Tips For Dealing with Your Business Partner's Impending Bankruptcy

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Introduction

"Contracts are risk shifting devices"[1] that allocate leverage. But bankruptcy law alters negotiated leverage in many ways. The Bankruptcy Code's mirror policies are to: (1) give the debtor a fresh start and (2) provide equitable distribution to creditors. It is thus engineered to redistribute leverage to achieve these goals.

The bankruptcy estate is often referred to as a pie, and creditors compete for their share. A creditor's share depends on its rights against the debtor and the nature of its claim, which is normally fixed at the time of the bankruptcy filing. Because the treatment of creditors in a chapter 11 case is normally done by classes of claims,[2] any musical chairs must occur before the bankruptcy filing. Accordingly, pre-bankruptcy planning is critical and may make a significant difference in the creditor's ultimate share of the pie at the end of a bankruptcy case.

Tips To Dealing with Business Partner's Impending Bankruptcy[3]

I. Analysis of Underlying Documents

A creditor's understanding of its obligations and rights against the putative bankruptcy filer is critical. In contractual arrangements, the creditor should immediately determine whether the counterparty is in default. Depending on the creditor's obligations under the contract and the relative benefits it derives from the contract, terminating the agreement may be appropriate. Importantly, under section 365(e)(1) of the Bankruptcy Code,[4] the counterparty cannot terminate or modify its contract with the debtor merely because of a bankruptcy filing or financial condition, notwithstanding such provisions in the contract. The inability to terminate contracts could be problematic. The Bankruptcy Code gives the debtor until confirmation of a chapter 11 plan (which could be months) to decide whether to assume, assign, or reject executory contracts or unexpired leases. During this decision-making time, the debtor most likely may force the non-debtor to perform under the agreement, but the non-debtor cannot force the debtor to perform. *N.L.R.B. v. Bildisco and Bildisco*, 465 U.S. 513, 531 (1984).[5]

When the debtor has defaulted or is approaching a contract default, the counterparty must look beyond the contract's four corners to fully assess its leverage. For example, the creditor should investigate whether the debtor's default would cross-default its own or its affiliates' other agreements or credit facilities. An insolvent subsidiary may threaten bankruptcy and thus

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[1] Professor David S. Sokolow, Texas Law.

[2] *See* 11 U.S.C. § 1122(a) ("a plan may place a claim in a particular class only if such claim or interest is substantially similar to the other claims or interests of such class").

[3] This paper is focused on a chapter 11 reorganization case scenario.

[4] The Bankruptcy Code is 11 U.S.C. § 101 et seq.

[5] If the debtor requires that the parties perform under the agreement, the debtor is obligated to pay for the reasonable value of services. *N.L.R.B. v. Bildisco and Bildisco*, 465 U.S. at 531.

pressure the contract's renegotiation. But the creditor has more leverage knowing that the subsidiary's solvent parent is unlikely to allow a subsidiary bankruptcy that would cross-default the parent's credit facilities.

II. Secured Creditor Status In Anticipation of Bankruptcy

A. SECURED CREDITOR RIGHTS IN BANKRUPTCY

Secured creditors have better protections in bankruptcy than unsecured creditors. The following are just some examples:

Cash Collateral: Cash collateral is defined in 11 U.S.C. § 363(a). In general, it means any of the debtor's cash or cash equivalents (including accounts) in which another party also has an interest. Cash collateral cannot be used without (i) the court's order or (ii) the other party's consent. This restriction on cash collateral is often the reason why debtors seek emergency hearings of "first day motions" in the initial days of a bankruptcy case. Absent consents, the debtor cannot use cash collateral unless it gives the non-debtor party "adequate protection" of the party's interest, meaning that the debtor's use of the cash collateral will not diminish the value of the party's secured interest (at the time of the bankruptcy filing). Adequate protection may be given in a variety of ways, including giving the secured creditor periodic cash payments, a replacement lien on other assets, or some form of value equivalent.

Stay relief: The automatic stay may be lifted for "cause," including the lack of adequate protection. 11 U.S.C. § 362(d). The secured creditor may ask the court to lift the stay to permit it to foreclose on its lien if it does not receive adequate protection.

