

## What To Do When A Customer is Going Under

By Raymond P. Kolak

It's one of the most distressing calls an attorney can get. "One of my biggest and best customers, Sure-Pay, hasn't paid me. It's a lot of money and their invoice is way past due. I think they're going under. What can I do? Can you go after them?"

When a call comes in like this, it's usually too late to do much of anything. The best ways to insure collection must be planned and put in place before the delinquency arises. Still, there are a few things that any business can do, even after the debt becomes overdue. These are the questions I would ask if I were your attorney:

*Is the sale to Sure-Pay on open account?* A sale on open account means that no other security devices are in place. If Sure-Pay doesn't pay, your only way to collect is to file suit for breach of contract for failure to pay. If there are security devices in place, such as a letter of credit, security interest or pledge of property, or personal guarantee, then collection through those means may be most effective. Usually, though, the sale is on open account, and the rest of this article assumes that.

*Are you still shipping (or servicing) the Sure-Pay account?* This fits under the idea of not throwing good money after bad. If Sure-Pay doesn't pay you, then at least stop the bleeding by not handing over more product or services that you won't be paid for. You might be able to use the threat of withdrawing as a vendor as a way to obtain a partial payment from Sure-Pay. But, if you get a payment for \$25,000, but have to ship another \$35,000 in product, are you ahead or behind? It seems so basic, but I see clients run into big collection problems that might have been minor write-offs had they cut off the customer at an earlier time.

*Has Sure-Pay filed for bankruptcy? If they have...* Federal bankruptcy law has a feature called the "automatic stay" which is intended to freeze the status quo for a company that just filed for bankruptcy. The automatic stay halts all legal proceedings and collection efforts against the company upon the filing of the bankruptcy case. No special notice or other legal steps are needed. Anybody still pursuing collection after the bankruptcy filing is subject to sanctions in the bankruptcy court. If you have a special reason, it is possible to have the automatic stay lifted to permit your collection proceeding to go forward, but in general you must prove that your proceeding will not have an adverse impact on the bankruptcy case.

Once bankruptcy has been filed, you should get a notice of the filing from the bankruptcy court. I also think it's a good idea to get a copy of the asset and liability schedules Sure-Pay has to file with the court. In this way, you can verify that your debt is listed, and in the proper amount. You should file a proof of claim with the court (no charge for this) to have your debt registered.

Disposition of your claim in bankruptcy depends on whether Sure-Pay has filed for bankruptcy liquidation (Chapter 7) or bankruptcy reorganization (Chapter 11). Under Chapter 7, the bankruptcy trustee will collect all of Sure-Pay's assets, then apply them to claims in a particular order. In general, secured interests and mortgages are paid first, then bankruptcy administrative costs, such as filing charges and attorney's fees, then taxes, and finally unsecured creditors, such as you. You may get 10¢ or 25¢ on the dollar, maybe more, but sometimes nothing at all because the claims with higher priority have sucked up all of Sure-Pay's assets.

If Sure-Pay has filed under Chapter 11, it must file a plan of reorganization which states how and when its liabilities will be paid. As an unsecured creditor, Sure-Pay doesn't have to pay your debt in full, though in many cases the plan contemplates payment of unsecured creditors over time, perhaps 2-5 years. Just remember that the majority of Chapter 11 cases fail, and end up being Chapter 7 liquidations anyway.

Once you confirm that your claim has been registered, in most cases you simply await payment from the bankruptcy trustee or from Sure-Pay in liquidation. You can monitor the bankruptcy case to make certain that you are treated on a par with the other unsecured creditors. If your claim is large enough compared to all the other claims, you might want to form or get appointed to a creditor's committee to oversee the bankruptcy.

*Has Sure-Pay filed for bankruptcy? If they have **not**...* Try to get as much money from Sure-Pay as you can immediately. Threaten to withhold future shipments. Have your lawyer send a collections letter. Appeal to Sure-Pay's sense of obligation.

In most cases, you can keep any payment you receive from Sure-Pay, even if it files for bankruptcy later. There are some important exceptions, called the rules for "preferences." Sometime long ago, a company near bankruptcy decided to make the best of a poor situation by paying off all of its friends in full, then filing for bankruptcy and leaving all of its other creditors penniless. Federal bankruptcy law now forbids this by treating all payments from a bankrupt company in the 90 days prior to filing as a preference (one year for payments to insiders such as shareholders or family members). The bankruptcy trustee will sue to get back any preferential payments and add them to the assets to be distributed to unsecured creditors.

Even if Sure-Pay files for bankruptcy within 90 days after you receive your payments, you still might be able to keep it under one of the many exceptions to the 90-day preference rule. For example, if you received the payment in the ordinary course of business, under regular payment terms, you can keep it. Keep the money, wait to see if a suit to collect it as a preference is filed, then ask your lawyer whether any of the exceptions to the preference rule applies.

*Is filing a collection suit worthwhile?* If Sure-Pay hasn't filed for bankruptcy, then there is no automatic stay, and you can file suit to collect. But before you do so, assess the probabilities of collecting. It will probably be easy to get a judgment against

Sure-Pay (a court order stating that it owes you money and how much), but that does not mean you will get paid. You must also determine whether Sure-Pay has any assets.

As a law student, I always wondered about this. If you sold Sure-Pay product, and it still had your product, couldn't you just show up and reclaim your product? Surprisingly, no. You are not entitled to an automatic return of the unpaid product (absent a security interest in the product, or as described below).

You need to collect financial information about Sure-Pay. Can you get financial statements from Sure-Pay or a credit reporting agency? Try to visit Sure-Pay's offices or plant to see if it is still in operation. Talk to other creditors or competitors to find out its plans. Have your lawyer do a search of the public records to see if it has security interests filed against its property which would be superior to your unsecured claim.

If you and your attorney decide that there are assets which can be used to satisfy your claim, then file a collections suit. Most collections attorneys will handle your claim for the filing costs, plus 20-40% of the amount recovered, assuming that Sure-Pay defaults and does not contest your claim.

*Have shipped any goods to Sure-Pay in the last 10 days?* A special rule recognized in state law and federal bankruptcy law allows you to reclaim any goods you shipped to Sure-Pay in the last 10 days, if Sure-Pay became insolvent during that time. Proving insolvency may be difficult, but if Sure-Pay has filed for bankruptcy within that 10-day period, it will be deemed insolvent. This is only a right to reclaim goods you have sold which are still in Sure-Pay's possession; if Sure-Pay has sold the goods already, you are out of luck. To reclaim, your lawyer needs to send a special notice to Sure-Pay asserting the right to reclaim within the 10-day period. Time is of the essence here, so act quickly.

*Have you tried all of the above, but nothing has worked?* Write off the receivable as a bad debt. Uncle Sam will assume part of the cost, at least to the extent of your tax rate. And re-examine your credit and collections policy.

*Raymond P. Kolak is a principal at the Chicago law firm of Eckhart Kolak LLC. The examples in this article represent an aggregate of experiences from several persons. See a lawyer before you take any action involving a legal matter. Ray can be reached at [rkolak@eckhart.com](mailto:rkolak@eckhart.com).*