

The Corsaro Commentary

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Minimize Your Losses If The Customer Goes Bankrupt

Many of our clients have recently seen a customer file for bankruptcy. When that happens, the client wants to know if there is any way of getting paid from the customer. Many times the unfortunate answer is “No.” Depending on the facts, sometimes litigation in bankruptcy court yields positive results, but the best plan avoids the need for litigation. Below are some quick tips you should know in order to put yourself in the best position possible and minimize your losses.

1. **Security Interest:** Although not always practical, it is always best if you get the customer to grant you a security interest in some collateral to secure the payment. If given and properly documented and filed, then if the customer goes bankrupt the chances of you being paid in full or of receiving a greater payment increases. Even if a bank has a previous “blanket” security interest over all of the assets of the customer, in certain circumstances you can take priority over the bank. However, achieving this priority status depends on following strict rules and short deadlines, so close attention must be paid.
2. **Preferences:** Unfortunately, in many circumstances if you have received a payment within 90 days of the customer filing bankruptcy you will be required under federal bankruptcy law to refund that payment to the customer. However, in certain limited circumstances if you have delivered product to a customer who shortly thereafter files bankruptcy, you can get the product back.
3. **Personal Guaranty:** If possible, you should have the owners of the customer personally guaranty the debt to you. Sometimes even though the company files bankruptcy, the owners do not. A personal guaranty will sometimes allow you to collect from an owner when the company is insolvent.
4. **Financial Data:** For ongoing customers, periodically request that they provide you with financial statements or other documentation of their financial condition. This will enable you to monitor the customer’s ability to pay your bill.
5. **Get Specific:** If you are working out payment terms for a delinquent customer, make sure the terms are specific regarding how much is to be paid and when. Also, be as specific as possible as to where the money will come from to pay (e.g., SBA Loan; payment on contract; investor funds, etc.) Reduce the terms to writing and have at least one officer of the customer sign the terms.

The best defense against significant bankruptcy losses is common sense. Do not keep supplying the customer if it gets too far behind in making payments (90 days is a good rule of thumb). If appropriate, make the customer pay within 7 or 14 days rather than 30 days. Do not allow the customer to give you un-kept promises, even if the owner is “good guy” who has always paid eventually in the past. The customer may have good intentions, but those intentions will not help you if it files bankruptcy. If payment is doubtful, require additional information or personal guarantees from the customer. Never extend more credit than you can afford to lose.

If you or your company is ever in a situation in which your customer files for bankruptcy, contact us immediately so that we can best protect you and assist you in minimizing your losses.