Sale rights: The debtor can sell its assets under Section 363 of the Bankruptcy Code free and clear of interests in property, including liens. 11 U.S.C. § 363(f).[6] Some debtors file bankruptcy because of the ability to sell assets free and clear. However, the debtor must satisfy certain criteria to sell free and clear (*see id*. § 363(f)(1)–(5)), usually if the secured creditor consents or the sale proceeds exceed the lien's value. The lien will attach to the sale proceeds. Further, unless the court orders otherwise for cause, the secured creditor may credit bid its claim in a sale of assets subject to its lien. 11 U.S.C. § 363(k).

Cramdown: Creditors vote to accept or reject the chapter 11 plan within classes. For example, tort claims, government claims, asbestos claims, and trade claims may all be separated by classes in a chapter 11 plan. Votes are tallied by class, but unanimity is not required. *See* 11 U.S.C. § 1126(c). But secured creditors are normally placed in individual classes, and thus it can control its own class's vote. If the class votes to reject the plan, the

[6] *See also* 11 U.S.C. § 1141(c) (except as otherwise provided in the plan or in the order confirming the plan, after confirmation of a plan, the property dealt with by the plan is free and clear of all claims and interests of creditors, equity security holders, and of general partners in the debtor.")

debtor must "Cramdown" the class under the requirements of 11 U.S.C. § 1129(b). For secured creditors, that means that the debtor must satisfy one of the three requirements in 11 U.S.C. § 1129(b)(2)(A). These include providing the secured creditor (1) retention of its lien or deferred cash payments, (2) in the event of a sale, a lien on the sale proceeds, with the right to credit bid, or (3) the indubitable equivalent of the secured creditor's interest (such as the return of the collateral).

Interest and fees for oversecured creditors: An oversecured creditor may be entitled to reasonable attorneys' fees and interest (to the extent the agreement provides for both). 11 U.S.C. § 506(b). Such interest and fees will be limited to the extent of the equity cushion, and the interest and fees may not be immediately payable, but rather may be included in the oversecured creditor's ultimate allowed claim in the bankruptcy.

Note: Except with respect to statutory liens, lien perfection on prepetition debt must be accomplished before the bankruptcy, and preferably at least 90 days prior to the bankruptcy. The bankruptcy trustee or debtor in possession may avoid liens that are perfected within the 90 days prior to the bankruptcy. 11 U.S.C. § 547(b).[7] Whether the creditor properly perfected its lien will be governed by applicable non-bankruptcy law.

B. MINERAL LIENS UNDER TEXAS AND LOUISIANA LAW

Some states including Texas and Louisiana protect service providers in the oil and gas industry for payment of their services. Section 56.002 of the Texas Property Code provides that "a mineral contractor or subcontractor has a lien to secure payment for labor or services related to the mineral activities."[8]

The Louisiana mineral lien statue is referred to as LOWLA (the Louisiana Oil Well Lien Act). "[T]he purpose of the Oil Well Lien Act is to protect those . . . who contribute labor, services, and equipment to the drilling of wells from the default of those engage them." *Guichard Drilling Co. v. Alpine Energy Servs.*, 657 So. 2d 1307 (La. 1995).[9]

[7] *Imagine Fulfillment Services, LLC v. DC Media Capital, LLC (In re Imagine Fulfillment Serv., LLC)*, 489 B.R. 136, 151 (Bankr. C.D. Cal. 2013) ("the mere act of perfecting a security interest within the preference period has a preferential effect as it allows that creditor to realize more than it otherwise would have in a liquidation under Chapter 7.").

[8] Under Texas law, "mineral activities means digging, drilling, torpedoing, operating, completing, maintaining, or repairing an oil, gas, or water well, an oil or gas pipeline, or a mine or quarry." Tex. Prop. Code § 56.001. "Mineral contractor means a person who performs labor or furnishes or hauls material, machinery, or supplies used in mineral activities under an express or implied contract with a mineral property owner or with a trustee, agent, or receiver of a mineral property owner." *Id*.

[9] The parties that may asset the lien are listed in LA Rev Stat § 9:4862.

