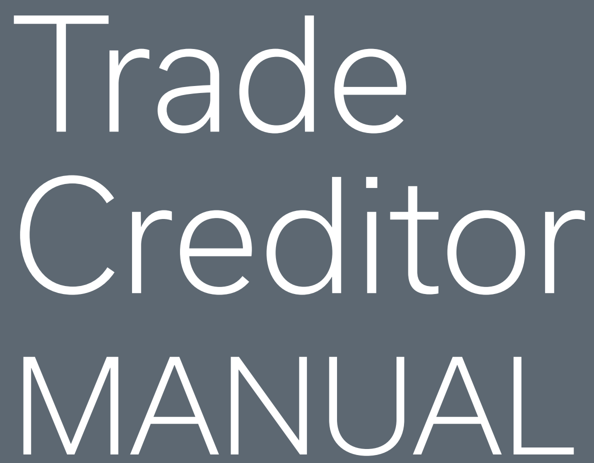

Trade Creditor MANUAL

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INTRODUCTION

Businesses supplying goods or services to customers on credit (collectively, "trade creditors") invariably encounter financially troubled customers. Some customers may even end up in a bankruptcy case. The law provides trade creditors with a wide array of legal rights and remedies to deal with a financially troubled customer.

This Manual discusses trade creditors' legal rights when confronting such a customer. With this knowledge, trade creditors can better address the challenges posed by a financially troubled or bankrupt customer.

The trade creditor's rights differ vastly depending on whether the customer has filed a bankruptcy case or not. Strategies available before the customer files bankruptcy are often not available after a bankruptcy filing. Accordingly, this Manual has two parts. Part I addresses strategies for dealing with a financially troubled customer outside of bankruptcy. Part 2 addresses strategies for dealing with a customer in bankruptcy.

Outside of bankruptcy, the trade creditor's legal rights mainly arise under the Uniform Commercial Code (the "UCC"). The UCC is a collection of laws governing commercial transactions. The UCC has been enacted (with minor variations) in all 50 states, the District of Columbia, and various other U.S. territories.

On the other hand, the Bankruptcy Code is a federal statute enacted in 1978 and amended many times after that. The Bankruptcy Code imposes significant limitations on trade creditors' ability to exercise rights, including rights under the UCC. Moreover, because the Bankruptcy Code is a federal law, it supersedes conflicting state laws, including the UCC.

We hope this Manual will help trade creditors deal with their financially troubled customers. However, we have not attempted to describe every single legal complication. Bankruptcy and creditors' rights laws are complex and can dramatically affect a trade creditor's rights depending upon the particular facts in a given situation. We strongly encourage trade creditors confronted with a financially troubled customer to seek advice from an experienced bankruptcy and creditors' rights attorney.

PART I – DEALING WITH THE FINANCIALLY TROUBLED CUSTOMER OUTSIDE OF BANKRUPTCY

A. OVERVIEW

A trade creditor of a distressed customer typically has two goals: (a) limiting any further financial exposure and (b) collecting any amounts due from the customer.

Sections B and C discuss strategies for trade creditors to limit their future exposure after they learn of their customer's financial problems. Sections D and E discuss collection strategies. And Section F discusses alternative structures to reduce credit risk.

B. DEMAND ADEQUATE ASSURANCE OF FUTURE PERFORMANCE

1. *Grounds for Insecurity*
2. *Demand for Adequate Assurance*
3. *Concluding Observations*

There are two alternative structures for a typical trade creditor relationship. Either the trade creditor supplies goods on an "open account" arrangement where the trade creditor sells goods or services on a transaction-by-transaction basis, or the trade creditor and its customer operate under a supply contract covering a specific period.

A trade creditor under an open account arrangement can easily limit its future credit risk by simply discontinuing its business relationship with the customer (*e.g.,* refusing to accept any future purchase orders from the customer). Alternatively, the trade creditor in an open account arrangement could require the customer to pay on a cash-in-advance or cash-upon-delivery basis.

A trade creditor with a supply contract also has some ability to manage future risk, but the issues are more complex than in an open-account arrangement. A trade creditor with a contract generally remains bound to perform under the contract so long as the customer has not defaulted, even if the trade creditor is uncomfortable with the customer's financial condition. However, UCC §2-609 permits a concerned trade creditor to demand adequate assurance of future performance if the trade creditor has "reasonable grounds" to question a "customer's ability to pay for future goods or otherwise perform under the contract." Moreover, the trade creditor with a contract may "suspend any performance for which [it] has not already received the agreed return." Thus, a trade creditor with a supply agreement may temporarily suspend its contractual obligation to supply goods on credit to a financially distressed customer if the trade creditor makes a valid demand under UCC §2-609.

Upon receiving a valid demand under UCC §2-609, the customer must provide the trade creditor within a "reasonable time" (not to exceed 30 days) with "adequate assurance" of the customer's ability to continue to perform under the supply contract. If the customer does not provide adequate assurance, the trade creditor may consider the contract repudiated, and the trade creditor is relieved from further contractual obligations.

1. *Grounds for Insecurity*

To invoke UCC §2-609's right to demand adequate assurance, a trade creditor must have "reasonable grounds for insecurity" regarding the customer's ongoing ability to pay or perform under the parties' supply contract.

A trade creditor cannot make a valid adequate assurance demand based upon a purely subjective feeling of insecurity. Instead, a trade creditor must have an objective factual basis or credible outside source to support its adequate assurance demand.

Trade creditors cannot use UCC §2-609 as a pretext to escape economically unfavorable contracts or renegotiate the terms of the contract. A trade creditor's grounds for insecurity must arise because of events occurring after the parties originally signed the supply contract.

Whether there are reasonable grounds for insecurity under UCC §2-609 depends on the facts and circumstances. Nevertheless, one or more of the following might constitute reasonable grounds for insecurity that justify a contract trade creditor in utilizing the provisions of UCC §2-609:

- A customer's failure to pay invoices on a timely basis;
- A customer's withholding, post-dating, or bouncing of checks;
- Financial problems disclosed by a customer;
- A customer's default on a loan from a lender;
- A customer's refusal to provide financial information;
- The resignation, termination, or loss of a customer's key management or board members;
- Tax liens or lawsuits filed against a customer by governmental agencies or other creditors;
- A customer's hiring of a restructuring officer or other insolvency professional; or
- News reports regarding a customer's financial condition.

2. Demand for Adequate Assurance

A demand for adequate assurance should be in writing and identify the grounds for the creditor's insecurity. The letter should spell out the trade creditor's intention to suspend performance under the contract until it receives the requested adequate assurance. Likewise, the demand letter should state that the trade creditor will repudiate the contract if the requested adequate assurance is not received.

The adequate assurance demand letter should also include a timeframe within which the customer must provide the requested adequate assurance. UCC §2-609 says a customer must furnish adequate assurance within a "reasonable time (not to exceed 30 days)" after demand.

The letter should also describe the form of acceptable adequate assurance. Depending upon the circumstances, such forms of adequate assurance might consist of payment terms (*e.g.*, payment in advance or cash-on-delivery terms), a third-party guaranty, a standby letter of credit, or some other form of "credit enhancement." Finally, the letter should include catch-all language (*e.g.*, "or any other similar form of adequate assurance that sufficiently addresses the reasonable grounds for insecurity referenced herein").

3. Conclusions

The right to demand adequate assurance under UCC §2-609 provides contract trade creditors with a valuable tool for addressing concerns raised by a customer's financial distress. However, as described above, a contract trade creditor's proper use of UCC §2-609 involves complex considerations, such as whether the contract trade creditor has "reasonable grounds for insecurity" and what constitutes "adequate assurance." Moreover, the potential consequences of improperly evaluating these considerations can expose the trade creditor to liability. Accordingly, contract trade creditors are well-advised to consult with qualified counsel before utilizing the provisions of UCC §2-609.

C. STOP DELIVERY OF GOODS

1. *Trade Creditor's Right to Conditionally Refuse to Supply Additional Goods On Credit*
2. *Trade Creditor's Right to Stop Delivery*
3. *Stoppage of Delivery of Goods in Transit*
4. *Termination of Right to Stoppage of Delivery*
5. *Liability for Stoppage of Goods in Transit*

The UCC gives trade creditors certain rights after their customer is "insolvent." In this context, "insolvent" does not require the customer to have filed a bankruptcy case. A company is "insolvent" under the UCC in any of the following circumstances: (1) the company has stopped paying its debts in the ordinary course of business; (2) the company cannot pay its debts as they become due; or (3) the total value of the company's assets (using a "fair valuation" standard and not book value) exceeds the total amount of its liabilities. See UCC §1-201(22).

1. *Trade Creditor's Right to Conditionally Refuse to Supply Additional Goods on Credit*

Upon discovering that a customer has become "insolvent" (using the UCC's definition), a trade creditor may refuse to supply the customer with additional goods even if the parties have a supply contract. Instead, UCC §2-702(1) permits a trade creditor in such circumstances to condition the supply of any additional goods to the customer upon (1) the customer's payment in cash (*i.e.*, cash-in-advance or cash-upon-delivery) for such additional goods; or (2) the customer's immediate payment of any unpaid goods previously supplied by the trade creditor under the same contract.

This right is similar to the "reasonable grounds for insecurity" under UCC §2-609 because both sections permit trade creditors to refuse to supply goods in some circumstances. The principal difference between the two rights is that the customer must be "insolvent" before a trade creditor can invoke UCC §2-702(1).

2. *Trade Creditor's Right to Stop Delivery*

A trade creditor that learns of a customer's insolvency may also stop the delivery of any goods in possession of a third-party carrier, per UCC §2-705. To stop delivery, a trade creditor must provide the third-party carrier with sufficient notice to enable the carrier, with reasonable diligence, to prevent the delivery of the goods to their ultimate destination.

The notice to stop delivery should be in writing and give the carrier enough time to stop the delivery of the goods. Given the relatively short time intervals in which goods typically remain in transit, a trade creditor should provide its notice to the carrier as quickly as possible.

Assuming a trade creditor is appropriately identified and provides a stoppage notice in time to enable the carrier, upon reasonable diligence, to prevent delivery of the goods, the carrier must hold and deliver the goods according to the trade creditor's directions. If the carrier fails to do so, the trade creditor may recover appropriate monetary damages against the carrier. However, a carrier may insist that the trade creditor reimburse and indemnify the carrier for any charges or damages it may incur from stopping delivery.

The right to stop delivery exists until the customer takes actual or constructive possession of the goods. For instance, if the trade creditor learns of the customer's insolvency while the trade creditor still possesses the goods, it may withhold the goods' delivery. A trade creditor may also instruct the warehouseman or bailee to stop the delivery of the goods after the trade creditor learns of the customer’s insolvency.

3. *Termination of Right to Stop Delivery*

Any of the following will terminate a trade creditor's right to stop the delivery of goods in transit:

- Receipt of the goods by the customer;
- A third-party's (other than a carrier's) acknowledgment that it is holding the goods for the customer;
- A carrier's acknowledgment that it is holding the goods for the customer by either reshipping the goods according to the customer's instructions or holding the goods as the customer's warehouseman; or
- Negotiation to the customer of any negotiable document of title.

See UCC §2-705(b).

4. *Liability for Stoppage of Goods in Transit*

A trade creditor exercising a right of stoppage of goods will be liable for any damages incurred by a wrongful stoppage. As a result, a trade creditor should cautiously exercise this right.

D. RECLAMATION

1. *"Reclamation" Defined*
2. *Elements of a Valid Reclamation Demand*
3. *Timing and Notice Considerations Outside of Bankruptcy; Contents of Reclamation Letter*
4. *Limitations on Availability of Reclamation*
5. *Conclusions About Reclamation*

Many trade creditors have heard about the legal remedy called “reclamation,” which theoretically permits a trade creditor to “reclaim” goods sold to a customer that does not pay for them. In our experience, reclamation is not usually a particularly useful remedy for the reasons we explain below.

