

February 11, 2009

WEATHERING THE STORM

Doing Business with Struggling Customers

When customers begin struggling with liquidity issues or file for bankruptcy protection, you can continue to conduct business with them. *You must simply be cautious and prudent in your dealings.* Consider the following issues:

1. **Has the customer shown signs of a liquidity crisis?**
Liquidity issues, or cash flow problems, often affect a customer's relationships with its suppliers and other creditors and could force the customer to consider the protections offered in bankruptcy. Some common signs of liquidity problems are: delayed payments; NSF checks; reduced orders; and modifications to the terms, mode, or method of payment.
2. **Has the customer filed for bankruptcy protection?**
A customer that has filed bankruptcy becomes a "debtor." The bankruptcy filing severely impacts your relationship with the debtor.

SOUND PRACTICES:

- **Demand prompt payment for any and all goods shipped to or services rendered to the debtor after the bankruptcy petition date.** A debtor is required to pay all post-petition claims incurred by the debtor in the ordinary course of its business under ordinary business terms. If the debtor does not remit payment, you may assert such claims with the court as "administrative expense claims," which garner higher priority than general unsecured pre-petition claims.
- **Exercise reclamation rights.** Creditors are automatically entitled to an administrative expense claim for goods shipped to the debtor during the 20 days before the bankruptcy petition date. In addition, depending on the circumstances of the case, creditors may be entitled to an administrative expense or other priority claim for goods shipped during the 45 days prior to the bankruptcy petition date if the creditor makes a timely demand in compliance with applicable law. ***Seek the advice of qualified legal counsel to obtain guidance regarding these potential avenues of recovery.***
- **Monitor relationships with non-debtor affiliates.** Attempt to prevent the build up of receivables owed by the debtor's affiliates that are not debtors in the bankruptcy case. Because these entities are non-debtors, you are within your rights to exercise normal collection efforts, including demanding payment of arrearages and refusing to ship new product unless past due payments are made. Of course, you must decide if such action makes good business sense because the affiliate may choose to stop doing business with you, or your actions could force the affiliate into bankruptcy.

- **Request adequate assurance.** If you are purchasing from a debtor in bankruptcy, then your primary concern will be obtaining adequate assurance that the debtor will be able to perform. You want to know the debtor will be able to timely deliver the quantity you ordered at the quality for which you contracted. Your counsel can assist in this regard.
- **Meet all court-ordered deadlines.** Take care to meet all deadlines imposed by the bankruptcy court, including the bar date for filing proofs of claim, or your claim may be disallowed in its entirety.

PRACTICES TO AVOID:

- **Do not demand that a debtor pay pre-petition claims** (debts incurred by the debtor before it filed bankruptcy). This practice includes threats that you will terminate contracts with the debtor and refusals to perform contractual obligations. Pre-petition claims can *only* be paid pursuant to a plan of reorganization or an order of the bankruptcy court, like in the case of court approval of payment to critical vendors. Payment demands could result in sanctions against you by the bankruptcy court.
- **Do not misapply post-petition payments.** If a customer pays you for shipments received after the petition date, and it owes you for shipments before bankruptcy, you cannot apply the payment to the oldest invoices first without risking sanctions by the bankruptcy court. If the customer references a particular invoice with a payment, the payment must be applied to the receivable related to the goods shipped.

3. **When can you expect payment?**

Asserting an administrative claim increases the likelihood that you will be paid, but it does not guarantee payment. You should generally monitor the debtor's reorganization efforts, especially the terms of any proposed plan of reorganization, to ensure that the debtor is timely paying all post-petition claims.

Pre-petition claims are paid under the terms of a plan of reorganization. However, it could take years for a plan of reorganization to be approved, and such plans generally provide for some pro-rata payment of pre-petition claims in an amount significantly less than 100 cents on the dollar. Certain companies may approach you to purchase your pre-petition claims, and selling your claims *may* be a viable option under the right circumstances.

4. **How do you treat the business relationship moving forward?**

If you become uneasy about the debtor's ability to satisfy post-petition obligations, you are entitled to tighten credit terms, require cash in advance, COD, or letter of credit for future purchases, provided that your contract with the debtor allows for such modifications. Whatever new terms you establish should be memorialized in writing with the customer.

Remember to always notify your legal department or outside counsel at the first sign of liquidity issues. The faster and sooner you act, the more you may be able to recover in the end. For more information, please contact:

[Ian T. Peck](mailto:ian.peck@haynesboone.com)
817.347.6613
214.651.5155
ian.peck@haynesboone.com

[Stephen M. Pezanosky](mailto:stephen.pezanosky@haynesboone.com)
817.347.6601
214.651.5254
stephen.pezanosky@haynesboone.com