

**BAKER DONELSON**  
BEARMAN, CALDWELL & BERKOWITZ, PC

## Tricks or Treats? Getting Paid When Your Tenants, Suppliers, Clients and Businesses Declare Bankruptcy

Max Moseley  
205. 244.3817  
[mmoseley@bakerdonelson.com](mailto:mmoseley@bakerdonelson.com)

Jan Hayden  
504.566.8645  
[jhayden@bakerdonelson.com](mailto:jhayden@bakerdonelson.com)

Bill Bensinger  
205.250.8359  
[bbensinger@bakerdonelson.com](mailto:bbensinger@bakerdonelson.com)

Dan Ferretti  
205.250.8338  
[dferretti@bakerdonelson.com](mailto:dferretti@bakerdonelson.com)

EXPAND YOUR EXPECTATIONS®

- 
- **RECOGNIZING THE SIGNS  
OF IMPENDING  
BANKRUPTCY**

## WHAT CAUSES A BUSINESS TO GO BELLY UNDER?

---

- **INTERNAL CAUSES**
  - Ineffective management
  - Failure to perceive and manage risks
  - Too much debt
  - Dishonesty and fraud
- **EXTERNAL CAUSES**
  - Economic conditions
  - Changes in competition, society, technology
  - Governmental action

Source: *Troubled Workouts Reference Guide*, Turnaround Management Association (2006)

## HOW CAN YOU TELL A BUSINESS IS FAILING?

---

- **FINANCIAL ANALYSIS**
  - Do you receive financial reporting from your customer? What are the trends (lower revenue, higher expenses)?
  - Have they been consistently delaying payment? ("If you can just wait, I have some A/R that will hit any week now.")
  - If they are a publicly traded company, look at their stock price, or better yet, their SEC filings.

## HOW CAN YOU TELL A BUSINESS IS FAILING?

---

- MANAGEMENT ANALYSIS
  - Do you know who their management personnel are? How good is your relationship with them?
  - Have they had a lot of changes at the top? For instance, is the principal owner involved in a messy divorce (see L.A. Dodgers)?
  - Is the number one person still in place, but there are several defections just below him?

## HOW CAN YOU TELL A BUSINESS IS FAILING?

---

- MONITOR THE INDUSTRY
  - What is happening in the customer's industry?
  - What is the competitive environment? How many other people are doing what the customer is doing?

## HOW CAN YOU TELL A BUSINESS IS FAILING?

---

- WHAT DO THE PUBLIC RECORDS SAY?
  - Secretary of State website: Search for UCC filings under a borrower's name for free. The big things you are looking for here are IRS or state department of revenue filings
  - Look up their property tax payment history online from most county websites
  - Are they being sued? Ask your in house or outside attorneys to do a quick litigation search.
  - Any bad press?

## PROTECT YOURSELF! ACTION STEPS

---

- COD or Pre-pay! But be careful . . .
- SECURE some COLLATERAL: A deposit account, security deposit, UCC. But be careful . . .
- Get a GUARANTY from the principals/affiliated company
- If they have fallen way behind, get them on a payment plan with a PROMISSORY NOTE (hopefully with collateral/guaranty)
- Call your ATTORNEY (at Baker Donelson), who can help think through these options (and others)

## **BANKRUPTCY CODE SECTION 365**

---

- The primary Bankruptcy Code section addressing the relationship between a landlord and tenant is § 365. Section 365(a) states simply:
- "Except as provided in sections 765 and 766 of this title and in subsections (b), (c) and (d) of this section, the trustee, subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor." 11 U.S.C. § 365(a).

## **UNEXPIRED LEASES**

---

- A debtor has two choices with regard to an unexpired lease: the debtor may assume the lease or the debtor may reject the lease. When a debtor assumes a lease, it agrees to be bound by the terms of the lease. Therefore, a debtor must assume the lease in whole; the debtor may not assume the favorable aspects of the lease and reject the unfavorable aspects.

## **LEASE OBLIGATIONS**

---

- Prior to the debtor's assumption or rejection of the lease, the debtor must timely perform all of its lease obligations.

## **ASSUMING A LEASE**

---

If the debtor has defaulted under the lease, the debtor may not assume the lease unless it first:

- A. cures, or provides adequate assurance that the trustee will promptly cure such default;
- B. compensates, or provides adequate assurance that the trustee will compensate, a party other than the debtor to such contract or lease, for any actual pecuniary loss to such party resulting from such default; and
- C. provides adequate assurance of future performance under such contract or lease.

## **ASSIGNING A LEASE**

---

- In addition to assuming a lease, a tenant in bankruptcy may also assign the lease. However, assumption and assignment are not independent alternatives. In order to assign a lease, the debtor must first be able to assume the lease. In addition to assuming the lease, the debtor must also provide adequate assurance of the assignee's performance.

## **LEASE REJECTION**

---

- In addition to assuming a lease, or assuming and assigning a lease, a debtor may also choose to reject the lease. Rejection does not terminate an unexpired lease, but merely removes it as property of the estate.

## **DAMAGES**

---

- When the debtor rejects a lease, the rejection is deemed a breach of the lease. When a debtor rejects a lease, the landlord is entitled to a claim for damages against the debtor. However, the damages claim is subject to several modifications under the Bankruptcy Code.
- The first step in determining a landlord's rejection damages is to compute the damages in accordance with the lease and state law.
- Once the court determines the amount of damages under the contract and state law, this amount is limited by Section 502(b)(6) of the Bankruptcy Code.

---

## **Bankruptcy Preferences**



### **What Is A Preference?**

---

- Payment to Creditor of Pre-Existing Debt
- Made within 90 Days Prior to filing for Bankruptcy. (Within 1 Year for Insiders)
- Debtor is Insolvent
- Creditor Receives More Than Fair Share – Beyond Pro Rata Amount

---

### **Defenses To Preference Lawsuits**

### **MOST COMMON DEFENSE ORDINARY COURSE OF BUSINESS**

- Ordinary Course between Debtor & Transferee; or
- According to Ordinary Business Terms.

### **Contemporaneous Exchange**

- Contemporaneous Exchange for New Value (Such as C.O.D. Delivery)
- Also: Payment for Old Debt in Return for New Goods or Services of Equal Value

## Subsequent New Value

---

- Example: Shipment of New Goods on Credit after Payment on Old Debt.
- Not a Matter of Netting the Numbers Over 90 Days.

## GENERAL PRINCIPLES

---

- Always accept payments, as you would much rather defend giving payments back than have an unsecured claim
- Always monitor late paying customers and minimize payments outside ordinary course of business
- Use leverage where possible: Require C.O.D., obtain personal guarantees, etc.

## **Consider Preferences When Dealing With Your Customers**

---

- Demand letters and collection calls can be evidence that payments received are not ordinary course
- Require payment of old invoice before shipping new goods or providing new services

## **How To Respond When Preference Demand Letter is Received or Complaint Filed**

---

- Trustee Sends Demand Letter.
- Often Letter Sent to Every Payee.
- Understand the Process:
  - Lawsuit is Required

## **When To File A Proof of Claim . . . When To Do More?**

---

- Most claims may be asserted by filing a Proof of Claim with the U.S. Bankruptcy Court
- Administrative Claims should be asserted by filing a Motion in the bankruptcy case

## **Asserting Administrative Claims: What Are They and How Do You Assert Them?**

---

- Claims for actual and necessary expenses of the estate
- Claims of Petitioning Creditors
- Claims for Goods Delivered 20 days prior to filing of Petition
- Assumed Leases and Executory Contracts