1. *"Reclamation" Defined*

Section 2-702(2) of the UCC provides that when a trade creditor discovers that an insolvent customer has received goods on credit, the trade creditor may reclaim the goods upon demand made within ten days after receipt.

2. *Elements of a Valid Reclamation Demand*

The following requirements must be satisfied for a valid reclamation demand:

- The customer must have been “insolvent” at the time it received the goods;
- The trade creditor must demand a return of the goods within ten days after the customer received the goods (unless the customer has made a written misrepresentation of solvency within three months before delivery of the goods, in which case the 10-day limitation does not apply);
- The trade creditor sold the goods on credit, or the customer's check for payment of the goods was dishonored; and
- When the seller makes the reclamation demand, the customer must still possess the goods.

A customer is "insolvent" for purposes of reclamation if either (1) the customer cannot pay its debts as they come due in the ordinary course of business or as the debts mature, or (2) the customer's liabilities are greater than the value of its assets. Insolvency is presumed where the customer is not paying its debts as they come due.

3. Timing and Notice Considerations Outside of Bankruptcy; Contents of Reclamation Letter

The seller should send a written reclamation demand to the customer within ten days after the customer's receipt of the goods. The written demand should also identify the goods, which must still be in the customer's possession when the demand is received. We have attached a form reclamation letter if your customer has not filed bankruptcy as Exhibit A.

4. Limitations on Availability of Reclamation

There are several reasons why reclamation is generally not particularly useful in practice. First, the goods must remain in the customer's possession when the trade creditor makes the reclamation demand. Second, a reclaiming seller's rights are subject to the holder of a prior perfected security interest in the customer's inventory. In other words, if the customer has granted another creditor a security interest in the customer's inventory, that other creditor will have priority over the reclaiming seller's rights.

5. Conclusions About Reclamation

Sending a reclamation demand letter is simple and inexpensive. However, a trade creditor should not expect the reclamation letter to result in the return of the goods. Reclamation rights under the Bankruptcy Code are addressed later in this Manual.

E. FILING A LAWSUIT TO COLLECT THE BALANCE DUE

If all else fails, a trade creditor with past due invoices can sue the customer to collect the balance due. Since the rules for bringing litigation differ depending on the jurisdiction, a detailed description of all of the issues a trade creditor will face in filing a collection lawsuit is beyond the scope of this Manual.

However, below is a checklist of items that a trade creditor should consider before filing litigation.

- Make sure the creditor has the right to sue. Sometimes, the invoice or contract terms may contain a binding arbitration clause. These clauses are usually enforceable and may require the trade creditor to begin an arbitration proceeding instead of a lawsuit.

- The trade creditor should consider where the lawsuit must be filed. Once again, the trade creditor should carefully review the invoice terms or contract to determine if they contain a forum selection clause. In many cases, the invoice or contract will contain a provision that binds both parties to bring litigation in a specific state or locale.

- Ensure that the trade creditor has provided all required notices and that all cure periods have expired. For example, the invoice or contract may require the trade creditor to send a written demand for payment and provide a certain number of days for the customer to remit payment before the trade creditor can sue.

- Decide the kind of lawyer to use. Many lawyers specialize in collecting commercial debts on a contingent fee basis, *i.e.*, the lawyer accepts an agreed-upon percentage of the recovery. This alternative may be more advantageous for a trade creditor if it believes that collection from the creditor is unlikely. Other lawyers charge an hourly rate for their litigation services.

F. ALTERNATIVE TRANSACTIONAL STRUCTURES TO MINIMIZE CREDIT EXPOSURE

1. *Purchase Money Security Interests*
2. *Consignments*
3. *Bailments and Tolling Arrangements*
4. *Letters of Credit*
5. *Guarantees*
6. *Credit Insurance*

A careful trade creditor will consider at the outset of the credit relationship whether there are alternative transaction structures that could limit the trade creditor's risk. This Section discusses six strategies for trade creditors to structure their business relationships differently that could limit losses in the future.

1. *Purchase Money Security Interests*

A trade creditor that sells goods on credit can minimize its credit exposure by obtaining a purchase money security interest ("PMSI") in the goods it sells to its customer. If done correctly, the trade creditor (in this context, a "PMSI Creditor") obtains a security interest in the goods it delivers that is superior to the interests of all other creditors. A PMSI will even be superior in priority to a blanket lien previously granted by the customer to a bank lender, provided that the PMSI Creditor follows the detailed procedures in Article 9 of the UCC.

The requirements for obtaining a PMSI in goods are as follows:

1. The customer must sign a security agreement in favor of the PMSI Creditor where the customer grants the PMSI Creditor a PMSI in the goods it sells to the customer. The security agreement must describe the goods in sufficient detail to enable their identification to the exclusion of other goods.

2. The PMSI Creditor must file a UCC-1 financing statement that covers the purchase money goods. The financing statement must (i) include the exact legal name of the customer, (ii) describe the goods, and (iii) be filed in the appropriate filing office, generally the state where the corporation is incorporated.

3. If the goods covered by the PMSI are inventory in the customer's hands (*i.e.*, goods that the customer will hold and sell or use in its business), the PMSI Creditor must also notify all creditors holding prior perfected security interests in the customer's inventory (a "PMSI Notice"). The PMSI Creditor must first conduct a UCC search to identify these secured creditors. After reviewing the search results, the trade creditor must send the PMSI Notice to all other secured creditors holding a security interest in the customer's inventory. We recommend that trade creditors send the notice by both certified mail and regular mail. The PMSI Notice should advise each secured party claiming an interest in the inventory that the PMSI creditor asserts a PMSI in the inventory it sells to the customer. A form PMSI Notice is set forth as Exhibit B.

4. The PMSI Creditor's UCC-1 financing statement and the notice to secured parties are valid for only five years. The PMSI Creditor must continue the UCC-1 filing within the 6 months before the fifth anniversary of the UCC-1 filing. At the same time it files the five-year continuation statement, the trade creditor should conduct a new UCC search and send a new PMSI Notice to all secured creditors holding a security interest in the customer's assets.

2. Consignments

Trade creditors can also protect themselves by supplying goods to customers "on consignment." A consignment is a transaction in which the seller (the "Consignor") provides goods to its customer (the "Consignee") for purposes of sale, but the seller retains title to the goods until they are sold.

Article 9 of the UCC governs consignments. A consignment transaction must satisfy UCC § 9-102(a)(20), which defines a consignment as a transaction in which a person delivers goods to a merchant for purposes of sale, and (a) the merchant deals in goods of that kind under a name other than the name of the person making the delivery, is not an auctioneer and is not generally known by its creditors to be substantially engaged in selling the goods of others, (b) the goods have a value of at least $1,000 at the time of delivery, (c) the goods are not

consumer goods immediately before delivery, and (d) the transaction does not create a security interest.

If the Consignor does not "perfect" its interest in the consigned goods, the Consignor's interest will be subject to the interest held by a creditor holding a security interest in the Consignee's inventory. To perfect the consignment, the Consignor should file a UCC-1 financing statement and provide advance notice to any secured creditor of record. By complying with these requirements, the trade creditor will have priority over other perfected secured creditors for the goods sold on consignment and in identifiable proceeds (except accounts arising from the sale of the goods).

The Consignor and Consignee should sign a written consignment agreement to evidence their understanding. The agreement should clearly state the arrangement is a consignment of goods in which the Consignor retains title until the Consignee sells the goods. We recommend the consignment agreement also include a grant of a security interest in the consigned goods and all proceeds. This additional language may help if a court later determines that the transaction does not qualify as a consignment.

3. *Bailments and Tolling Arrangements*

Trade creditors may also protect themselves from their customer's financial distress by entering into a bailment and tolling arrangement. Generally speaking, a bailment is the delivery of goods by one person (the "bailor") to another person (the "bailee") for a particular purpose without intending to transfer ownership of the goods.

The most common type of bailment is a "tolling" arrangement. A tolling arrangement is a type of bailment where a seller provides goods to a manufacturer or processor, such as the bailee, so that the bailee may perform a particular task on the goods for a fee (sometimes referred to as a "tolling fee"). After performing the task, the bailee returns the goods to the trade creditor-bailor. To prevent the bailee's creditors from looking to the consigned goods to satisfy their claims against the bailee, the seller-bailor should obtain a written tolling agreement. The tolling agreement should say the goods remain the bailor's property, even while they are in the bailee's possession, and that the goods will be re-delivered to the bailor after the bailee completes its work on the goods. We also recommend the tolling agreement include a grant of a security interest in the bailed goods if a court later determines that the transaction does not qualify as a true bailment.

Courts have looked to the following factors to determine whether an arrangement will be a true bailment or an outright sale of goods:

1. There is an agreement that the Consignor delivered the goods to the bailee for processing and redelivery to the bailor;
2. The bailor specifically retains title to the goods at all times;
3. The bailor maintains the right to recall the goods or direct their transfer at any time;
4. The bailee retains the risk of loss while the goods are in its possession;
5. The bailee segregates the goods from the bailee's other property; and
6. The bailor does not show an account receivable owing by the bailee.

Although it is not technically required, we recommend the seller-bailor file a UCC-1 financing statement against the bailee that identifies the bailment arrangement and the goods that are the subject of the bailment. The UCC-1 financing statement provides constructive notice to the public that a bailment arrangement exists.

4. *Standby Letters of Credit*

A trade creditor can also protect itself by requiring the customer to obtain a standby letter of credit in favor of the trade creditor. A standby letter of credit is a written commitment by the issuing bank to pay the party for whose benefit the letter of credit is issued (the "beneficiary") up to a specified dollar limit if the beneficiary "draws" on the letter of credit. To draw on a

standby letter of credit, the creditor must present the issuing bank with a "draw request" and other written documentation described in the letter of credit, which usually consists of copies of the past-due invoices. The bank will pay the trade creditor so long as the accompanying documents conform with the documentation spelled out in the standby letter of credit. A standby letter of credit is a separate agreement with the issuing bank, which means the beneficiary can draw on the letter of credit even if its customer is in a bankruptcy case.

Standby letters of credit contain an expiration date. If a trade creditor anticipates doing business with a customer beyond the expiration date, the trade creditor should request that the standby letter of credit include an "evergreen" provision. Under a typical evergreen provision, the letter of credit automatically renews for another year (or another period) unless the issuing bank provides advance written notice that it will not renew the letter of credit. Typically, a non-renewal notice triggers the trade creditor's right to immediately draw upon the remaining balance of funds available under the letter of credit. The trade creditor can hold these funds as "cash security" for the customer's existing and future payment obligations.

5. Guarantees

A trade creditor can also obtain a guaranty to protect itself against the customer's default. A guaranty is a contractual commitment by a third party to pay the customer's obligations if the customer defaults.

A third-party guaranty must be in writing and signed by the guarantor. Oral guarantees are not generally enforceable. A guaranty can be either a "guaranty of collection" or a "guaranty of payment." Under a guaranty of collection, a trade creditor cannot seek immediate payment from the guarantor until it pursues collection from the customer. In contrast, under a guaranty of payment, a trade creditor can directly pursue recovery from the guarantor without first suing the customer so long as the customer is in default of its obligation to the trade creditor.

The guaranty should be a "continuing guaranty," which means the guarantor agrees to guarantee all current and future indebtedness due to the trade creditor. The guaranty should also be an "absolute and unconditional" guaranty, which means the guarantor waives certain defenses that might be otherwise available under the law.

