

NEWS & INSIGHTS

How a vendor can deal with a bankrupt client

INSIGHTSARTICLE

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Vendors are often at the mercy of the courts and far down the list of who gets paid outstanding invoices when one of their clients files for bankruptcy.

But it doesn't have to be that way.

While limited, there are things vendors can do within the parameters of the Bankruptcy Code when a client files for bankruptcy and suddenly are no longer required to pay their bills.

Reclamation claims

Since 2005, the Bankruptcy Code has included a clause allowing for claimants to file for “administrative expenses,” which includes the value of goods received by the debtor within 20 days of the bankruptcy filing.

These administrative expenses are paid in full before unsecured claims. The claims must be for goods (not services), must have been received by the debtor within 20 days of the filing, were sold in the ordinary course of the debtor’s business and can only be for the actual value of the goods sold.

The “goods” and not “services” is an important distinction. A vendor such as a law firm that supplied legal advice would be out of luck, but a wholesaler that sold the debtor paper, for example, would be able to file for the administrative expenses.

Critical vendors

Bankruptcy is normally a last-ditch effort for a business to survive, not to close their doors immediately. In its efforts to continue to operate, there are always goods and services the business needs to continue its operations during the bankruptcy operation. The vendors who provide those essential goods and services for the continued and future viability of the businesses are considered “critical vendors.”

Those critical vendors have a possible avenue to payment. They can use their leverage to have the debtor petition the courts to approve immediate payment to the vendor, so long as the vendor continues to supply the debtor with its goods or services.

Courts are split on approvals of these kinds of claims, as there is nothing in the Bankruptcy Code concerning critical vendors. But it could be worth a shot.

Avoidance actions

The court-appointed trustee can bring avoidance actions to attempt to claw back payments made to a creditor shortly before the bankruptcy filing. Often, it is for fraudulent-conveyances, or preferential transfers. These are defenses to these actions and counsel should be consulted. The most important thing to remember is that once a company files for bankruptcy an “automatic stay” is in effect and no further actions can be brought against the bankrupt without first seeking relief from the Court. A Proof of Claim must be filed to recover monies owed if there is a distribution in the bankruptcy case. If you are a vendor that has questions about retrieving payments from a bankrupt business, please contact anyone in the [Saxton & Stump Bankruptcy and Financial Restructuring Group](#).

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