

Article

Trade Creditors in Bankruptcy

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This article is for non-bankruptcy attorneys who have clients that may become involved in a bankruptcy case because they sold goods to a party that subsequently filed bankruptcy (a “debtor”). Accordingly, this article discusses, among other things, factors influencing whether trade creditors should become actively involved in a bankruptcy and the remedies available to trade creditors in bankruptcy.

I. WHO IS A TRADE CREDITOR

A “trade creditor” is a creditor whose claim is based on goods it sold to a debtor prior to the date the debtor commenced its bankruptcy case (the “petition date”).

II. FACTORS INFLUENCING ACTIVE INVOLVEMENT IN A BANKRUPTCY CASE

Determining whether a client should be proactive in a bankruptcy case can be difficult, particularly when it appears the recovery on the client's claim may be nominal. When making this determination, it is important to understand the priority distribution scheme in bankruptcy. Not all claims are treated similarly.

Secured claims are afforded the highest priority and are secured by virtue of valid liens on the debtor's property. Second in priority to secured claims are administrative expense claims. Generally, administrative claims are claims incurred after the petition date for an actual, necessary expense incurred to preserve the bankruptcy estate. Following administrative claims are priority claims. Priority claims are claims that Congress has determined, based on public policy, should be paid before general unsecured claims (e.g., domestic support claims; certain wage claims; and certain tax claims). Last in the priority distribution ranking of claims are general unsecured claims. In most bankruptcy cases, the holders of unsecured claims receive a recovery equal to a small fraction of the amount of their claim.

If a trade claim is secured by a valid lien, the case should be closely monitored to ensure nothing happens that negatively impacts the lien's priority. If the trade claim is unsecured, the degree of involvement in the bankruptcy case becomes more of a cost/benefit analysis. To assist in this analysis, a party can review the debtor's schedules to get an understanding of the debtor's assets and liabilities and the number of claims with greater priority.

III. TRADE CREDITOR REMEDIES

The following are some potential remedies available to a trade creditor:

(i) Stopping goods in transit: Following the petition date, a trade creditor should investigate if the debtor has ordered goods on credit that haven't been delivered. If your client is in this situation, consider stopping shipment of the goods.

(ii) Critical vendor: In Chapter 11 cases, courts sometime approve a debtor's request to pay certain pre-petition claims of trade creditors in exchange for them agreeing to continue supplying goods to the debtor on similar or better terms. Such creditors are believed to be so critical to the debtor's reorganization that the debtor cannot risk discontinuing its relationship with those creditors. If your client is considered a critical vendor, request that the debtor ask the court for full payment of the claim.

(iii) Reclamation: A trade creditor may assert a reclamation claim for goods it sold to a debtor, in the ordinary course of the creditor's business, within the 45 days prior to the petition date if the debtor was insolvent when it received the goods. The claim requires a written demand sent to the debtor within 45 days after the debtor received the goods or, if such period expired after the petition date, within 20 days after the petition date.

(iv) 503(b)(9) claim: A trade creditor may assert an administrative claim for the value of goods it sold in the ordinary course and received by the debtor within 20 days before the petition date. Unless the court orders otherwise, a 503(b)(9) claim should be asserted by filing an application with the court.

(v) Proof of claim: A proof of claim should be filed by a trade creditor, especially when the creditor disagrees with how its claim is scheduled by the debtor.

IV. RETAINING BANKRUPTCY COUNSEL

Bankruptcy, like patent law and healthcare law, is a sophisticated practice. Whether or not your client should retain experienced bankruptcy counsel depends on a variety of factors, including the amount of the claim, the potential for recovery on the claim, the complexity of the issues presented to your client, your familiarity with bankruptcy law, your ability to monitor the bankruptcy case and your proximity to the bankruptcy court hearing the bankruptcy case. Bankruptcy courts will not allow attorneys to file pleadings or appear before them unless they are admitted to appear in that court.

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