The degree of credit protection a guaranty offers depends on the creditworthiness of the guarantor. If the guarantor and the customer are closely affiliated, the customer's financial distress may affect the guarantor's ability to satisfy the guaranty.

The law remains unsettled on whether the federal Equal Credit Opportunity Act, 15 U.S.C. §1691, restricts a trade creditor's right to demand a guaranty from a business owner's spouse if the spouse is not actively involved in the business's operations. Trade creditors considering requesting a spousal guaranty should consult with an attorney before making any such request.

6. Credit Insurance

Trade creditors can also purchase credit insurance, which protects the creditor against losses suffered by a customer's failure to pay. The insurance policy itself spells out the specific circumstances that trigger coverage, such as the customer's insolvency, bankruptcy, or protracted non-payment. Credit insurance may also include protection against non-payment by foreign customers due to currency issues or political unrest.

Trade creditors often purchase insurance only for their most significant or vulnerable accounts. The insurance will usually contain a credit limit for each account.

There are two basic types of credit insurance policies: cancellable and non-cancellable. The insurance company can cancel a cancellable policy at any time. For example, if the insurance company believes its risk has increased because the customer's financial situation has deteriorated, it may cancel the policy or modify the pre-established credit limit. As its name implies, an insurance company may not cancel a non-cancellable policy or modify the pre-established credit limits established for particular accounts during the policy period.

Credit insurance costs vary depending on the type of policy purchased and the covered accounts. Premiums are usually charged monthly and are calculated as a percentage of monthly sales or as a percentage of all outstanding receivables. As a rough rule of thumb, policy premiums typically hover around $1 per $1,000 of covered domestic sales and $1.50 for export sales.

A trade creditor should review and understand the policy’s terms and conditions, including the covered accounts and the events triggering coverage. Also, the trade creditor should review the policy for any exclusions and deductibles.

There will typically be many policy "exclusions." Common exclusions include:

- Transactions or sales that a buyer disputes (at least until the trade creditor has obtained a court judgment ruling the buyer is liable)
- Claims that are not timely filed with the insurance company
- Sales that occur after the buyer's default or insolvency
- The failure to report a past due or insolvent buyer

- A change in payment terms without the insurance company's consent

Policies almost always contain both deductibles and co-insurance. A deductible is a fixed amount the trade creditor must cover before the insurance company's coverage is triggered. On the other hand, co-insurance is a percentage of the loss that the trade creditor must absorb. For example, if there is a claim for $500,000 and there is a $50,000 deductible and 10% co-insurance, the trade creditor will only recover $405,000 ($500,000 minus the $50,000 deductible, times 90%).

PART II – DEALING WITH A FINANCIALLY TROUBLED CUSTOMER IN BANKRUPTCY

A. OVERVIEW OF BANKRUPTCY

1. *Chapter 7 Cases*
2. *Chapter 11 Cases*

A financially troubled customer may choose to file a voluntary bankruptcy petition. Occasionally, as is described in Section II.I. below, creditors may decide to file an involuntary bankruptcy petition against a customer. Whether the customer's case begins with a voluntary or an involuntary bankruptcy filing, trade creditors must abide by a new set of rules after a bankruptcy case is on file.

A company that finds itself in bankruptcy, whether through a voluntary or an involuntary bankruptcy filing, is called a "debtor." Accordingly, this Manual uses the term "debtor" to refer to a company in bankruptcy.

Federal law establishes the Bankruptcy Code. Congress passed the most recent Bankruptcy Code in 1978 and has amended it countless times. Approximately 94 judicial districts have bankruptcy courts. Every state has at least one federal judicial district, and many states have more than one.

Bankruptcy cases are also governed by the Federal Rules of Bankruptcy Procedure—commonly known as the "Bankruptcy Rules." The Bankruptcy Rules address various procedural matters arising in a bankruptcy case and supplement the Bankruptcy Code.

There are different types of bankruptcy cases as follows:

- Chapter 7 (Liquidation);
- Chapter 9 (Adjustment of Debts of a Municipality);
- Chapter 11 (Reorganization);
- Chapter 12 (Adjustment of Debts of a Family Farmer With Regular Annual Income);
- Chapter 13 (Adjustment of Debts of an Individual With Regular Income).

This Manual does not discuss Chapter 9 municipal bankruptcies (extraordinarily rare), Chapter 12 family farmer cases, or Chapter 13 individual wage earner cases. Instead, this Manual addresses the two most common types of bankruptcy faced by commercial trade creditors: Chapter 7 bankruptcy cases and Chapter 11 reorganization cases.

1. *Chapter 7 Cases*

A Chapter 7 bankruptcy is a liquidation proceeding available to individuals, corporations, partnerships, and other business and non-business entities. Upon filing a voluntary Chapter 7 case, virtually all of the debtor's property interests become part of a "bankruptcy estate." Individual Chapter 7 debtors, however, may claim certain assets (or a specific dollar amount of certain assets) as "exempt" and, thereby, remove them from their bankruptcy estate. In contrast, corporate and non-individual Chapter 7 debtors cannot claim exemptions.

Shortly after the debtor files a Chapter 7 case, the court appoints a trustee who liquidates the bankruptcy estate's assets and then distributes the resulting proceeds to the debtor's creditors following the Bankruptcy Code's priority scheme.

In exchange for relinquishing their non-exempt assets, individual Chapter 7 debtors receive a "discharge" of most debts existing at the bankruptcy filing date. This discharge permanently bars creditors from collecting or enforcing claims against the debtor, providing the debtors with a so-called "fresh start." However, individuals cannot discharge certain kinds of debts, such as most tax claims and debts incurred through fraud.

Corporate and non-individual Chapter 7 debtors do **not** receive a discharge in a Chapter 7 case because those entities are liquidated and have no continued existence after the conclusion of the Chapter 7 case.

As is the case with all chapters of the Bankruptcy Code, the filing of a Chapter 7 petition triggers an "automatic stay" that prohibits creditors from collecting or enforcing their claims against the debtor or the debtor's property. The automatic stay's scope is extremely broad and generally applies to all collection efforts, including written or oral payment demands. This Manual discusses the automatic stay in more detail in Section II.B.2.

To share in any creditor distributions from a Chapter 7 case, trade creditors must file a proof of claim with the Bankruptcy Court. This Manual discusses filing proofs of claim in Section F.

2. *Chapter 11 Cases*

A Chapter 11 bankruptcy case is very different from a Chapter 7. Unlike a Chapter 7 debtor, which must cease operating when it files bankruptcy (unless the Bankruptcy Court specially authorizes limited postpetition operations), a Chapter 11 debtor usually continues to operate its business after the filing. Furthermore, no bankruptcy trustee is appointed in a Chapter 11 case unless the court finds that the debtor's management engaged in serious misconduct before or after the case is filed.

Although Chapter 11 cases are far more complex than Chapter 7 cases, there are five main points that every trade creditor should remember about Chapter 11 cases.

a) The automatic stay applies in Chapter 11 cases to the same extent as in Chapter 7. However, a trade creditor can still attempt to stop goods in transit and seek reclamation of the goods it provided. See Sections I.C and I.D.

b) Since the debtor can continue to operate its business, the trade creditor may have the opportunity to sell goods or services to the debtor after the filing. See Section II.E. for a discussion about doing business with a Chapter 11 debtor.

c) A Chapter 11 debtor cannot pay a trade creditor's pre-bankruptcy claim without a court order that authorizes such payment. See Section II.D.

d) A trade creditor's pre-bankruptcy claim is usually paid under a "Chapter 11 plan" that the bankruptcy court approves. The payment may be (and usually will be) less than payment in full. Unless the Plan calls for trade creditors to be paid in full in cash, trade creditors will have an opportunity to review the Plan and cast a ballot to accept or reject it. The Bankruptcy Code contains very detailed and complex rules governing Chapter 11 plans that are beyond the scope of this Manual. Suffice it to say, however, that a Chapter 11 plan, once "confirmed" (*i.e.*, approved) by the bankruptcy court, constitutes a new contract that obligates the post-confirmation debtor to repay its creditors as set forth in the confirmed Chapter 11 plan.

e) A trade creditor will usually be required to file a Proof of Claim to receive any distributions on account of its pre-bankruptcy claims.

The bankruptcy code also recognizes a special category of Chapter 11 cases called "Subchapter V" for so-called small business debtors. A debtor is eligible for a Subchapter V Chapter 11 case if (a) the debtor is an individual or a non-public company engaged in commercial or business activities; (b) the debtor's aggregate noncontingent, unliquidated debt (both secured and unsecured) is less than or equal to $7,500,000; (c) at least fifty percent (50%) of the debtor's aggregate noncontingent liquidated debt arose from the debtor's commercial or business activities, and (d) the debtor's primary activity is not the business of owning single asset real estate. The $7,500,000 debt limitation on a Small Business Case is scheduled to be reduced to slightly more than $3 million in 2024. However, if experience is any guide to the future, Congress will postpone the scheduled reduction.

From the trade creditor's perspective, most of the rules for a regular Chapter 11 case also apply in a Subchapter V case.

B. INITIAL RESPONSE STEPS

1. *Notice of Bankruptcy Filing*
2. *Stop All Collection Efforts Against the Debtor*
3. *Stop Goods in Transit*
4. *Consider Reclamation Rights*
5. *Discontinue Credit Sales*
6. *Calendar Important Dates*

A customer's bankruptcy filing **immediately** changes the trade creditor-customer relationship. First, as described elsewhere, and with certain narrow exceptions discussed in this Manual, the automatic stay is triggered, and creditors are prevented from demanding payment or trying to collect any amounts due as of the bankruptcy filing date (also called the "petition date"). Second, the customer is prevented by law from paying any amounts due at the filing date unless the bankruptcy court enters an order permitting the payment. Third, unless a pre-bankruptcy supply agreement binds the creditor, it is free to restructure its business relationship after the filing by requiring payment in advance, for example.

The following sections describe the sorts of things that a trade creditor should consider after learning of its customer's bankruptcy filing.

1. Notice of Bankruptcy Filing

A company filing bankruptcy must immediately file a list of all creditors and addresses. The bankruptcy court then sends an official notice to each listed creditor. Under the best circumstances, a trade creditor may not receive the official notice until a week after the filing. Moreover, in our experience, the notice is often sent to a post office box or other remittance address that may further delay a trade creditor in receiving official confirmation of a bankruptcy filing. Therefore, a trade creditor may hear informally about a potential bankruptcy filing before receiving official confirmation.

2. Stop All Collection Efforts Against the Debtor

The automatic stay goes into effect as soon as the bankruptcy case is filed, regardless of a creditor's actual knowledge of the filing. Trade creditors who hear a rumor about a bankruptcy filing should reach out to their contacts at the customer to determine if the rumor is true and to request basic information about the rumored filing, such as the court where it is filed and the case name. If a filing has occurred, the customer should be willing to forward a copy of the bankruptcy petition filed with the bankruptcy court. However, the trade creditor cannot use such a call as an excuse to demand payment of any outstanding invoices.

The automatic stay goes into effect immediately upon the filing, whether the creditor knows about the filing or not. Generally, the automatic stay prohibits all creditors from starting or continuing any collection efforts against the debtor or the debtor's property. For instance, a trade creditor cannot: (a) send demand letters to the customer in bankruptcy insisting that it pay any outstanding obligations incurred before bankruptcy; (b) file suit against a customer in bankruptcy to collect debts incurred before bankruptcy or continue to prosecute any suit filed before bankruptcy; (c) enforce any judgment obtained before bankruptcy against a customer or any property belonging to the customer; or (d) set off against any outstanding obligations owing by the customer any amounts that the trade creditor might owe to the customer. As we will see below, notwithstanding the bankruptcy filing, the creditor can sometimes (i) attempt to stop the delivery of any goods in transit and (ii) send a reclamation letter. (See Sections II.B.3 and II.B.4 below.)