1. What Does the Texas Mineral Lien Cover?

Section 56.003 of the Texas Property Code provides that the following property are subject to the lien:

> (1) the material, machinery, and supplies furnished or hauled by the lien claimant;
>
> (2) the land, leasehold, oil or gas well, water well, oil or gas pipeline and its right-of-way, and lease for oil and gas purposes for which the labor was performed or material, machinery, or supplies were furnished or hauled, and the buildings and appurtenances on this property;
>
> (3) other material, machinery, and supplies used for mineral activities and owned by the owner of the property listed in Subdivision (2); and
>
> (4) other wells and pipelines used in operations related to oil, gas, and minerals and located on property listed in Subdivision (2).

While the lien does not affect an encumbrance that attached to land or a leaseholder before the lien's inception (Tex. Prop. Code § 56.004(a)), "the lien on material, machinery, supplies, or a specific improvement takes priority over an earlier encumbrance on the land or leasehold on which the material, machinery, supplies, or improvement is placed or located." Tex. Prop. Code § 56.004(b).

2. What Does LOWLA Cover?

Section 9:4863 of LOWLA provides that subject to certain limitations, the privilege given by R.S. 9:4862 is established over:

> (1) The operating interest under which the operations giving rise to the claimant's privilege are conducted together with the interest of the lessee of such interest in a:
>
> (a) Well, building, tank, leasehold pipeline, and other construction or facility on the well site.
>
> (b) Movable on a well site that is used in operations, other than a movable that is only transiently on the well site for repair, testing, or other temporary use.
>
> (c) Tract of land, servitude, and lease described in R.S. 9:4861(12)(c) covering the well site of the operating interest.
>
> (2) Drilling or other rig located at the well site of the operating interest if the rig is owned by the operator or by a contractor from whom the activities giving rise to the privilege emanate.
>
> (3) The interest of the operator and participating lessee in hydrocarbons produced from

the operating interest and the interest of a non-participating lessee in hydrocarbons produced from that part of his operating interest subject to the privilege.

(4) The proceeds received by, and the obligations owed to, a lessee from the disposition of hydrocarbons subject to the privilege.

3. When Must the Lien Be Filed?

Both the Texas and Louisiana statutes permit the contractor to perfect its lien by filing in the real property records of the county or parish within 6 months of the accrual of the indebtedness.[10] *See* Tex. Prop. Code § 56.021(a); La. Rev. Stat. § 9:4865.[11]

In Texas, the claimant must initiate an action in court to enforce the lien through foreclosure. Tex. Prop. Code § 53.154. The suit must be brought within the later of (i) two years after the last day a lien claimant may file its lien affidavit or (ii) one year after the completion, termination, or abandonment of the work. *Id*. at § 53.158.

In Louisiana, the claimant must initiate an action for enforcement of the privilege within a year of the filing and file a Notice of Lis Pendens within 30 days of the initiation of the lawsuit (except with respect to drilling or other rigs). *Id*.

4. How Does Bankruptcy Affect the Lien?

Under Section 546(b) of the Bankruptcy Code, the bankruptcy trustee (or debtor in possession) cannot avoid a statutory lien that is perfected in accordance with applicable law. Thus, the bankruptcy trustee cannot avoid the mineral liens properly perfected by Chapter 56 of the Texas Property Code or LOWLA. In fact, the bankruptcy filing will not interfere with the service provider's 6-month window within which to file the lien under Texas or Louisiana law. *See* 11 U.S.C. §§ 362(b)(3) (an exception to the automatic stay); 546(b). The automatic stay would prevent, however, the enforcement of the lien absent relief from the automatic stay.

III. Other Security Vehicles

The bankruptcy of a business does not affect the obligations of any other party. 11 U.S.C. § 524(e). Thus, a creditor who is the beneficiary of a guaranty from the business's principal or financially solvent affiliate has bargaining leverage when the debtor is financially vulnerable. *See, e.g., F.D.I.C. v. Municipality of Ponce*, 904 F.2d 740, 747–48 (1st Cir. 1990); *Sandy Ridge Dev. Corp. v. La. Nat'l Bank (In re Sandy Ridge Dev. Corp.)*, 881 F.2d 1346, 1351 (5th Cir. 1989).

