

# THE CREDIT TIMES



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## Doing Business with a Chapter 11 Debtor

Ever been put in a situation where a client has filed Chapter 11 Bankruptcy but wants to continue doing business? The following is an excerpt from an article provided by the Credit Research Foundation which may be useful if you find yourself confronted with that decision.

- \* Upon the filing of a Chapter 11 by a customer, vendors must determine whether to sell to the debtor post-petition.
- \* To avoid the inherent risk of a Chapter 11, vendors often sell on a cash before delivery or "CBD" basis.
- \* To remain competitive, vendors are sometimes compelled to extend credit terms to Chapter 11 customers. In this event, creditors should carefully evaluate the risk of non-payment in Chapter 11.
- \* The Bankruptcy Code treats credit extended to a Chapter 11 debtor in the ordinary course of business as an administrative expense priority claim. As indicated below regarding claim priorities, administrative expense claims enjoy a "high priority" and are generally paid, absent an "administrative insolvency".
- \* By contrast, extensions of credit that are not in the ordinary course of business must first be approved by the Bankruptcy Court, or they are not entitled to administrative expense priority treatment.
- \* At the time of the Chapter 11 filing, it is common for vendors to have open purchase orders from debtors that arose prior to the Chapter 11 filing, that provide for post petition shipment by the vendor.
- \* In a recent Bankruptcy Court ruling, the Court denied the vendor administrative expense priority status for post-petition shipments on pre-petition purchase orders since the shipment arose from a pre-petition contract.
- \* The practical solution to this problem has been for vendors to require the pre-petition purchase orders to be re-issued post-petition.
- \* Many debtors, particularly in larger cases, file a "first day" motion seeking an order from the Bankruptcy Court granting administrative claim priority for post-petition shipments on pre-petition orders, to avoid there-issuance of purchase orders.

*Continued on the next page...*

### In this Issue

- \* **Doing Business with a Chapter 11 Debtor**
- \* **Experian offer**
- \* **Believe it or Not**
- \* **Birthday Club**

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\* In a recent Bankruptcy Court ruling, a vendor sold goods to a Chapter 11 debtor on a cash before delivery basis. The Court later ordered the vendor to disgorge the payments received, since the Debtor did not have authority to use its cash (pledged to a lender) pursuant to a DIP financing or cash collateral order.

\* In the case of a pre-petition supply contract which provides for credit terms, debtors may assert that such contracts impose an obligation on the vendor to extend credit. While Bankruptcy Courts usually compel a vendor who is a party to a supply contract to ship goods, Bankruptcy Courts have rarely forced a vendor to extend credit to a Chapter 11 debtor.

\* Since a Chapter 11 filing effectively relieves the debtor of pre-petition debt, the debtor's post-petition cash flow may actually be healthier than it was pre-petition. However, creditors should independently evaluate the risks of extending credit to a Chapter 11 debtor. A key component of this evaluation should be the debtor's DIP financing and its impact on the debtor's working capital requirements.

Article provided by The Credit Research Foundation



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## *Believe It or Not*

***The 2016 NACM Credit  
Congress is around the corner!***

*This year it will be held in Las Vegas, Nevada  
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E-mail [brafferty@commercialcollection.com](mailto:brafferty@commercialcollection.com)  
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