The automatic stay is the primary debtor protection under the Bankruptcy Code. The automatic stay gives bankruptcy debtors a "breathing spell" in which they can sort out their financial affairs without the pressure of creditors demanding payment or collecting their claims. Bankruptcy courts will impose appropriate sanctions against a creditor that violates the automatic stay, especially if the creditor has actual knowledge of the bankruptcy case.

Although the automatic stay is extensive, it usually does not extend to parties other than the entity in bankruptcy. For instance, if a trade creditor has a personal guaranty from a third party who has not filed bankruptcy, the customer's bankruptcy does not prohibit collection efforts against the guarantor.

3. Stop Goods in Transit

In Section I.C., we discussed the ability of a trade creditor to stop delivery of goods in transit when it learns of its customer’s insolvency. Notwithstanding the bankruptcy filing, a trade creditor that sold goods on open account (*i.e.*, not under a pre-bankruptcy supply agreement) can attempt to stop the delivery of goods in transit without violating the automatic stay. Accordingly, as soon as a trade creditor learns about a customer’s bankruptcy filing, it should evaluate whether it has shipped any goods to the customer that have not yet arrived at the destination. However, if the goods are already in the bankrupt customer’s possession at the time the creditor learns about the bankruptcy filing, the trade creditor cannot demand that the goods be returned except through “reclamation,” which is described below.

4. Consider Reclamation Rights

We discussed reclamation outside of bankruptcy in Section I.D. However, as a practical matter, this right has limited effectiveness for two reasons: (a) the goods must still be in the customer's possession when the demand is made, and (b) a secured creditor with a security interest in the customer's inventory has a higher priority to the goods than the reclaiming seller. Nevertheless, a creditor that wants to leave "no stone unturned" may wish to consider making a reclamation demand after learning of its customer's bankruptcy.

The automatic stay does not prohibit sending a reclamation letter. The rules for making a post-bankruptcy reclamation demand are very detailed. A seller may send a written reclamation demand for goods the debtor received within 45 days of the bankruptcy filing. The reclamation demand must be made no later than 20 days after the bankruptcy filing date. We have included a sample form reclamation demand letter to be used if your customer has filed for bankruptcy as Exhibit C.

The right of reclamation in bankruptcy must be distinguished from the special higher priority for trade creditors for "the value" of any goods the debtor receives within 20 days before the bankruptcy filing. For a more thorough discussion of this special priority, see Section II.C. (Section 503(b)(9) Rights).

5. Discontinue Credit Sales

Since a Chapter 11 debtor continues to operate its business after it files bankruptcy, it will still need to purchase goods or services after the filing. Unless there is a prepetition supply agreement between the parties, a trade creditor can decide to discontinue business with the customer after a bankruptcy filing. If there is no supply agreement between the parties, a trade creditor can refuse to do business with the debtor. Alternatively, a trade creditor without a supply agreement can insist that the debtor pays on a "cash in advance" or "cash on delivery" basis.

See Section II.E. below for more discussion on this issue.

6. Calendar Important Dates

The debtor or the court must notify trade creditors of the case's key dates and events. A creditor's failure to comply with these dates and deadlines could cause the creditor to forfeit its rights to receive any distribution made from the bankruptcy estate. We discuss some of these dates and deadlines in Section II.F. below. We recommend that creditors establish an internal "tickler" system to keep track of the critical deadlines.

C. RIGHT TO PRIORITY UNDER BANKRUPTCY CODE SECTION 503(B)(9)

1. *Significance of Priority*
2. *Special Priority for Goods Shipped Within Twenty Days Before the Filing*
3. *Enforcing Right to Payment for a Section 503(b)(9) Claim*

1. *Significance of Priority*

Not all claims in a bankruptcy case have the same priority. The Bankruptcy Code contains a set of detailed rules that establish that certain kinds of claims have a higher priority and are paid in full before lower priority claims receive anything. As a general rule, secured creditors have the highest priority to the extent of the value of the collateral. If a secured creditor's collateral is worth less than the amount owed, the creditor will have an unsecured claim for the deficiency amount. Different types of unsecured claims have different priorities. For instance, unpaid employees have a higher priority for at least a portion of their claims than unpaid taxes. And both employees and taxing authorities have priority over general unsecured creditors.

Generally, trade creditors who supply goods and services to a customer do not obtain collateral to secure their claims. Therefore, most trade credit is a general unsecured claim and will be paid after all claims with higher priority are paid in full. However, general unsecured creditors have a higher priority than shareholders.

2. *Special Priority for Goods Shipped Within Twenty Days Before the Filing*

There is one notable exception to the rule that trade creditors hold general unsecured claims. Creditors who shipped goods which the customer received within twenty days of the bankruptcy filing have a higher priority claim for the value of goods received during those twenty days.

This higher priority applies only to claims for goods delivered within the twenty-day period and does not apply to services rendered during the period. A claim under this special priority provision is sometimes called a "Section 503(b)(9) claim."

In today's economy, trade creditors frequently provide a combination of goods and services to their customers. Accordingly, a trade creditor may still qualify for a higher priority Section 503(b)(9) claim to the extent that it can sufficiently identify the outstanding indebtedness to its supply of goods (as opposed to services) during the twenty days.

Because Section 503(b)(9) focuses upon the debtor's "receipt" of goods within the twenty days, trade creditors should not limit Section 503(b)(9) claims to goods shipped during that

period. The critical date is the date the customer received the goods, not the date the goods were shipped. A trade creditor is probably not eligible for a higher priority Section 503(b)(9) claim if the goods were "drop-shipped" (*i.e.*, delivered directly) to the debtor's customer or are otherwise not delivered to the debtor or one of its agents.

3. Enforcing the Right to Payment of Section 503(b)(9)

Neither the Bankruptcy Code nor the Bankruptcy Rules directly address how a trade creditor should assert a Section 503(b)(9) claim. In large bankruptcy cases, however, the court usually establishes special procedures for Section 503(b)(9) claims. These special procedures typically allow a trade creditor to assert a Section 503(b)(9) claim by completing and filing a modified proof of claim form. If there are no special case-specific procedures, a Section 503(b)(9) claimant will have to file a written motion in the bankruptcy court, which will require the trade creditor to retain outside counsel to file the necessary papers.

A Section 503(b)(9) creditor must prove the debtor received the goods within the twenty days before bankruptcy. We recommend that the trade creditor attach proof of delivery documentation to its Section 503(b)(9) claim.

D. CRITICAL VENDOR MOTIONS

As mentioned above, a bankrupt customer cannot pay its pre-bankruptcy debts without specific authorization from the bankruptcy court. Bankruptcy courts are reluctant to approve such payments, but occasionally they will approve payment of some or all of prepetition amounts owed to so-called "critical vendors." The term "critical vendor" is not defined in the Bankruptcy Code, but it usually refers to a creditor that supplies goods or services essential to the debtor's financial restructuring. For instance, the bankruptcy court might consider a trade creditor a "critical vendor" if it is the sole supplier of a key component necessary for the bankrupt company's product.

Bankruptcy courts typically require critical vendors to continue extending trade credit after the filing. Thus, eligible vendors will have to weigh the benefit of receiving an immediate "critical vendor" payment of the pre-bankruptcy balance against the possibility the debtor will be unable to pay for the post-bankruptcy goods or services. In short, a trade creditor should read the "fine print" of any critical vendor motion to ensure it is comfortable with all consequences of being named a critical vendor.

Trade creditors generally cannot force the debtor to designate them as a critical vendor. The decision to designate a particular creditor as "critical" or not is entirely up to the debtor and is subject to approval by the bankruptcy court.

E. DOING BUSINESS WITH A CHAPTER 11 DEBTOR

1. *Chapter 11 Debtor's Continuing Authority to Do Business*
2. *Creditor's Obligation to Continue Doing Business with Chapter 11 Debtor*
3. *Switching to CIA or COD Payment Terms*
4. *Continuing to Make Credit Sales to a Chapter 11 Debtor*
5. *Performance After the Filing Under a Prepetition Supply Agreement*

1. Chapter 11 Debtor's Continuing Authority to Do Business

A Chapter 11 debtor may continue to operate in the "ordinary course" of its business without approval from the bankruptcy court. However, a Chapter 11 debtor must obtain court approval to operate *outside* of the "ordinary course" of its business. Since the typical trade credit transaction is in the ordinary course of business, a Chapter 11 debtor usually will not need court approval to purchase products or services.

2. Creditor's Obligation to Continue Doing Business with Chapter 11 Debtor

A trade creditor that sold goods or services to a customer on an open account before bankruptcy is not required to do business with its customer after it files bankruptcy. The trade creditor can refuse to sell to the company in bankruptcy, or the trade creditor can insist that the debtor pays for the goods in advance or upon their delivery. In short, the trade creditor with no ongoing supply contract may structure its postpetition relationship any way it pleases, provided that it does not pressure the debtor to pay its prepetition obligations as a condition of doing business after the filing. The situation is very different if the trade creditor and the bankrupt customer signed a supply agreement before the bankruptcy filing. The Manual discusses this situation in Section 2(E) (5) below.

3. Switching to CIA or COD Payment Terms

As noted above, if there is no pre-bankruptcy supply agreement or similar contract, a trade creditor can change the credit terms for post-bankruptcy sales. For instance, if the trade creditor sold a product on an open account with net 30-day credit terms before the bankruptcy filing, it can choose to tighten or eliminate the credit terms after the filing. The trade creditor can reduce the number of days in which payment is expected, or the trade creditor can insist on "cash-in-advance" or "cash-on-delivery" terms for post-bankruptcy sales.

4. Continuing to Make Credit Sales On Open Account to a Chapter 11 Debtor

The Chapter 11 debtor may be unable or unwilling to purchase goods on a "cash-in-advance" or "cash-on-delivery" basis, so the trade creditor may be faced with a decision on whether to extend trade credit after the filing. While post-bankruptcy sales are entitled to so-called "administrative expense priority," that does not mean a post-bankruptcy trade creditor will always be paid. Some Chapter 11 cases fail, and holders of administrative expense claims are not paid. Accordingly, a trade creditor should consider the risk of extending post-bankruptcy trade credit.

In evaluating the potential risk of extending trade credit to a company in bankruptcy, a trade creditor should ask its customer whether it obtained a "debtor-in-possession loan" (referred to as a DIP Loan). Banks or other secured lenders sometimes make a DIP Loan to a company in bankruptcy. If the debtor has a DIP Loan, it is more likely to have the liquidity to pay its post-bankruptcy trade creditors. While a DIP Loan is not conclusive evidence that trade creditors will be paid, it is a positive sign.

If a creditor extends post-bankruptcy trade credit that is not paid, it should file an administrative claim with the court for the amount of the unpaid post-bankruptcy balance due. The administrative claim should not be confused with the proof of claim for the pre-bankruptcy claim. Section II.F.8 below explains how to file administrative claims.

5. Performance After the Filing Under a Prepetition Supply Agreement

The issue of doing business with the debtor is complicated if the trade creditor and the debtor have an ongoing supply agreement as of the petition date. Such an agreement is called an "executory contract." A debtor may either assume or reject the contract at any time before confirmation of a Chapter 11 plan. The parties' rights under the prepetition supply agreement are in a kind of limbo after the bankruptcy filing but before the confirmation of a plan. As a general rule, the trade creditor must perform under the supply agreement during this limbo period so long as the debtor also performs. If the debtor defaults under the supply agreement, the trade creditor should consider filing a motion with the bankruptcy court seeking the authority to terminate the contract. Trade creditors in this situation should tread very carefully to avoid liability for violating the automatic stay and are well advised to retain counsel.

