanding of how bankruptcy can affect your ability to collect an outstanding debt and the steps you should take to maximize that potential recovery,” says Bradley C. Mall, attorney with Munck Carter, P.C. in Dallas. “Even before the current financial crises, we saw a sharp increase in the number of bankruptcy filings.”

In August 2008, bankruptcy filings reached a new high of 4,476 per day. At that time, predictions were that bankruptcy filings would top one million by the end of 2008. Given the current financial times, actual filings are likely to be significantly higher. What is a business owner to do?

Smart Business asked Mall how a business owner should react to a client's bankruptcy filing.

If I hear that a client is declaring bankruptcy, what should I do first?

The safest thing is to confirm that filing by contacting the debtor and obtaining a case number and/or name and telephone number of the debtor's attorney. Alternatively, most attorneys can confirm the filing through the bankruptcy court's online filing system, PACER.

Failing to confirm a filing can have adverse consequences. Not only is any action taken in the pursuit of collection avoidable post-filing, such action may open you to monetary liability. Actions taken in pursuit of debt collection — even actions as simple as filing a lien — violate the Bankruptcy Code's 'automatic stay' provisions and are avoidable.

What is 'proof of claim'?

In the business world, to receive payment for services rendered or products supplied, you submit an invoice. In a



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bankruptcy proceeding, creditors file a proof of claim. You should attach any and all documents that support your claim. For example, if the claim is based on a promissory note, attach the note. If the debt is secured by collateral, attach confirming documents, such as a Uniform Commercial Code Financing Statement (UCC-1). A proof of claim is deemed allowed upon filing with no more action to be taken unless and until an objection is filed as to the claim.

This does not mean that you will receive all or any money from the debtor. Rather, it establishes your claim and its position within the hierarchy of claims payment. You do not have unlimited time to file proof of claim. In a Chapter 7 (liquidation) case, the deadline is usually 90 days after the first meeting of creditors. In Chapter 11 (reorganization) cases, the court sets the deadline.

How do I move up in the payment hierarchy?

Vigilance in the processing and protection of your claim before bankruptcy is filed is key to your position in the hierarchy of claims payment under the

Bankruptcy Code. Where your claim falls in terms of payment is entirely dependent upon the classification of your debt prior to the bankruptcy filing. So, if your debt is secured, your claim will have priority, i.e., be paid before general unsecured creditors. This does not mean that your claim will be paid in full, or even at all.

Conversely, failure to properly perfect and record your security interest may cause your claim to be classified as unsecured, which is close to last in line for payment. Further, because the bankruptcy trustee (or the debtor in Chapter 11 cases) can avoid any transfer of an interest in the debtor's property (such as filing a UCC-1 or other lien documents) that occurred up to 90 days before the filing, it is important to ensure that you are timely taking the necessary steps to perfect your security interests and thereby protect any potential claim should the debtor file for bankruptcy protection.

What is this going to cost me?

This depends on numerous variables that should be analyzed in considering how best to proceed. Just because a debtor files for bankruptcy protection does not mean you should throw up your hands and write off the debt. Chances are you will not receive 100 cents on the dollar. But, if you take the necessary steps during the course of your everyday business activities to perfect and protect your claim, chances are good that you will receive some return.

In any case, consult a bankruptcy attorney who can explain the process and your options and help you determine an appropriate course of action. <<

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