

DOING BUSINESS IN A TROUBLED ECONOMY

Everyone knows the economy is in trouble. What most people don't know is how to avoid the pitfalls involved with doing business with troubled companies and individuals. Whether it's a new deal like a purchase, sale or loan, the settlement of a lawsuit or the negotiation of a long term lease or business relationship, the business issues should be tailored with a view towards a future bankruptcy filing. Although most of the tailoring should be done by attorneys who are experienced in bankruptcy and workouts there are some problems any business man can identify. Knowing that there is a potential problem will help to get a lawyer involved early enough in the deal to avoid "bankruptcy pitfalls".

It's not always easy to tell when a company or individual is a candidate for bankruptcy. Most types of individuals and companies except for banks, savings and loan companies and insurance companies, can file bankruptcy even if they are not "bankrupt". Even cities and counties can file a special type of bankruptcy.

Individuals and companies can file a Chapter 11 bankruptcy and remain in possession and control of their assets. Troubled businesses often try to settle disputes and work out problems with an eye towards unwinding the settlement or workout if and when they must file for bankruptcy.

Once in a Chapter 11 bankruptcy the "debtor in possession" or estate representative (the "Bankrupt") has remarkable powers that are not available outside of bankruptcy. These powers include: selling property free and clear of liens; obtaining a "priming lien" to finance the operations of the bankruptcy estate; rejecting leases and other types of "executory" or long-term agreements, restructuring debts; "avoiding" security interests and mortgages and other transfers of money and property that occurred up to two years before the bankruptcy case is filed; recovering gifts and other transfers of property made with intent to defraud creditors or made for less than reasonably equivalent value; forcing creditors to take little or no money on their claims and getting a discharge or release of debts.

Once a bankruptcy is filed the Bankrupt is protected by an automatic stay that prevents creditors from taking any action to collect or pursue their claims. In a Chapter 11 the Bankrupt can continue to conduct business, protected by the stay, without a court order. Thus it is too late for creditors to fix or address problems in their dealings with the Bankrupt.

Although the best solution to these risks is to hire a good bankruptcy attorney, there are things a smart business person can (and should) do to protect your interests. Below is a list of some of the most important:

1. Be Diligent

Bankruptcy penalizes the careless and rewards the careful. If you are claiming a security interest or mortgage you must be certain that all of the documents describing your security and "perfecting" the security (such as UCC-1 financing statements) must be exactly correct

and must be filed on time. If you delay or fail to file a proper UCC-1 or mortgage, or if you fail to file the documents in the proper place, you may lose your security.

2. Be Informed

Certain rights, such as the right to reclaim goods that are sold on credit, are triggered by a bankruptcy filing and certain actions are stayed by the filing. So it is important to know if a person has filed. The Bankrupt may not have filed in the place where they are doing business with you. A bankruptcy case can be filed in the state where the Bankrupt is incorporated, where it has its principal place of business or where it has its principal assets. If the Bankrupt is part of an affiliated group of companies the Bankrupt can file where any affiliate can file. Thus the Tropicana and the Montbleu casinos both recently filed bankruptcy in Delaware. You can get information about bankruptcy cases on PACER. A PACER account will let you find out who has filed bankruptcy and get copies of information filed in the bankruptcy case. The Pacer system also has a national index for U.S. District, Bankruptcy, and Appellate courts. <https://pacer.login.uscourts.gov>.

3. Be careful

Bankruptcy has been called a “trap for the unwary”. There are many things to be careful of before and after a bankruptcy case is filed. Here are a few:

Filing a claim in a bankruptcy case

If you are a creditor of a Bankrupt you will get a notice of the bankruptcy filing and a proof of claim. Filing a claim seems like a simple process. Creditors who want to file claims fill out the claim form they get from the bankruptcy court and file the claim with the court. Information on claim filing is available by calling the bankruptcy court clerk. In Reno the number is 784-5559. The recording will give you most of the information you need.

However, filing a claim is not always a good idea. If you are involved in a dispute or lawsuit with the Bankrupt filing a claim will make you subject “subject” to the bankruptcy court jurisdiction for all counterclaims the bankrupt might decide to bring against you. This means that you have just lost your right to have a trial on the Bankrupt’s case in your home court. You may find yourself defending a lawsuit filed by the Bankrupt in bankruptcy court in New York or Delaware. You have also waived your right to a jury trial. Even if there is litigation with the Bankrupt already started somewhere else. If you know the bankruptcy estate has lots of money to pay your claim, you don’t mind appearing in the bankruptcy court wherever it is and you think you have a great defense against the Bankrupt’s claims, you might go ahead and file your claim. If you are not sure – discuss the issues with a lawyer and do some investigation about the Bankrupt’s case.

Settling disputes and lawsuits

Settling disputes with troubled companies seems like a commendable idea. However, if you give up rights (like the right to record a judgment lien or to be paid in full) as part of a

settlement in exchange for a promise of a future payout and the payor files bankruptcy, the bankruptcy estate can recover the payments made to you within the 90 days before bankruptcy. Meanwhile, you do not have the right to “revive” the claims and/or liens and/or rights that you have given up in the settlement. You are “stayed”. Settlements have to be carefully structured to “bankruptcy proof” the benefits you are getting and the things you have given up.

Getting “great deals”

Troubled companies and individuals are often desperate to raise cash and will sell valuable assets at deep discounts. These “great deals” should raise red flags. If the seller files bankruptcy within two years after you buy the asset you may have to give the asset back. A sale for less than “reasonably equivalent value” can be set aside as a “fraudulent transfer” under the Bankruptcy Code even if no fraud was intended. Being a bona fide purchaser is no defense.

Next week – How Can You Protect Your Rights In A Bankruptcy Case?