

## Selling to Customers or Clients in Financial Distress or in Bankruptcy? Proceed, but with Caution.

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You have heard the rumor that one of your clients or customers is on the verge of **bankruptcy**. What should you do? Although your instinct may be to suspend all dealings with them for fear of total loss in the abyss of bankruptcy, you should not over-react. With proper assistance, you can safely navigate as a creditor in even the murkiest waters.

While there is no reason to suspend dealings with a client in financial distress, there is ample reason to decline to extend credit to that client as part of those dealings. Requiring payment in advance or at the time of delivery is the most basic and effective form of protecting your interests as a creditor. Moreover, while there is ordinarily concern about payments received during the 90-day "preference" period before a bankruptcy, a payment made as part of a contemporaneous exchange of goods or services is not an avoidable preference.

Once a petition for bankruptcy reorganization is filed, you should have even less concern about selling to the Debtor. To incentivize vendors to continue providing goods and services to Debtors, the **Bankruptcy Code** gives an "administrative claim" - a claim that is entitled to priority, and that is generally *paid in full* - to any creditor who provides goods or services to a debtor any time *after* the petition date (the date on which the bankruptcy is filed). The Code even gives an administrative claim to any vendor that sold goods to the debtor in the ordinary course of business in the twenty days before the date of the bankruptcy.

Where you still remain at risk is for any outstanding debt as of the petition date. With respect to such pre-petition debt, you will want to file a proof of claim and should brace yourself to receive a fraction (if any) of what you are owed. There are exceptions, however, even as it relates to pre-petition debt. The first is for a pre-petition obligation that is owed in connection with "executory contracts," where performance is ongoing in nature (i.e., an equipment lease). To the extent the Debtor wants to keep that contract in place throughout and/or after the bankruptcy, the Debtor must "cure" any existing defaults under that contract to do so, thereby entitling you to be paid in full. Second, under certain circumstances, you may also qualify as a "critical vendor," which would entitle you to be paid by the Debtor for some or all of any past due amounts owed as a condition for continuing sales. "Critical vendor" status involves a fact intensive analysis, which varies from state to jurisdiction.

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