F. FILING PROOFS OF CLAIM AND THE BANKRUPTCY CLAIMS PROCESS

1. *Necessity of Filing Proof of Claim*
2. *Claims Bar Date*
3. *Preparing a Proof of Claim*
4. *Filing a Proof of Claim*
5. *Amending Proofs of Claim*
6. *Claim Objections*
7. *Section 503(b)(9) Claims*
8. *Administrative Claims*
9. *Claims Purchasers*

1. Necessity of Filing Proof of Claim

Trade creditors should file a "proof of claim" with the bankruptcy court to preserve their right to receive distributions from the bankruptcy estate. The proof of claim relates only to the balance due on the bankruptcy case filing date. We will discuss filing claims for post-bankruptcy amounts in Section II.F.8.

There is one narrow exception to the general rule that a trade creditor should file a proof of claim. If a Chapter 11 debtor lists a trade creditor's claim as "undisputed," "liquidated," and "noncontingent," the creditor's claim will automatically be allowed at the amount listed by the debtor. As a practical matter, however, it is frequently difficult for a trade creditor to determine exactly how its claim is listed, and the debtor can also amend its schedules of liabilities at a later date. Accordingly, we believe trade creditors should **always** file a proof of claim.

2. Claims Bar Date

In Chapter 11 cases, the bankruptcy court will almost always establish a deadline for creditors to file proofs of claim. The deadline is called a "claims bar date." With the one narrow exception mentioned above, creditors that fail to file a proof of claim on or before the claims bar date cannot receive a distribution from the debtor.

The bankruptcy court will notify creditors of the claims bar date by mailing a notice to all creditors. The notice is sent to the address listed by the customer in its bankruptcy filing. In our experience, debtors frequently use the remittance address on the invoice from the trade creditor, which may not be the address of the person responsible for monitoring bankruptcy cases. A trade creditor should develop a system where bankruptcy notices received at the remittance address are promptly redirected to the appropriate person.

While the courts almost always establish a claims bar date in a Chapter 11 case, the same is not true in a Chapter 7 case. In a Chapter 7 case, the court may initially notify creditors that a claims bar date will not be established until it appears there will be assets available for creditors. If assets are located, the creditors will receive a second notice that contains a claims bar date. However, a trade creditor does not have to wait for the second notice. It can file a proof of claim before the claims bar date has been established. A creditor **must** file a proof of claim in a Chapter 7 case, even if the debtor does not dispute the validity or amount of the claim.

3. Preparing a Proof of Claim

A proof of claim is a written statement signed by a creditor or its authorized agent. It describes the amount and the nature of the creditor's claim. An "Official Form" has been established for creditors to use in submitting a proof of claim. A copy of this Official Form is located in **Exhibit D.** The court will typically mail a blank copy of the Official Form to creditors along with the notice setting the claims bar date. Blank, fillable versions of the Official Form are also easy to locate on the Internet.

Most of the questions on the Official Form are self-explanatory, but creditors frequently have questions about questions 7-12 on the form.

- Question 7 asks for the amount of the claim. The creditor should list the amount due as of the bankruptcy filing date, including any interest or late fees accrued through the filing date. The creditor should **not** include any postpetition amounts.

- Question 8 asks for the basis of the claim. The typical trade creditor should say "goods sold" or "services provided."

- Question 9 asks whether all or part of the claim is secured. A trade creditor should check the "No" box unless it holds collateral, *i.e.*, it has a security interest in the debtor's assets. A trade creditor that holds collateral must attach documents showing the security interest. **This question only asks for collateral owned by the company in bankruptcy**.

- Question 10 asks whether the claim is based on a lease. For a trade creditor that simply sells goods or provides services to the debtor, the answer to this question will be "no."

- Question 11 asks whether the claim is based on a right of setoff. A "setoff" arises when the debtor and the creditor each owe the other as of the petition date. If the creditor does not owe the debtor any money, it should check the "No" box. If the trade owes

something to the debtor on the filing date, it should check the "Yes" box and describe how much it owes.

- Question 12 asks whether the claim is entitled to priority. In business bankruptcy cases, priority claims are usually held by certain types of employees or taxing authorities. So a trade creditor that sold goods or provided services to the debtor should generally check the "No" box.

Creditors should attach copies of any appropriate documentation evidencing their claims to their proof of claim. We recommend that trade creditors attach copies of the bankrupt customer's unpaid invoices (or a summary of those invoices). The creditor can always attach an additional page or two disclosing any other information about its claim that it believes will be relevant, but simply attaching the unpaid invoices (or a summary) will almost always suffice.

Finally, as mentioned above, notices from the bankruptcy court may go to the remittance address or some inconvenient address. Question 2 of the Official Form permits creditors to change the address for mailing from the court.

4. Filing a Proof of Claim

The claims bar date notice will explain how to file a proof of claim. Many courts now permit electronic filing through the Electronic Proof of Claim (ePOC) program. Other courts still require a paper copy of the proof of claim form. In large bankruptcy cases with thousands of potential creditors, the court will often appoint a third-party service to accept the claims. In short, every case may have slightly different requirements for filing a proof of claim, and the creditor should follow the instructions in the claims bar date notice. In almost all cases, filing a proof of claim is relatively intuitive and inexpensive. Most trade creditors prepare their proofs of claim without a lawyer.

The claims bar date establishes the last date by which proofs of claim must be received and not the last date by which creditors may mail out their proof of claims. If the creditor transmits its proof of claim to the court by mail, it must allow enough time for the documentation to reach the Clerk (or other designated filing office) on or before the claims bar date.

5. Amending Proofs of Claim

Before the claims bar date, a creditor can freely amend its proof of claim to correct the amount, attach additional documents, or simply update the required information. The Official Form contains a specific box for creditors to check when filing an amended claim.

After the claims bar date, a creditor's ability to amend a timely filed proof of claim is less certain. Although courts frequently allow post-claims bar date amendments, trade creditors should make every effort to file the original claim with correct information.

6. Claim Objections

A proof of claim is deemed valid unless someone objects to it. Although any creditor or interested party can object to a proof of claim, most objections are filed by the bankruptcy trustee or the debtor itself. The creditor must receive a copy of the written objection to the claim by mail at the address listed in the proof of claim. The creditor has a minimum of thirty days to respond to the objection. The written objection should contain specific reasons why the objection is filed. Sometimes a creditor can resolve the objection without hiring counsel. For instance, if the objector complains that the proof of claim contained inadequate support for the claims, the trade creditor can send the missing invoices to the objector and ask that the objection be withdrawn. In most cases, however, a creditor will have to retain counsel to file a response to the claims objection. If the objection cannot be settled, the bankruptcy will hold a hearing on the claim objection.

7. Section 503(b)(9) Claims

As described in Section I.C., a trade creditor that supplies goods the debtor receives within twenty days of the bankruptcy filing receives a higher priority for the value of such goods. In large bankruptcy cases, however, the court usually establishes special procedures for Section 503(b)(9) claims. These special procedures typically allow a trade creditor to assert a Section 503(b)(9) claim by completing and filing a modified proof of claim form. If there are no special case-specific procedures, a Section 503(b)(9) claimant will have to retain counsel and file a written motion in the bankruptcy court seeking allowance of its Section 503(b)(9) claim.

8. Administrative Claims

As mentioned above, a Proof of Claim should be used to claim amounts due on the filing date, and it should **not** be used to claim unpaid amounts arising **after** the bankruptcy filing. Claims arising after the bankruptcy filing are called "administrative" claims and are entitled to a higher priority than pre-bankruptcy claims.

If all goes according to plan, trade creditors should not have an administrative claim because the debtor should pay all post-bankruptcy expenses as they arise. However, some Chapter 11 cases fail, and debtors in those cases do not pay all of their post-bankruptcy creditors.

The court will then establish a deadline to file administrative claims, called the "administrative claim bar date." Creditors should not confuse the "administrative claim bar date" with the "claims bar date" discussed in the previous sections of this Manual.

The notice establishing the administrative claims bar date should explain how to file an administrative expense claim. Sometimes, the court may direct administrative claimants to file a modified version of the Proof of Claim form, which the court will provide. Other times, the court may require administrative claimants to file a separate application with the court. Therefore, administrative creditors should carefully follow the directions in the court notice.

9. Claims Purchasers

In large Chapter 11 cases, a trade creditor may receive solicitations from companies that wish to purchase their claim against the Chapter 11 debtor. In the typical transaction, the claims purchaser will offer a trade creditor a specific price for the claim, say 40% of the claim's face amount, for example. If accepted, the trade creditor will execute a claim assignment form where the trade creditor transfers its rights to receive distributions on account of the claim to the claim purchaser. The claim purchaser hopes to receive more than it paid for the claim.

The claims purchaser will provide the trade creditor with an assignment document that must be signed before the claim is purchased. These assignments almost always require the seller to return the purchase price to the claims buyer if the debtor objects to the trade creditor's claim. Accordingly, selling a disputed claim is not generally a good idea.

Over the years, a robust market has developed for the sale and purchase of bankruptcy claims. In our experience, many trade creditors are willing to trade a potentially higher recovery at some unknown point in the future for a more certain recovery at an earlier stage.

G. PREFERENCES

1. *Preferences—An Overview*
2. *Policy Rationales Behind the Bankruptcy Code's Preference Provisions*
3. *Defenses to Preference Actions*
4. *Procedural Issues*
5. *Conclusions*

1. Preferences—An Overview

Most trade creditors have encountered "preference" claims. For example, a trustee or debtor-in-possession can sue creditors to return payments they received within ninety days of the petition date. A preferential payment is a payment made by the debtor: (1) to a creditor; (2) for or on account of a pre-existing debt or obligation; (3) made while the debtor is "insolvent"; (4) on or within 90 days before the petition date.[1]; or (5) that enables the creditor to receive more than it would have received if the debtor were liquidated in a Chapter 7 proceeding.

Most payments made by a debtor to a trade creditor within the 90-day period satisfy the technical definition of a "preference." However, the law creates several "defenses," and a creditor that proves one or more of these preference defenses may reduce or even eliminate the amount it must repay.

Preference claims are prosecuted through lawsuits brought by the trustee. However, the trustee typically sends a demand letter to the creditor before filing the lawsuit. As a general rule, we recommend that creditors respond to the demand letter by raising their available defenses instead of ignoring the letter. Many preference demands are settled before the trustee files a lawsuit. The trustee is usually eager to settle if you prepare a well-thought-out response with supporting evidence. While every case is different, we have generally found that creditors can negotiate a more significant discount before the lawsuit is filed than afterward.

Before describing the defenses in detail, creditors should be aware of a recent change in the law. Bankruptcy trustees are now supposed to evaluate your defenses before they file suit. But the law does not require trustees to evaluate a creditor's defenses before sending a demand letter. Courts are still struggling with exactly how much due diligence the trustee must perform before filing the lawsuit. Some observers believe that a trustee may be able to satisfy its statutory duty to evaluate the creditor's defenses if the trustee sends a demand letter to the creditor and it does not respond by describing its defenses. However, if a creditor

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[1] This ninety-day period is extended to one year in the case of creditors who qualify as an "insider." Although the Bankruptcy Code's definition of "insider" is broad, ordinary trade creditors will generally not be insiders unless they have some unique affiliation with the debtor (*e.g.,* if they are a subsidiary of the debtor).

responds to the demand letter and sets forth its defenses, the trustee must show the court that the trustee evaluated the identified defenses before filing the lawsuit.