A letter of credit is another attractive form of security in a bankruptcy scenario. The issuer of a letter of credit (for example, a bank) forms an independent contract with the creditor (the

[10] *See* Section 56.005 of the Texas Property Code for "Accrual of Indebtedness."

[11] *See* Tex. Prop. Code § 56.021 and La. Rev. Stat. § 9:4865 for other requirements.

beneficiary). The issuer agrees to perform (usually a tender of funds to the beneficiary/creditor) in the event of certain circumstances such as a default of the applicant/debtor on obligations to the beneficiary/creditor. Because of the independence rule, the automatic stay does not prevent the issuer from honoring the letter of credit to the beneficiary. *See, e.g., First Fidelity Bank, N.A. v. Prime Motor Inns, Inc. (In re Prime Motor Inns, Inc.)*, 130 B.R. 610, 614 (Bankr. S.D. Fla. 1991); *Kellogg v. Blue Quail Energy, Inc. (In re Compton Corp.)*, 831 F.2d 586, 589 (5th Cir. 1987). The letter of credit should be drafted to permit the beneficiary to submit a certificate to the issuer (instead of the debtor) notifying of the draw condition, e.g., the bankruptcy filing.

IV. Reclamation In and Out of Bankruptcy

The Uniform Commercial Code (UCC)[12] gives a seller remedies in the event the buyer is insolvent or the seller believes the buyer may be insolvent. Under UCC § 2-702(1), the seller can refuse delivery to an insolvent buyer other than on cash terms. Further, the seller has 10 days to reclaim the goods from a buyer the seller discovers is insolvent (unless solvency was misrepresented). UCC § 2-702(2). The seller can also stop a shipment of goods that are in transit to an insolvent buyer or if the parties' agreement is breached. Insolvency can be evidenced by balance sheet insolvency or the inability to pay debts as they become due.

The seller is often unaware of a buyer's solvency. UCC § 2-609 permits a seller that has reasonable grounds to be insecure about the buyer's performance to request adequate assurance of the buyer's ability to perform under the contract. The buyer must respond within a reasonable time, but not later than 30 days. The seller can suspend delivery pending the receipt of the adequate assurance if such suspension is commercially reasonable. The insecure party can treat the contract as repudiated if the other party does not provide such adequate assurance or refuses to respond.

The Bankruptcy Code also provides a reclamation remedy in 11 U.S.C. § 546(c). The seller must make a written demand for reclamation (i) not later than 45 days after the debtor's receipt of the goods or (ii) not later than 20 days after the bankruptcy filing if the 45 day period expires after the bankruptcy filing. Like in the UCC, the debtor must have been insolvent when it received the goods. The Bankruptcy Code's reclamation right is subject to the rights of a secured creditor who was previously given a secured interest in the goods or their proceeds. However, the seller will have an administrative expense for the value of any goods that the debtor received within 20 days before the bankruptcy filing. The debtor cannot emerge from chapter 11 without confirmation of a plan that pays administrative expenses in full (unless the parties agree otherwise). 11 U.S.C. § 1129(a)(9)(A).

[12] The Texas version of the Uniform Commercial Code is in TEX. BUS. & COM. CODE ANN. §§ 1.101 et seq.

V. Prepetition Litigation

If the debtor breaches a contract or fails to pay money due and owing, a natural first step in pursuing collection is initiating a lawsuit. If the case would not involve disputed facts, the creditor may obtain summary judgment, which could be a materially faster method of obtaining a judgment than through a trial on the merits. The ultimate goal of going through the litigation process is to enforce a judgment and collect assets to the satisfy the judgment, or at least obtain secured creditor status for all of the reasons mentioned in Section II above.

The risk of pursuing litigation, though often there is no better alternative, is that the debtor may file bankruptcy at any point in the litigation, which would immediately trigger the automatic stay. *See* Section VIII below. If the bankruptcy is filed after a judgment has been entered, the claim is likely to be allowed in the bankruptcy for the same amount. Theoretically, the debtor could object to the claim in the bankruptcy on the basis that an appellate court would have likely reversed or reduced the judgment. If the bankruptcy is filed before judgment, the bankruptcy court could liquidate the claim either in the bankruptcy court, or lift the automatic stay and allow the non-bankruptcy court to continue adjudication of the case. In either scenario, the ultimately allowed claim would be treated according to the terms of a confirmed chapter 11 plan.

