

Getting paid

What rights creditors have in a business bankruptcy case **Interviewed by Clare DeCapua**

When one of your customers files for a Chapter 7 bankruptcy, you're not only losing a customer, but, in many cases, you're losing whatever assets they might owe you, and even what they've most recently paid you for products or services.

"Even when there are no assets in the case, the creditor has the right to participate in the bankruptcy proceeding, ask questions of the debtor, find out about the debtor's financial affairs, and find out what happened to the debtor's assets," says Larry McClatchey, director and chair of the Creditors' Rights & Bankruptcy practice at Kegler, Brown, Hill & Ritter.

Smart Business learned more from McClatchey about what businesses can do when faced with the bankruptcy of one of their customers.

What rights does a creditor have in these situations?

Although a lot of bankruptcy cases are what we call 'no asset' cases and no dividend is paid, the principal right that a creditor has in a Chapter 7 liquidating bankruptcy is to participate in the case to try to get a payment on the claim if there are any assets in the estate.

Another right that the creditor has is the right to expose any wrongdoing on the part of the debtor. In a lot of cases, the creditor will know a lot more about the debtor's business than the trustee in the bankruptcy case, or even the debtor's attorney. Particularly if a credit manager has been working with a problem account for several months or a year, the creditor may have a lot of information about what the debtor has been up to. That information can be invaluable to the court or the trustee.

What is the first thing a creditor should do?

Carefully read all of the notices that are received from the bankruptcy court and pay particular attention to the various dates that are set forth in the notice.

There are three important dates to note: the Meeting of Creditors; 60 days later is the deadline to object the discharge; 30 days after that is the deadline to file proof of claim.

You're not required to attend the Meeting of Creditors, but it is an opportunity to ask questions. If you're talking about an indi-



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vidual debtor — if you're selling goods to somebody who is a sole proprietor and if they've engaged in any kind of wrongdoing before the bankruptcy was filed — you can object to the discharge. The significance of the third date is that if there's going to be any distribution to creditors, only creditors who file proofs of claim will be entitled to receive any distribution. You should use the official proof of claim form from the bankruptcy court, and you should attach an official explanation of your claim and copies of invoices or other documents that support the claim.

Creditors who have filed proofs of claim will share pro rata in the net proceeds of whatever the trustee recovers. My experience is that there are many Chapter 7 bankruptcy cases where a lot of creditors do not file proofs of claim, so the ones who do can get a pretty large dividend. The national average dividend in Chapter 7 bankruptcy cases is between 7 and 10 percent on the dollar. But if few creditors file claims you can get 25, 50, 60 percent dividend.

What steps will creditors need to take during this process to help ensure success?

Aside from filing a proof of claim, the most likely involvement that a creditor is

going to have in a business bankruptcy case is if they are asked to repay a preferential payment. The bankruptcy code allows the trustee to recover certain kinds of payments made within 90 days before the bankruptcy is filed.

Creditors should think defensively and gather up all the records of the business dealings they've had with the debtor over at least the last year before the bankruptcy was filed. They should look for any information about concealed assets or property transfers that the debtor made. For example, if the creditor learns that the principal of the company repaid a large debt to a family member within a year before the bankruptcy was filed, the creditor should bring that information to the attention of the bankruptcy trustee and the court. The trustee may be able to get that money back.

If the debtor has committed some sort of wrongdoing, the creditor could take action to get a court order barring the debtor from getting a discharge. If there's no discharge, then the creditor could still try to collect the debt.

What expectations should creditors have of the outcome?

Be realistic about the likelihood of a small dividend or no dividend. Take a look at the business you've done with the debtor and be prepared to defend yourself if it looks like you've been paid a significant amount of money by the customer before the bankruptcy was filed, because the trustee may try to recover it.

You do need to be a little careful here because the discharge and objections to discharge are really significant if the debtor is an individual. A corporate debtor that is being liquidated in a bankruptcy proceeding and has ceased operation does not actually get a discharge by law. There are obviously a lot of proprietorships out there and you could very well have a customer who's an individual.

Work with an experienced bankruptcy lawyer to learn whether you are in a class of creditor with special rights under the bankruptcy code that will give you some additional protection. <<

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