2. Policy Rationales Behind the Bankruptcy Code's Preference Provisions

Many trade creditors believe the preference laws are unfair, and it is hard to quarrel with that belief. After all, a trade creditor is frequently left with an unpaid claim **and** the obligation to return some of the money it did receive. However, there are two reasons for the preference laws. First, the preference laws promote equality of distribution among similarly situated creditors by requiring "preferred" creditors to return some of their payments to the estate where the amounts can be redistributed on a pro-rata basis to all similarly situated creditors. Second, the preference laws discourage creditors of financially troubled companies from employing overly aggressive collection efforts and unnecessarily forcing their customers into bankruptcy.

Although the law is intended to promote these two policies, the preference laws operate mechanically. A creditor not actually preferred may still be sued for a preference. The best way to minimize preference liability is to take full advantage of the statutory defenses.

3. Defenses to Preference Actions

The statute contains nine separate defenses to preference liability. However, only four are available in an ordinary trade creditor context. A brief description of the four significant defenses follows:

a. *Subsequent New Value Defense.* The "subsequent new value" defense is one of the easiest defenses to prove. Under this defense, a trade creditor can reduce its preference liability by the amount of any "new value" it supplied to the debtor after receiving a preferential payment. Suppose a trade creditor receives a preferential payment of $10,000 on January 2, which is within 90 days of the bankruptcy filing date, and then, on January 8, provides the debtor with an additional $8,000 worth of goods; the "subsequent new value" defense reduces the $10,000 potential preference liability by $8,000, for a net preference after the defense of only $2,000. To qualify for the subsequent new value defense, some bankruptcy courts require the $8,000 in "new value" in the above example to be unpaid as of the filing date. Other courts permit the new value to be used to reduce the preference liability even if the debtor paid for the new value before the filing date. Trade creditors should consult with counsel regarding the full availability of the subsequent new value defense.

b. *Ordinary Course of Business Defense*. A creditor is not required to return a payment if the underlying debt was (i) incurred in the "ordinary course" of both the creditor's and the debtor's businesses and (ii) if the payment was made in the ordinary course of the creditor's and debtor's conduct of business with one another **or** the payment made according to the relevant industry's typical practices.

Trade creditors can almost always satisfy the first element of the defense because the debt between the creditor and the debtor usually arises during their normal business activities. The second element is more challenging and can be proved by focusing on either the ordinary course of business between the two parties to the transaction or the ordinary course of business in the relevant industry.

Most creditors initially focus on whether the payments in the 90-day period were in the ordinary course of business between the debtor and the creditor. The most important issue is the timing of the payments made in the 90 days before bankruptcy (the "Preference Period") versus the timing of the payments made to the same creditor before the preference period ("Pre-Preference Period"). If the average number of days between the invoice date and the payment is 42 days during the Preference Period and 45 days during the Pre-Preference Period, the creditor has a very strong ordinary course of business defense. On the other hand, if the average number of days outstanding was substantially longer during the Preference Period, the defense would be weaker. The timing of payments is probably the most important factor to consider in analyzing the ordinary course of business defense, but there are others. For instance, even if the timing of payments was relatively consistent, a court may still conclude the payments were not made within the ordinary course of business if the creditor employed unusual collection techniques during the 90-day period, such as threatening litigation or demanding a personal guaranty. This prong of the ordinary course of business is subjective, and the parties frequently disagree on what is ordinary or not.

A creditor can also satisfy the ordinary course of business defense if it shows the payments were made consistent with what is considered ordinary in the parties' respective industries. For the most part, courts liberally apply this prong of the ordinary course defense. Thus, a payment will generally be considered to have been made "according to ordinary business terms" unless paid in a manner that significantly deviates from "industry norms." For instance, if no one in the parties' respective industries ever pays using wire transfer, a wire transfer payment might fail to satisfy the industry prong of the ordinary course defense. One of the key issues in establishing this defense is defining the relevant industry. A creditor will frequently have to retain an expert witness to prove this prong of the defense.

c. *Substantially Contemporaneous Exchange Defense*. Another useful preference defense is the "substantially contemporaneous exchange" defense. This defense protects payments that: (a) were intended by the parties to be a contemporaneous exchange for new value; and (b) were, in fact, substantially contemporaneous with the exchange of new value. The classic illustration of the substantially contemporaneous exchange defense occurs when a debtor purchases goods during the preference period by providing the supplier with a check at the time of purchase. Generally, a payment by check is not considered to occur until the check clears the bank against which it was written. Because checks normally clear at least two or three days after they are tendered, such a payment is technically a payment on a pre-existing debt. However, the substantially contemporaneous defense protects the creditor.

d. *De Minimis Payments*. The Bankruptcy Code imposes a minimum amount for preference claims for commercial debtors. Therefore, as of 2021, the Trustee cannot sue to recover less than $7,575 in total transfers. This amount is indexed and changes every three years, with the next scheduled change to occur on April 1, 2025.

4. Procedural Issues

A bankruptcy trustee usually has two years to file preference actions. Nothing in the Bankruptcy Code prohibits the filing of preference actions after a Chapter 11 plan of reorganization has been confirmed. Nevertheless, a Chapter 11 debtor may waive its right to bring such actions if it fails to sufficiently reserve the right to do so in the reorganization plan or the disclosure statement describing the reorganization plan.

Preference actions are typically filed in the same court in which the debtor's bankruptcy case is pending. For many trade creditors, this means litigating in a court far from home. However, in those instances in which the total amount of preference claims asserted against a trade creditor is less than $25,000, a trade creditor **may** be able to force the trustee to sue in the trade creditor's home state.

5. Conclusions

The preference laws are undoubtedly frustrating, but a creditor's maximum liability is the total amount it received in the 90 days before the bankruptcy filing. And, if the creditor is forced to return any of the payments, it can file an unsecured claim proof of claim for the amounts it returned. In short, a creditor that returns a preferential payment ends up in the

same position it would have been if it never received the payment. Accordingly, there is no reason for a trade creditor to refuse to accept a payment from a financially troubled customer because the payment may later constitute a preference. Instead, the better practice is to accept the payment and hope that the customer is not forced into bankruptcy within the next ninety days.

Furthermore, even if the customer does file bankruptcy, it is always possible that the trustee will not seek to recover the payment. And creditors may qualify for one of the defenses outlined above. So, for those reasons, we recommend that creditors accept any payments they can get from their distressed customers and then cross their fingers.

H. CHAPTER 11 CREDITORS' COMMITTEES

1. *Formation*
2. *Purpose and Responsibilities*
3. *Retention of Professionals*
4. *Function and Operation of the Committee*
5. *Fiduciary Duties of Committee Members*
6. *Advantages of Serving on a Committee*
7. *Disadvantages of Serving on a Committee*

1. Formation

In a Chapter 11 case, an Official Committee of Unsecured Creditors (the "Committee") is often formed to represent the debtor's unsecured creditors. The U.S. Trustee's Office—a division of the U.S. Department of Justice, selects the committee members. The U.S. Trustee usually selects the seven largest unsecured creditors willing to serve. In some cases, however, the U.S. Trustee may ask other unsecured creditors to serve on the Committee or form a Committee with fewer or more than seven members.

No one can compel a creditor to serve on a Committee. Moreover, the U.S. Trustee will not form a Committee if there is insufficient interest among the debtor's unsecured creditors.

The U.S. Trustee generally forms a Committee as quickly as possible after the Chapter 11 debtor files its case. One reason this is so important is that the court considers many critical issues in the first days of a Chapter 11 case, such as matters concerning the Chapter 11 debtor's post-petition financing.

2. Purpose and Responsibilities

The Committee protects the interests of the debtor’s unsecured creditors and seeks to maximize recoveries for the unsecured creditor body as a whole. Specifically, the Committee should: (1) consult with the Chapter 11 debtor-in-possession regarding the administration of the bankruptcy case; (2) investigate the debtor's financial circumstances and the desirability of the debtor's continued operation; (3) participate with the debtor-in-possession in formulating a plan of reorganization; and (4) request the appointment of a trustee or examiner when appropriate. The Committee can also be heard on all matters arising during the Chapter 11 case. Indeed, because the unsecured creditors usually have the most to gain or lose from the outcome of a Chapter 11 case, the bankruptcy court will usually give considerable weight to the Committee's position.

3. Retention of Professionals

Subject to the bankruptcy court’s approval, the Committee may retain attorneys and other professionals (such as an accountant) whose fees and expenses are paid by the bankruptcy estate. One of the Committee’s first acts is usually the selection of counsel for the Committee. The Committee’s counsel typically plays a significant role in shaping and implementing the Committee’s strategy and objectives in the case.

The Committee's ability to retain attorneys and other professionals paid by the bankruptcy estate is very important. While any unsecured creditor can hire its own attorney, a single unsecured creditor is rarely willing to pay its own attorney to make arguments that benefit the entire body of unsecured creditors. Individual creditors do not have enough at stake to justify paying an attorney to pursue issues that, although they may significantly increase distributions to all unsecured creditors, will only incrementally increase the single creditor's recovery. However, because the Committee's fees and expenses are paid from the bankruptcy estate, the Committee can focus on broader issues that are important to the unsecured creditor body as a whole.

4. Function and Operation of the Committee

A Committee usually appoints one member to serve as the Chairperson. The Chairperson is the principal contact person for the Committee’s professionals. The Committee adopts by-laws that govern its meetings and the members’ voting rights. While Committee members may be reimbursed for their out-of-pocket expenses if travel is involved, most Committee meetings are conducted by telephone.

5. Fiduciary Duties of Committee Members

Committee members have a fiduciary obligation to the entire unsecured creditor body. Therefore, if the individual committee member's interests conflict with the entire unsecured creditor body, the member should be recused from voting on the issue.

6. Advantages of Serving on a Committee

By serving on a Committee, a creditor has a greater opportunity to remain involved in a Chapter 11 case and possibly affect the direction and outcome of the case. Moreover, by serving on a Committee, a creditor generally has greater access to critical information regarding the debtor's ongoing operations and prospects for recovery. Many of our clients have found service on a Committee personally rewarding because they learn more about the relevant industry and debtor-creditor rights.

7. Disadvantages of Serving on a Committee

Serving on a Committee often requires a commitment of some time to attend committee meetings. However, most committee meetings now take place via conference calls or video calls and do not require travel. In addition, for some creditors, the fiduciary duties that committee members owe to the unsecured creditor body may also be a disincentive to serving on a Committee. Indeed, this is particularly true if the creditor perceives that its interests may be directly adverse to the overall interests of the debtor's unsecured creditors. Similarly, a creditor may not want to serve on a Committee out of concern that, as a Committee member, it will have access to confidential information that it will find difficult to consider and utilize solely in a fiduciary capacity.

I. INVOLUNTARY BANKRUPTCIES

1. *Eligibility for Filing an Involuntary Petition*
2. *Grounds for Filing an Involuntary Bankruptcy*
3. *Reasons to File an Involuntary Bankruptcy*
4. *Risks of Filing an Involuntary Bankruptcy*

1. Eligibility for Filing an Involuntary Petition

Most of the discussion so far assumed that the troubled company filed a voluntary bankruptcy case. However, creditors can band together and file an involuntary bankruptcy petition against the debtor.

Generally, filing an involuntary bankruptcy case requires at least three "petitioning creditors." The petitioning creditors' claims: (1) must collectively total at least $18,600[2] in unsecured debt; and (2) cannot be contingent as to liability or the subject of a bona fide dispute. Unfortunately, courts have had difficulty consistently applying the second of these two conditions. Consequently, there is no precise or universal understanding of when a claim will be considered contingent as to liability or the subject of a bona fide dispute. However, everyone agrees that certain types of creditors are eligible petitioning creditors, including (a) creditors holding a judgment against the debtor; (b) creditors holding a promissory note from the debtor that is in default and has become due and payable; and (c) trade creditors with past due invoices, unless the debtor maintains that the goods it received from the creditor were defective or that it is not liable on the outstanding invoices for some other, legitimate reason.