VI. Preference Exposure

The Bankruptcy Code gives the bankruptcy trustee or debtor in possession the power to recover payments on antecedent debt made to creditors within the 90 days before the bankruptcy filing. There are two sides of preference analysis to understand: (1) the requirements for a preference and (2) defenses against preferences.

A preference necessarily requires the "transfer" of the debtor's interest in property. 11 U.S.C. § 547(b). Thus, if the creditor received a payment from the debtor's affiliate or other entity, the payment will not be a preference.[13] But the definition of transfer is broad, and thus could include more than the payment of money. For example, the debtor's issuance of a guaranty or grant of security interests in its property could be considered a preference.[14] The transfer also has to be for an "antecedent debt." Thus, advanced payments for goods or services are not considered preferences.[15] The transfer must also entitle the creditor to more than it would be entitled to receive in chapter 7 (a liquidation). For that reason, secured

[13] *See, e.g., Hofmann v. Drabner (In re Baldwin)*, 514 B.R. 646, (Bankr. D. Utah 2014) ("Generally, a transfer of money or property owned by a third person to a creditor of a debtor is not a preference.") (internal citations and quotations omitted); *Krommenhoek v. Estate of Pfankuch Food Servs., Inc. (In re Pfankuch)*, 393 B.R. 18, 24 (Bankr. D. Idaho 2008) (same); see also *Ellenberg v. First Nat'l Bank (In re Hollvey)*, 15 B.R. 850, 851 (Bankr. N.D. Ga. 1985).

[14] *See Rubin Bros. Footwear, Inc. v. Chemical Bank (In re Rubin Bros. Footwear, Inc.)*, 73 B.R. 346, 355 (Bankr. S.D.N.Y. 1987) ("The grant of a security interest by a debtor, however, is itself a "transfer" within the definition of Section 547 of the Bankruptcy Code.").

[15] *Rooster, Inc. v. Raphael Roy, S.R.L. (In re Rooster, Inc.)*, 127 B.R. 560, 567 n.8 (Bankr. E.D. Pa. 1991).

creditors are normally not subject to preference actions.[16] The preference must have been made to the creditor within 90 days of the bankruptcy filing (but the preference period is a year for insiders). Most courts hold that a "transfer" occurs, for preference purposes, when the creditor receives payment, rather than when the debtor issues payment. *See, e.g., Barnhill v. Johnson*, 503 U.S. 393, 394-95 (1992) (holding that, for preference purposes, a transfer made by check is deemed to occur on the date the check is honored, rather than the date of payee's receipt of the check). If any of these elements are not met,[17] the transfer will not be a preference.

Even if the transfer is considered a preference, there are a variety of defenses. The three most common are (1) contemporaneous exchange, (2) new value, and (3) ordinary course. The contemporaneous exchange exception protects transfers to the extent they were intended by the debtor and creditor to be a contemporaneous exchange for new value and were in fact substantially contemporaneous. *See* 11 U.S.C. § 547(c)(1). The new value defense applies when the creditor delivers "money or money's worth" (*see* 11 U.S.C. § 547(a)(2)) to the debtor after receiving the preferential payment. *See* 11 U.S.C. § 547(c)(4). For example, if a furniture retailer paid a wholesaler's invoice but the wholesaler shipped more inventory, the estate will have been provided with new value from which the debtor's other creditors may benefit. Finally the ordinary course exception protects certain transactions that are (i) in the ordinary course of business for the debtor and the transferee or (ii) ordinary course in the parties' industry. *See* 11 U.S.C. § 547(c)(2). Thus, ordinary course applies if, for example, the preference payment was a 45-day late payment but such lateness is in line with the debtor's payment history to the creditor within the prior year. As to ordinary course in the industry, a retailer of holiday goods may receive the inventory on credit months before payments are actually made in the ordinary course when customers purchase the holiday items.

