

BANKRUPTCY LAW ALERT

Be Prepared for a Record Setting Year of Business Bankruptcy Filings

Last year, 10,084 companies filed for Chapter 11 bankruptcy, a 62 percent increase from 2007 and more than double the number of filings in 2006. The business bankruptcy surge is expected to continue in 2009 and is predicted to surpass the number of filings in 2008.

In light of these statistics, if your business is owed money from a company you suspect is in financial distress and on the brink of bankruptcy, your business should take certain precautions to ensure that it is in the best position to collect – and keep – its receivable.

Keep What You Receive: Avoid Having to Return Payments from Your Bankrupt Customers

Once a company files for bankruptcy protection, other than filing a claim with the Bankruptcy Court, you cannot make any efforts to collect an unsecured debt that you may be owed, and you will likely receive only a small portion of what you are owed years from the filing. This is always a frustrating concept for businesses that are owed money from companies that file for bankruptcy. To add insult to injury, the bankruptcy code contains preference laws which could result in your having to return funds that you received from the company within 90 days of its filing for bankruptcy protection. The good news is that the 2005 amendments to the bankruptcy code's preference laws have made it easier for creditors to defend against preference claims. However, with so many companies facing bankruptcy this year, businesses should take certain precautions to ensure that they are not required to return any funds they are paid by a company just prior to its bankruptcy filing.

One way to improve your chances of retaining funds you receive from a bankrupt debtor just before the filing is to keep your course of business dealings consistent even though the company appears to be headed for bankruptcy. In deciding whether funds should be returned, courts compare the parties' business relationship in the time just before the filing with the rest of the time they did business. If the business dealings are consistent over time, particularly just before the bankruptcy is filed, that business will most likely be able to keep the funds it received from a bankrupt debtor within the preference period.


Actions taken within 90 days before a bankruptcy filing will be closely scrutinized by a court in evaluating this issue. Courts focus on whether any undue pressure for payment was placed on the financially troubled company just before the bankruptcy filing, such as repeated phone calls and demand letters, that previously did not otherwise occur. If your company suddenly makes more phone calls than usual or writes a letter demanding payment, then those actions will likely constitute undue pressure that will result in your having to return the funds you received from the bankrupt company within 90 days of the bankruptcy filing.

With the current state of the economy and bankruptcy filings on the rise, businesses that remain consistent in their dealings with financially distressed companies will have the best chance of retaining funds they receive from companies that file for bankruptcy protection this year and in the future.

This Alert is written by Jessica Grossarth, an attorney in the Bankruptcy Law Section at Pullman and Comley, LLC. Please feel free to contact Jessica Grossarth or any of the attorneys listed below for more information.

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Obtain a Personal Guaranty From an Individual Associated with the Company

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Although bankruptcy laws prevent you from collecting a debt from a company once it files for bankruptcy and often allows the bankrupt corporation to pay you a fraction of what you are owed over time, these same protections do not extend to individuals who are personally obligated to pay the corporate debt.

Corporate owners, officers and/or directors are the most common individuals to become responsible for a corporation's debt. Typically, these individuals become responsible when they sign a personal guaranty promising to pay the corporation's debt in the event the corporation defaults.

Obtaining a personal guaranty from an individual associated with a company at the time you extend goods or services will provide you with a layer of financial security. A personal guaranty secured by the individual's home or other real property would be even more ideal. The added benefit in obtaining a personal guaranty is that it may be enforced against the individual even if the company chooses to close its doors as opposed to file for bankruptcy protection. Those who consider this issue before they are directly affected by the bankruptcy boom will at least have a chance of receiving payment in full despite these troubling economic times.

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