2. *Grounds for Filing an Involuntary Bankruptcy*

Assuming the petitioning creditors satisfy the statutory criteria, the Bankruptcy Code will declare the company to be "in bankruptcy" if: (1) the company is generally not paying its debts as they become due; or (2) within 120 days before the filing of the petition, a custodian was appointed to take possession of all or substantially all of the company's property. Creditors will most commonly file involuntary petitions because the debtor is "generally not paying its debts as they become due."

The Bankruptcy Code probits involuntary bankruptcy filings against certain businesses, such as farmers and not-for-profits.

3. *Reasons for Filing an Involuntary Bankruptcy*

Trade creditors may be motivated to file an involuntary bankruptcy for several reasons. Specifically, creditors may wish to force a debtor into bankruptcy to utilize the unique collection remedies that exist in bankruptcy. For instance, if the company made significant transfers that might be recovered by the bankruptcy estate (such as preferences or fraudulent transfers), trade creditors may have more to gain by forcing the debtor into bankruptcy than they would by pursuing their own remedies under non-bankruptcy law. Similarly, if creditors believe that a debtor's management has engaged in mismanagement or fraud, they may want to subject the debtor to the additional scrutiny of a bankruptcy case. Creditors also sometimes file an involuntary bankruptcy petition if another creditor is close to obtaining a judgment and

[2] This dollar threshold is adjusted every three years according to changes in the Consumer Price Index. The next adjustment is scheduled to occur on April 1, 2025.

executing on the company's assets to satisfy the judgment. The involuntary bankruptcy stops the "race to the courthouse" among similarly situated creditors.

4. Risks of Filing an Involuntary Bankruptcy

Petitioning creditors should be careful before filing an involuntary bankruptcy petition. The court can hold any petitioning creditor in an unsuccessful involuntary bankruptcy liable for damages, including the company's costs and reasonable attorneys' fees. Moreover, if the bankruptcy court determines that the involuntary petition was filed in "bad faith," the petitioning creditors may be liable for punitive damages or any damages proximately caused by the bad faith filing.

Although an involuntary Chapter 11 filing is theoretically possible, most involuntary cases are filed as Chapter 7 liquidation cases. However, the troubled company can, and frequently does, consent to the bankruptcy filing but then converts the case to a Chapter 11.

GLOSSARY

2004 Examinations: Bankruptcy Rule 2004 allows creditors and parties-in-interest to examine the debtor or others under oath about the debtor's financial affairs and matters relating to the bankruptcy case's administration. An entity may request permission to take a Rule 2004 examination even though there is no pending litigation or action to which it is a party.

341 Meetings: see definition of "First Meeting of Creditors."

Administrative Insolvency: "Administrative insolvency" describes a bankruptcy case in which there are not enough assets in the bankruptcy estate to pay all administrative priority claims in full.

Administrative Priority Claim (also referred to as "Administrative Expense"): Parties supplying goods or services to the bankruptcy estate on credit after a bankruptcy filing are entitled to assert an "administrative priority claim" for any unpaid amounts. Administrative priority claims have priority over prepetition, unsecured claims. Other items that qualify for treatment as administrative priority claims include certain postpetition tax obligations, certain professional fees, and claims for goods delivered within twenty days of filing for which a reclamation claim is unavailable.

Adversary Proceeding: Parties seeking certain forms of relief before the bankruptcy court must commence an "adversary proceeding." An adversary proceeding resembles a separate lawsuit occurring within the context of a bankruptcy case.

Automatic Stay: The filing of a bankruptcy case triggers an "automatic stay" that prohibits creditors from pursuing any collection efforts against the debtor or the debtor's property. The automatic stay does not stop creditors from pursuing personal guarantees unless the guarantor has also filed for bankruptcy.

Avoidance Powers: Under the Bankruptcy Code, the bankruptcy trustee and the debtor-in-possession may avoid certain prepetition transfers of estate property, including preferences and fraudulent conveyances.

Bankruptcy Code: The term "Bankruptcy Code" refers to the current federal bankruptcy statute. The Bankruptcy Code was enacted in 1978 but has been amended many times since its enactment.

Bankruptcy Estate: Upon filing a bankruptcy case, all of the debtor's assets become part of the "bankruptcy estate." The trustee or Chapter 11 debtor-in-possession must administer these assets for the benefit of the debtor's creditors.

Bankruptcy Schedules: Within 15 days after the entry of an order for relief, a debtor is required to file "Bankruptcy Schedules," where it must disclose all of its assets and liabilities and other financial information.

Cash Collateral: "Cash collateral" means cash or cash equivalents (*i.e.*, negotiable instruments, documents of title, securities, or deposit accounts) belonging to the debtor subject to a lien or security interest held by a lender or other secured creditor. A trustee or debtor-in-possession cannot use cash collateral unless the secured creditor or lender consents to such use or the court, after notice and a hearing, authorizes such use.

Chapter 11 Plan: A Chapter 11 plan is proposed in a Chapter 11 case under which the debtor or other plan proponent proposes a certain treatment for the debtor's creditors. Chapter 11 plans are generally of two varieties: (1) a Plan of Reorganization; or (2) a Liquidating Plan.

Claim: A claim is any right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured. The term "claim" also includes any right to an equitable remedy for breach of performance if that breach also gives rise to a right to payment.

Claims Bar Date: The claims bar date is the last date scheduled in a bankruptcy case by which creditors must file their proofs of claim with the bankruptcy court clerk (or other designated filing office). Creditors that fail to file their proofs of claim before the claims bar date may be disqualified from receiving any distribution from the bankruptcy estate.

Confirmation: Confirmation refers to a bankruptcy court's approval of a Chapter 11 plan that thereafter is binding on the debtor's creditors.

Confirmation Hearing: The confirmation hearing is the hearing at which a bankruptcy court decides whether to confirm a Chapter 11 plan.

Conversion: "Conversion" occurs when the bankruptcy court determines a case should be "converted" to another chapter of the Bankruptcy Code, *i.e.*, a case pending under Chapter 11 of the Bankruptcy Code may be converted to a case under Chapter 7 of the Bankruptcy Code or vice versa.

Cramdown: Cramdown occurs when the bankruptcy court confirms a Plan though one or more impaired classes under the plan did not vote to accept the plan.

Creditor: A creditor is any person, corporation, or other entity that holds a claim against the debtor as of the petition date.

Creditors' Committee: The Committee in a Chapter 11 case that represents the interests of unsecured creditors as a whole.

Debtor-in-Possession: In a Chapter 11 case, the debtor generally remains in control of its assets, continues to operate its business, and is referred to as the "debtor-in-possession." A debtor-in-possession generally has the same rights and powers as a bankruptcy trustee. However, the bankruptcy court may remove the debtor-in-possession and appoint a trustee to control a debtor's assets and business operations in certain circumstances, primarily when the debtor in possession has engaged in improper conduct.

Debtor-in-Possession Financing (or DIP Financing): see definition of "Postpetition Financing."

Discharge: "Discharge" refers to the relief awarded to certain bankruptcy debtors that eliminates their liability for most types of outstanding debts and obligations. In a Chapter 7 case, only individuals are eligible to receive a discharge.

Executory Contract: An "executory contract" is a contract (or lease) to which the debtor is a party as of the Petition Date. A trustee or debtor-in-possession has three options for an executory contract: (1) reject the contract; (2) assume the contract; or (3) assume the contract and assign it to a third party.

Exclusive Period: In Chapter 11 cases that are not Small Business Cases, the debtor-in-possession has the exclusive right to file a Chapter 11 plan during the first 120 days of the bankruptcy case. This period is commonly referred to as the "exclusive period." The bankruptcy court can extend the exclusivity period for "cause," subject to certain limitations. After the exclusive period expires, both the debtor and its creditors can file a plan.

First Meeting of Creditors: A debtor must appear at a meeting of creditors and testify under oath about the debtor's financial affairs. This meeting usually occurs within the bankruptcy case's first 20 to 40 days. The First Meeting of Creditors is also called the "341 Meeting." Creditors may attend the First Meeting of Creditors but are not required to attend.

Fraudulent Conveyance: A trustee or debtor-in-possession may avoid and recover certain prepetition transfers of the debtor's property if the transfer was made with either: (1) actual fraud evidenced by an intent to defraud, hinder or delay creditors; or (2) constructive fraud, which requires the transfer to have been made for than reasonably equivalent value in exchange for the transfer when the transferor was insolvent.

Gap Period: The "gap period" is the time between filing an involuntary petition and the entry of an order for relief.

Impaired Class: A Chapter 11 Plan must divide the claims of the debtor's creditors into different "classes." Only similarly situated creditors may be placed in a particular class. If the plan proposes to modify the class's legal rights, the class is an impaired class that is allowed to vote to accept or reject a plan.

Liquidating Plan: A liquidating plan is a Chapter 11 call for the debtor to be liquidated, not reorganized.

No-Asset Case: The term "no-asset case" refers to a bankruptcy case where no funds are available to distribute to unsecured creditors.

Petition Date: The date the debtor files a bankruptcy case is called the petition date. Similarly, the date that creditors file an involuntary petition against a debtor is also called the petition date.

Plan of Reorganization: A reorganization plan is a plan filed in a Chapter 11 case that proposes restructuring the Chapter 11 debtor's existing debts. To become binding on the debtor's creditors, a plan of reorganization must be "confirmed" by the bankruptcy court.

Postpetition: The term "postpetition" refers to any circumstances or events occurring *after* the commencement of a bankruptcy case.

Postpetition Financing: (Also known as "DIP financing"). A secured loan made after the petition date to a debtor. The bankruptcy court must approve the terms of any postpetition financing.

Preference: A trustee or debtor in possession may avoid and recover certain transfers made before the petition date. To constitute a "preference," a payment made by a debtor must: (1) be made to a creditor; (2) for or on account of a pre-existing debt or obligation; (3) made at a time when the debtor is "insolvent;" (4) made on or within 90 days before the petition date (or one year if the transfer was to an "insider"); and (5) that enables the creditor to receive more than it would have received if the debtor were liquidated in a Chapter 7 proceeding.

Prepetition: The term "prepetition" refers to any circumstances or events existing *before* the commencement of a bankruptcy case.

Proof of Claim: A proof of claim is a written statement signed by a creditor or the creditor's authorized agent, setting forth the amount and nature of the creditor's claim.

SBRA: See the definition for "Small Business Reorganization Act of 2019."

Secured Claim: A claim where the creditor holds collateral owned by the debtor to secure repayment of the amount due.

Small Business Case: The term "Small Business Case" means a Chapter 11 case in which: (a) the debtor is an individual or a non-public company engaged in commercial or business activities; (b) the debtor's aggregate noncontingent, unliquidated debt (both secured and unsecured) is less than or equal to $7,500,000; (c) at least fifty percent (50%) of the debtor's aggregate noncontingent liquidated debt arose from the debtor's commercial or business activities, and (d) the debtor's primary activity is not the business of owning single asset real estate. The $7,500,000 debt limitation on a Small Business Case will be reduced to approximately $3,000,000 in 2024 unless Congress postpones the reduction.

Small Business Reorganization Act of 2019: The Small Business Reorganization Act of 2019 or "SBRA" was signed into law on August 23, 2019, and went into effect in February 2020. Among other changes, the SBRA adds a new "Subchapter V" to Chapter 11, designed to provide small business debtors with a more cost-effective and efficient means of reorganizing under Chapter 11.

Statement of Financial Affairs: Within 15 days after the entry of an order for relief, a debtor must file a "Statement of Financial Affairs" with the bankruptcy court, in which it must provide certain specified information regarding its financial affairs.

Subchapter V: "Subchapter V" refers to certain provisions added to Chapter 11 of the Bankruptcy Code under the SBRA. These provisions enable small business debtors to restructure their debts more efficiently under Chapter 11.