If a creditor believes its debtor may file bankruptcy, the creditor should closely monitor the payments it receives from the debtor. Payment in advance of shipment of goods or performance of services will normally defeat a preference claim. If the payments received are in the ordinary course of the parties' business dealings, the payment can be defended. Activity that may defeat ordinary course is requiring payment quicker than usual, by an alternative payment means (e.g., wire versus check), and increased or unusual collection activity. Of course, receiving cash is usually better than not and thus the creditor will need to weigh the risks of a preference versus receiving certainty of payment.

[16] *See Redmond v. SpiritBank (In re Brooke Corp.)*, 541 B.R. 492, 522 (Bankr. D. Kan. 2015) ("Generally, payments to a fully secured creditor will not be considered preferential because the creditor would not receive more than in a chapter 7 liquidation.").

[17] The elements of preference are all contained in 11 U.S.C. § 547(b).

VII. Involuntary Bankruptcy

Companies in financial distress may be forced into bankruptcy by its creditors.[18] An involuntary case is commenced if at least three entities (if the company has more than 12 creditors) holding unsecured claims totaling, in the aggregate, at least $15,775 that are either non-contingent as to liability or the subject of a bona fide dispute (as to either liability or amount) file an involuntary petition. The petitioning creditors must serve the involuntary petition with a summons like a lawsuit. The putative debtor may either consent to the bankruptcy filing or challenge it. If the debtor challenges the involuntary, the bankruptcy court will hold an evidentiary hearing to determine whether the company is generally paying its debts as they become due (unless those debts are subject to a bona fide dispute as to liability or amount) or whether a custodian had been appointed within the past 120 days to take possession or control of substantially all of its assets. 11 U.S.C. § 303(h). Until the court enters an order approving the involuntary, the debtor may continue operating and using, acquiring, and/or disposing of property without prior court approval as if an involuntary case against the debtor had not been commenced. 11 U.S.C. § 303(f).

If the involuntary petition was filed in bad faith and the involuntary case is dismissed, a debtor may be awarded damages, including punitive damages, under 11 U.S.C. § 303(i). Reckless disregard of information may lead to a determination of bad faith. Bad faith may also be found if an involuntary petition was filed to harass. *See, e.g., Adell v. John Richards Homes Bldg. Co. (In re John Richards Homes Bldg. Co.)*, 439 F.3d 248, 256–57 (6th Cir. 2006).

VIII. The Automatic Stay

The automatic stay is a statutory injunction prohibiting a variety of collection remedies normally afforded to creditors. Several policies underlie the automatic stay. Chief among those are (1) preserving the status quo of the debtor's assets and value at the time of the bankruptcy filing, (2) equalizing the creditor body's position as to the debtor's assets, and (3) giving the debtor a breathing space in the initial phase of the bankruptcy. Without the automatic stay, an unsecured creditor with more financial wherewithal will have a strategic advantage over "mom and pop" creditors, though both have the same rights against the debtor.

Violation of the automatic stay may result in sanctions. *See* 11 U.S.C. § 362(k) ("an individual injured by any willful violation of the stay . . . shall recover actual damages, including costs and attorneys' fees, and in appropriate circumstances, may recover punitive damages.")[19] Among the prohibited activities are:

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[18] Section 303 of the Bankruptcy Code addresses involuntary bankruptcies.

[19] Although the statute refers to an "individual injured," some courts have applied the statute to business cases. *See Atl. Bus & Community Corp. v. Cuffee (In re Atl. Bus & Community Corp.)*, 901 F.2d 325, 329 (3d Cir. 1990) ("the section has uniformly been held to be applicable to a corporate debtor"); *Budget Service Co. v. Better Homes of Va.*, 804 F.2d 289, 292 (4th Cir. 1986) (determined that the word "individual," while not defined in the bankruptcy code, includes corporations).

- Continuing or initiating a lawsuit against the debtor for any claims that could have been asserted pre-bankruptcy;
- Calling the debtor or sending demand letters seeking collection of prepetition debt;
- Perfecting a lien against the debtor's assets;
- Terminating your agreement with the debtor merely because of the bankruptcy filing or the debtor's financial condition;
- Foreclosing on the debtor's assets; and
- Seizing or taking control of any of the debtor's assets.

