

Battling bankruptcy

Continuing our look at routinely encountered legal issues through the eyes of two fictitious electrical distribution companies: My customer filed bankruptcy after I purchased a ton of materials; what do I do now? by **Daniel Goldberg**

The economy is sluggish, and the stories we read change every day. One day, unemployment is improving slightly; the next day the story changes, suggesting that, yes, the economy is improving, but not in the construction industry. One day we hear that buildings are coming out of the ground at a quicker rate. The next day we hear that American banks aren't lending anyway, concerned about their stakes in Europe's financial system—which the media suggests is imploding. As the economy plods forward, Alvin Amp, owner of Distributor in a Rush, and Bobby Busduct, owner of Distributor in Control, were finding that some subcontractors were filing for bankruptcy protection, often quite unexpectedly. For the owners of our fictitious distribution companies, these bankruptcy filings raised a few questions right away.

Q: What's the difference between a Chapter 11 and a Chapter 7?

A: Companies can file one of several different types of bankruptcy petitions to be entitled to protection allowed under the *United States Bankruptcy Code*. Two that are widely encountered by electrical distributors, and most often seen by Amp and Busduct lately, are Chapter 11 and Chapter 7 filings.

In a Chapter 11, the debtor is hoping to reorganize his or her debts and continue in business after approval and confirmation of a bankruptcy plan. In a Chapter 7, the debtor's assets are vested in a trustee and liquidated and distributed according to priority of class of creditors. Generally speaking, the debtor's assets in a Chapter 7 go first to tax authorities, followed by secured creditors, and then unsecured trade creditors. A creditor establishes how much he or she is owed by filing a proof of claim in the proceedings.

Q: I've filed a lawsuit; now what?

A: One reason bankruptcies are filed is to put the brakes on the separate pro-

ceedings facing the debtor and to have them all centralized in one forum: the bankruptcy court. If a creditor starts a lawsuit to collect an amount owed by the electrical subcontractor before it filed bankruptcy, that action would be "stayed" once the bankruptcy is filed. The creditor could not continue without express permission of the bankruptcy court and only in limited circumstances.

Q: I sold materials to the electrical subcontractor right before he filed. Is there any chance I can still get paid or get the materials back?

A: This depends. If a contractor (or any other entity) files bankruptcy, the date of filing is referred to as its "petition filing date." If the contractor purchased materials before it filed, the creditor does have a few options. The first is to send a written "Demand for Reclamation" for any materials that were received by the debtor during the 45-day period immediately preceding its filing date. There are a number of caveats, but it is an option to consider.

As for the second option, for the 20-

day period immediately before the filing date, the creditor may also be entitled to an "administrative claim" for the amount owed. This essentially moves that creditor to the top of the line for this portion of the claim.

Q: I was just paid by the debtor for some of the materials right before they filed. Am I at risk of having to repay the amounts I was paid?

A: Maybe. The notion of a bankruptcy is that classes of creditors are treated the same, and if a favorite creditor received a large payment outside of the ordinary course within 90 days of the bankruptcy filing (or one year if to an insider), it may be deemed preferential. One defense is that the payment was, in fact, in the ordinary course of business. This analysis involves looking back to review how earlier payments had been made.

The takeaway here is that everything changes when a customer files for bankruptcy protection. If it happens to you, seek the advice of an attorney who understands bankruptcy laws to quickly determine your rights. ■

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