Trustee: A trustee is appointed by the court to represent certain bankruptcy estates. Although a trustee's specific duties vary depending upon the type of bankruptcy case (*i.e.*, Chapter 7, Chapter 11, or Chapter 13), a trustee administers the bankruptcy estate's assets for the benefit of the debtor's creditors.

United States Trustee: A representative of the U.S. Department of Justice appointed for a particular geographic region, whose responsibilities include: (a) supervising a panel of private trustees that serve as trustees in cases under Chapters 7 and 11; and (b) supervising the administration of cases and trustees in cases under Chapters 7, 11, 12, or 13.

Unsecured Claim: A claim not secured by a lien or security interest in any of the debtor's property or assets.

Exhibit A

(Reclamation Demand – No Bankruptcy)

[Date]

VIA EMAIL AND FEDERAL EXPRESS

[Customer]
[Customer's Address]

Re: Reclamation Demand

Dear __:

The undersigned has learned that the your company is "insolvent" within the meaning of Uniform Commercial Code Section 2-702.

Within the ten days before the date of this letter, your company has received the following goods (the "Goods") on credit from [*name of your company*] for which [*name of your company*] has yet to receive payment:

Invoice Number	Quantity	Description of Goods	Invoice Amount
[*insert invoice no.*]	[*insert quantity*]	[*brief description of goods*]	[*insert invoice amt.*]

Pursuant to the provisions of Uniform Commercial Code Section 2-702, we hereby make demand for reclamation of the Goods.

In accordance with this demand, [*name of Customer*] is instructed to set aside the Goods for return to [*name of your company*] and is prohibited from further using, processing, commingling, selling or in any way encumbering the Goods.

Please contact the undersigned for instructions concerning the return of the Goods to [*name of your company*].

Very truly yours,

[Name of Your Company]

Exhibit B

(Form PMSI Notice)

[COMPANY LETTERHEAD]

[Date]

VIA [UPS/FED EX/USPS CERTIFIED MAIL/EMAIL]

____
Attn:____________________________
____
____

Re: _____________________ ("Debtor")

Notice of Purchase Money Security Interest in Inventory

Ladies and Gentlemen:

Please be advised that [*insert your company name*] has or expects to acquire a purchase money security interest in all inventory of Debtor in all of its forms, financed by or leased from [*insert your company name*], wherever located, now or hereafter existing, including, but not limited to, (i) goods in which Debtor has any right or interest of any kind, and (ii) goods which are returned to or repossessed by Debtor and all accessions to, products of, and documents relating to any of the foregoing (collectively, the "Inventory"), together with any and all proceeds, products and profits of the Inventory.

Very truly yours,

[Name of Your Company]

cc: ___________________________________ ("Debtor")

Exhibit C

(Reclamation Letter – Bankruptcy Already Filed)

[COMPANY LETTERHEAD]

[Date]

VIA EMAIL AND FEDERAL EXPRESS

[Customer]
[Customer's Address]

Re: Reclamation Demand

Dear __:

It is our understanding that your company filed for relief under Chapter 11 of the United States Bankruptcy Code (the "Bankruptcy Code") on *[insert date of the bankruptcy was filed*] (the "Petition Date").

Within the forty-five day period preceding the Petition Date, your company has received the following goods on credit from [*name of your company*] for which [*name of your company*] has yet to receive payment:

Invoice Number	Quantity	Description of Goods	Invoice Amount
[*insert invoice no.*]	[*insert quantity*]	[*brief description of goods*]	[*insert invoice amt.*]

Pursuant to the provisions of Uniform Commercial Code Section 2-702 as adopted under applicable state law and the provisions of Bankruptcy Code Section 546(c), we hereby make demand for reclamation of the above-referenced goods.

In accordance with this demand, [*name of Customer*] is instructed to set aside the above-referenced goods for return to [*name of your company*] and is prohibited from further using, processing, commingling, selling or in any way encumbering said goods.

We reserve the right to withdraw this demand to the extent that the above-referenced invoices are paid in full pursuant to Bankruptcy Code Section 546(c) and/or as part of any critical vendor order.

Very truly yours,

[Name of Your Company]

cc: [Customer's outside bankruptcy counsel](via email and Federal Express)

Fill in this information to identify the case:
Debtor 1 ______________________
Debtor 2 (Spouse, if filing) ______________________
United States Bankruptcy Court for the: __________ District of __________
Case number ______________________

Exhibit D

Official Proof of Claim Form

Official Form 410

Proof of Claim

04/19

Read the instructions before filling out this form. This form is for making a claim for payment in a bankruptcy case. Do not use this form to make a request for payment of an administrative expense. Make such a request according to 11 U.S.C. § 503.

Filers must leave out or redact information that is entitled to privacy on this form or on any attached documents. Attach redacted copies of any documents that support the claim, such as promissory notes, purchase orders, invoices, itemized statements of running accounts, contracts, judgments, mortgages, and security agreements. **Do not send original documents;** they may be destroyed after scanning. If the documents are not available, explain in an attachment.

A person who files a fraudulent claim could be fined up to $500,000, imprisoned for up to 5 years, or both. 18 U.S.C. §§ 152, 157, and 3571.

Fill in all the information about the claim as of the date the case was filed. That date is on the notice of bankruptcy (Form 309) **that you received.**

Part 1: Identify the Claim

1. **Who is the current creditor?**	______________________ Name of the current creditor (the person or entity to be paid for this claim) Other names the creditor used with the debtor ______________________
2. **Has this claim been acquired from someone else?**	❑ No ❑ Yes. From whom? ______________________
3. **Where should notices and payments to the creditor be sent?** Federal Rule of Bankruptcy Procedure (FRBP) 2002(g)	**Where should notices to the creditor be sent?** Name Number Street City State ZIP Code Contact phone ______________ Contact email ______________ **Where should payments to the creditor be sent?** (if different) Name Number Street City State ZIP Code Contact phone ______________ Contact email ______________ Uniform claim identifier for electronic payments in chapter 13 (if you use one): __
4. **Does this claim amend one already filed?**	❑ No ❑ Yes. Claim number on court claims registry (if known) ______ Filed on ______________ MM / DD / YYYY
5. **Do you know if anyone else has filed a proof of claim for this claim?**	❑ No ❑ Yes. Who made the earlier filing? ______________

Official Form 410 **Proof of Claim** page 1

Part 2: Give Information About the Claim as of the Date the Case Was Filed

6. **Do you have any number you use to identify the debtor?**	❑ No ❑ Yes. Last 4 digits of the debtor's account or any number you use to identify the debtor: ____ ____ ____ ____
7. **How much is the claim?**	$_____________________. **Does this amount include interest or other charges?** ❑ No ❑ Yes. Attach statement itemizing interest, fees, expenses, or other charges required by Bankruptcy Rule 3001(c)(2)(A).
8. **What is the basis of the claim?**	Examples: Goods sold, money loaned, lease, services performed, personal injury or wrongful death, or credit card. Attach redacted copies of any documents supporting the claim required by Bankruptcy Rule 3001(c). Limit disclosing information that is entitled to privacy, such as health care information. ____
9. **Is all or part of the claim secured?**	❑ No ❑ Yes. The claim is secured by a lien on property. **Nature of property:** ❑ Real estate. If the claim is secured by the debtor's principal residence, file a *Mortgage Proof of Claim Attachment* (Official Form 410-A) with this *Proof of Claim.* ❑ Motor vehicle ❑ Other. Describe: ________________________________ **Basis for perfection:** ________________________________ Attach redacted copies of documents, if any, that show evidence of perfection of a security interest (for example, a mortgage, lien, certificate of title, financing statement, or other document that shows the lien has been filed or recorded.) **Value of property**: $__________ **Amount of the claim that is secured:** $__________ **Amount of the claim that is unsecured:** $__________(The sum of the secured and unsecured amounts should match the amount in line 7.) **Amount necessary to cure any default as of the date of the petition:** $____________ **Annual Interest Rate** (when case was filed)_______% ❑ Fixed ❑ Variable
10. **Is this claim based on a lease?**	❑ No ❑ Yes. **Amount necessary to cure any default as of the date of the petition.** $____________
11. **Is this claim subject to a right of setoff?**	❑ No ❑ Yes. Identify the property: ________________________________

12. **Is all or part of the claim entitled to priority under 11 U.S.C. § 507(a)?** A claim may be partly priority and partly nonpriority. For example, in some categories, the law limits the amount entitled to priority.	❑ No ❑ Yes. *Check one:*	**Amount entitled to priority**
	❑ Domestic support obligations (including alimony and child support) under 11 U.S.C. § 507(a)(1)(A) or (a)(1)(B).	$____________________
	❑ Up to $3,025* of deposits toward purchase, lease, or rental of property or services for personal, family, or household use. 11 U.S.C. § 507(a)(7).	$____________________
	❑ Wages, salaries, or commissions (up to $13,650*) earned within 180 days before the bankruptcy petition is filed or the debtor's business ends, whichever is earlier. 11 U.S.C. § 507(a)(4).	$____________________
	❑ Taxes or penalties owed to governmental units. 11 U.S.C. § 507(a)(8).	$____________________
	❑ Contributions to an employee benefit plan. 11 U.S.C. § 507(a)(5).	$____________________
	❑ Other. Specify subsection of 11 U.S.C. § 507(a)(__) that applies.	$____________________
	* Amounts are subject to adjustment on 4/01/22 and every 3 years after that for cases begun on or after the date of adjustment.	

Part 3: Sign Below

The person completing this proof of claim must sign and date it. FRBP 9011(b).

If you file this claim electronically, FRBP 5005(a)(2) authorizes courts to establish local rules specifying what a signature is.

A person who files a fraudulent claim could be fined up to $500,000, imprisoned for up to 5 years, or both. 18 U.S.C. §§ 152, 157, and 3571.

Check the appropriate box:

❑ I am the creditor.
❑ I am the creditor's attorney or authorized agent.
❑ I am the trustee, or the debtor, or their authorized agent. Bankruptcy Rule 3004.
❑ I am a guarantor, surety, endorser, or other codebtor. Bankruptcy Rule 3005.

I understand that an authorized signature on this *Proof of Claim* serves as an acknowledgment that when calculating the amount of the claim, the creditor gave the debtor credit for any payments received toward the debt.

I have examined the information in this *Proof of Claim* and have a reasonable belief that the information is true and correct.

I declare under penalty of perjury that the foregoing is true and correct.

Executed on date ____________________
MM / DD / YYYY

____
Signature

Print the name of the person who is completing and signing this claim:

Name ____
First name Middle name Last name

Title ____

Company ____
Identify the corporate servicer as the company if the authorized agent is a servicer.

Address ____
Number Street

____
City State ZIP Code

Contact phone ____________________ Email ____________________

Print | Save As... | Add Attachment | Reset

CHICAGO
55 East Monroe Street
37th Floor
Chicago, IL 60603
312 346 7500

LOS ANGELES
10100 Santa Monica Boulevard
Suite 500
Los Angeles, CA 90067
310 282 2500

ST. LOUIS
One US Bank Plaza
St. Louis, MO 63101
314 552 6000

DALLAS
2100 Ross Avenue
Suite 3200
Dallas, TX 75201
972 629 7100

NEW YORK
488 Madison Avenue
New York, NY 10022
212 478 7200

WASHINGTON, D.C.
1909 K Street, N.W.
Suite 600
Washington, D.C. 20006
202 585 6900

SOUTHERN ILLINOIS
525 West Main Street
Suite 300
Belleville, IL 62220
618 277 4700

BIRMINGHAM
2 20th Street North
Suite 1150
Birmingham, AL 35203
314 552 6000

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August 2024