Importantly, the automatic stay applies to claims that could have been asserted prior to the bankruptcy case. Thus, if the debtor commits a tort post-bankruptcy such as intentional interference with business, the creditor should be able to commence an action against the debtor. 28 U.S.C. § 959(a) states: "Trustees . . . including debtors in possession, may be sued, without leave of the court appointing them, with respect to any of their acts or transactions in carrying on business connected with such property."

A general rule of thumb is that it is better to seek permission than forgiveness. If a creditor believes that a course of action may violate the automatic stay (even if a slight chance), it is normally best practice to seek a lift or modification of the automatic stay. A violation of the automatic early in the case could sour the judge's view of the creditor going forward in the case.

IX. Proofs of Claim in Bankruptcy

In general, creditors are paid in a chapter 11 case under a confirmed chapter 11 plan of reorganization if (i) the debtor schedules the creditor's claim in its bankruptcy disclosures and does not list the claim as contingent, disputed, or unliquidated or (ii) the creditor files a proof of claim in the bankruptcy case. *See* 11 U.S.C. §§ 501, 1111(a); Fed. Rule Bankr. P. 3003. In chapter 11 cases, the debtor will often seek approval of a "bar date," the deadline by which creditors must file their proof of claim. The deadlines vary, but 90 days after the creditors meeting (which usually occurs 1-2 months after the bankruptcy filing) is a general default. Federal Rules of Bankruptcy Procedure 3001–3003 set forth the requirements for filing a proof of claim in bankruptcy cases. Many local bankruptcy rules also contain certain requirements.

Before filing a claim, the creditor should consult with its counsel. There may be strategic reasons not to file a claim even though the filing may be the only way to ensure that the creditor receives a distribution in the bankruptcy case. Some commentators state that the filing of a proof of claim "submits the creditor to the jurisdiction of the bankruptcy court." This statement is not entirely accurate. Claims against the bankruptcy estate are normally

adjudicated by the bankruptcy court (except personal injury claims). The question is whether the bankruptcy court may also adjudicate claims by the bankruptcy estate against creditors. If the bankruptcy estate's claim against the creditor is a garden variety claim that arises under state law, the bankruptcy court normally will not have the power to adjudicate that claim unless the parties consent.[20] The creditor's filing of a proof of claim does not change this analysis. *See Stern v. Marshall*, 564 U.S. 462 (2011) (holding that the bankruptcy court erred by adjudicating a state law tortious interference claim merely because the creditor filed a proof of claim). But if the claim against the creditor is factually intertwined with the creditor's claim against the estate or the claim is of the type listed in 11 U.S.C. § 502(d) (including preferences and fraudulent transfers), then the filing of a proof of claim will mean that the bankruptcy court will have the power to adjudicate the claim against the creditor.[21]

X. Contact Counsel

This paper is only a preview of the potential menu of options when faced with the threat of a counterparty's bankruptcy. A party's rights will vary from state to state and contract to contract. Legal counsel can assist with wading through the options when dealing with a potential bankrupt entity.

Further, the unprepared creditor may be caught off guard in the initial days of a bankruptcy case. Normally, the debtor's legal and financial advisors have spent days, maybe weeks, preparing for the bankruptcy filing. A slew of procedural and substantive motions ("first day motions") normally accompany the bankruptcy petition. The bankruptcy court may hear these first day motions within 1-3 business days after the filing. Creditors may receive notice of the bankruptcy and motions only on the eve of the first hearing. Legal counsel that is familiar with the agreements, liens, and other documents will likely be in a better position to counsel the creditor in these critical early case developments.

[20] However, the bankruptcy court may preside over pre-trial matters and may conduct the trial and submit proposed findings of fact and conclusions of law to the federal district court. 28 U.S.C. § 157(c)(1).

[21] For further explanation, *see Navigating Through the Post-Stern Word: A Comprehensive Survey of Cases Meaningfully Discussing Stern v. Marshall*, Omar J. Alaniz, 23rd Annual Conference on State and Federal Appeals, UT CLE.