



A Business Guide to Dealing with a Major Customer's Bankruptcy

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The number of incorporated businesses that declare bankruptcy is relatively low. Studies suggest that around 1 in 10 companies will file for bankruptcy protection at some point. Accordingly, the odds are in your favor that you won't be named as a creditor in a bankruptcy filing by one of your own customers.

But, in the unlikely event that it does happen, don't panic. In most cases the financial damage to your company and disruption to its operations resulting from a customer's bankruptcy can be minimized with a prompt and knowledgeable response.

Commercial Bankruptcy Filings Up Again in 2024

The volume of commercial bankruptcy filings for the year ending June 30, 2024 was 40 percent higher than for fiscal year 2023, which had also shown an increase over 2022 business bankruptcy filings. High interest rates, stringent lending standards and the end of pandemic-related financial assistance programs are among the key factors responsible for the recent increases.

According to most observers, however, the recent interest rate cut along with additional rate reductions expected later in 2025 will bring some much-needed relief and stability for many businesses. It should also result in an overall decrease of commercial bankruptcy filings.

Minimizing the Bankruptcy Filing of a Major Customer

The news that a large customer has declared bankruptcy can send shockwaves through an organization. It's not a routine event that most companies have a contingency plan for, but there are ways to respond to customer bankruptcies that will protect your company's financial interests, comply with legal requirements and limit operational disruptions.

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The following recommendations provide key information and detail the steps a company can take to meet the challenges related to the bankruptcy filing of a major customer.

Considerations After Being Notified of Customer's Bankruptcy Filing

- *Chapter 7 vs. Chapter 11* – Chapter 7 and Chapter 11 are the two most common bankruptcy options available to businesses and they differ significantly in their approach and outcomes. If your customer has filed a Chapter 7 bankruptcy, their assets will be sold off to pay its creditors and the business dissolved. In a Chapter 11 bankruptcy, the customer is asking for protection from creditors while they reorganize their debts and develop a plan to repay them over time. This process is overseen by the court and the goal is for the company to continue operations. (In recent years, about 60 percent of commercial filings have been under Chapter 11 and 40 percent under Chapter 7.) ***Please note that many Chapter 11 cases fail and end up converting to a liquidation under Chapter 7.**
- *Halt Shipment of Goods* – You have the legal right to halt the shipment of goods, provided they haven't been pre-paid. In the case that your customer has filed for a Chapter 7 bankruptcy and plans to liquidate, this option would be important to prevent those goods from being sold at a bankruptcy sale.
- *Cease Collection Attempts* – When a customer declares bankruptcy, an automatic stay is immediately imposed which prohibits its creditors from taking any collection action against them. This includes threatening letters or calls, foreclosures, repossessions or lawsuits.
- *File a Proof of Claim* – A proof of claim is a legal document filed with the court by a creditor in bankruptcy cases which formally states their right to receive payment from the debtor. It details the amount owed, basis of the debt and documentation supporting the claim. It's important to submit this claim in a timely manner to help protect your financial interests.
- *Preserve All Documents and Evidence* – Having accurate records of your sales transactions, payment terms, cancelled checks and other documentation or communication relating to your business relationship with the bankrupt customer is critical. This information will accurately present your company's side in any subsequent proceeding or liquidation sale.
- *Communicate with Your Customer and its Representatives* – Reach out and engage with your customer's management or legal counsel to discuss your claim and explore potential resolutions.
- *Monitor the Bankruptcy Proceedings* – Stay informed of the case's progress and any developments which may affect your claims. Attend all creditor meetings and review court proceedings. Understanding the case's progress enables an appropriate legal response.
- *Consult an Experienced Creditor's Rights Attorney* – Being involved in a bankruptcy case can be complex and confusing. Working with an attorney who has deep expertise in commercial bankruptcies and creditor's rights is recommended. It's the only way to fully protect your corporate interests and maximize your chances of recovering all or most that is owed.

Continuing to Do Business with a Customer in Bankruptcy



It's common for companies to continue a relationship with a customer that has filed for bankruptcy under the protection of a Chapter 11 proceeding. While there are certainly risks in working with a financially distressed business partner, there are also opportunities for mutual benefit. Some factors to consider include:

- *Customer Reorganization Plan* – Examine and evaluate the details and terms of how the customer's debts and repayment schedule have been restructured. Does it suggest that they have a viable plan for regaining financial stability? Does the customer appear to have the resources and will to continue doing business as normal? Would you like to continue doing business with this company?
- *Revisions to Your Contracts* -- Creditors continuing relationships with customers in bankruptcy proceedings will often revise their contracts with stricter payment terms, shorter payment cycles or more frequent payments. You may also want to consider requiring additional security for goods purchased, such as letters of credit, bonds, or personal guarantees.

The Bottom Line

The bankruptcy of a big customer can be a huge hassle. But if you understand and monitor the process and have experienced legal counsel, you're highly likely to weather the storm. By knowing your rights, protecting your claims and staying on top of all the bankruptcy proceedings, your company can limit its exposure, increase the chances for full recovery and avoid costly disruptions to the normal course of business.

Foster Swift's Bankruptcy and Restructuring Practice Group has decades of experience representing creditors, debtors, trustees and other parties in bankruptcy proceedings. Our team has extensive background in all areas of bankruptcy, including Chapter 11 reorganizations and Chapter 7 liquidations. If you are concerned about a pending bankruptcy matter involving your company or have other questions regarding insolvency or restructuring, please contact Scott Chernich, Scott Hogan or another member of our FREB team.