



MORE is better than less.

## Dear Friends:

Though we are optimistic about 2024, the economic challenges and uncertainty of the past year continue to impact your customers, with bankruptcy filings on the increase as federal pandemic support programs come to an end. This issue's feature article offers some guidance to protecting your accounts receivable portfolio from losses and what to do when a customer declares bankruptcy. Your best defense is a good offense when bankruptcies happen. Review and secure all related documents and be prepared to act quickly as the case progresses.

Our calendar for the New Year is filling up fast. On January 6, Szabo Associates will celebrate our dedicated staff at the 2024 Annual Szabo Employee Appreciation Party in Atlanta. Then Szabo will present "Terms and Conditions of Media Credit Sales" at the Media Financial Management (MFM) Town Hall Webinar on February 20. Next, we hope to see you at the 2024 MFM CFO Summit in Orlando, March 18-20.

All of us at Szabo Associates wish you a very Happy New Year and a healthy and prosperous 2024.

Robin Szabo, President  
Szabo Associates, Inc.

## Bankruptcies Are On The Rise... Are You Prepared?

With rising bankruptcy filings, it is important for credit and collections professionals to be prepared with a plan to protect their accounts receivable.

In 2022, business bankruptcy filings reached a fifteen-year low, with less than 13,500 cases filed, according to statistics published by the Administrative Office of the U.S. Courts. The unusually low number of filings was mostly attributable to the various federal COVID funding programs through the U.S. Small Business Administration and the Employee Retention Credit, which helped keep many businesses afloat.

Today, most of that funding has been used, and rising inflation and higher interest rates have created a challenging business environment. Business bankruptcies in the United States rose by more than 30 percent over the past 12 months, reaching 17,051 new cases for the period ending September 30, 2023.

The bankruptcy rate has been highest among larger companies. Companies with more than \$1 billion in assets have filed at a faster pace in 2023, according to the consulting firm Cornerstone Research. These filings include large retail chains, such as Bed, Bath & Beyond and Rite Aid. It is expected, however, that smaller and mid-sized filings will rise faster in the months ahead.

### Chapter by Chapter.

The business bankruptcies you will most likely encounter are Chapter 7 and Chapter 11, though a Chapter 11 can be further broken down into a SubChapter V. You may also come

across a few Chapter 13 filings for cases where you have an individual who is operating as a sole proprietor.

Chapter 7 is the most common type of bankruptcy and is available to both individual and business debtors. It is often referred to as Chapter 7 Liquidation as a company in a Chapter 7 ceases all operations and goes out of business. An appointed or elected trustee collects the debtor's non-exempt property, sells it, and distributes the proceeds among creditors. Unless otherwise instructed by the court, creditors must file a claim with the court within 90 days after the first date set for the first meeting of creditors (341 meeting) to have a chance of getting paid. There are Chapter 7 cases where there are no known assets at the time of filing and the court will notify you not to file a Proof of Claim (POC) until such time as assets may be found.

Chapter 11 is designed to "reorganize" a business' or an individual's finances through a court-approved plan, thus allowing the business to emerge from bankruptcy able to continue operations. The goal is to restructure the entity, not liquidate it as in a Chapter 7. It is typically used by businesses, corporations, proprietorships, or partnerships and is filed by individuals with assets and liabilities that exceed the monetary limits required for Chapter 13. Although Chapter 11 does not require creditors to file a Proof of Claim if the creditor

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recognizes its claim (listed in an indisputable amount on the schedule of liabilities filed by the debtor), it is *always* a good idea to file a Proof of Claim. The debtor will prepare a Disclosure Statement and Plan and submit it to the court for approval. The Disclosure Statement will provide insight into the debtor's financial situation and the Plan is proposed to allow payment to creditors, restructure the business model, and allow for the entity to emerge from bankruptcy. If the Plan is approved by the court, it is then submitted to creditors for a vote to accept or reject.

A relatively new option, Chapter 11 SubChapter V, took effect through the Small Business Reorganization Act. Businesses with up to \$7.5 million in debt are eligible. A trustee is appointed to oversee the business, assets, and distributions. The court has the authority to approve or reject the Plan, rather than creditors. These cases can be favorable for small businesses – and much faster and less expensive than standard Chapter 11 cases – and are on the increase. However, SubChapter V can be less favorable for a debtor and its management team in the regard that the trustee is in charge until the business emerges from the bankruptcy.

Regardless of the chapter, at the top of the ranking for receiving payment are Administrative Creditors. These are professionals that have helped administer the bankruptcy in some way. They are not related to past due debt, rather debt related to administration of the estate. Next come Secured Creditors, followed by Priority Creditors, such as tax claims from the Internal Revenue Service. Last to be paid are General Unsecured Creditors, the most common type of creditor. Unfortunately, advertising bills fall into this lowest ranked category.

### Case Progression.

The dreaded notice is received; your customer has filed bankruptcy. First and foremost, ensure a Proof of Claim is filed for the amount

you are owed, if the case is not a Chapter 7 No Asset. Bar dates will be set and your Proof of Claim must be received by the court prior to any Bar Date in order to protect your claim. With Chapter 11 cases, if your claim is not disputed and is reflected accurately in the debtor's records, you are not required to file a POC; however, the best practice is to do so.

*Review and secure all documents.* Your documents may reveal you have other parties to pursue. Were any payments made to you within 90 days of the bankruptcy filing? If so, ensure you preserve the documents showing what was received, from who, and applied where. Your best defense to any possible issue in the future will be your documentation. Operating systems change and documents can be misplaced, so maintain your records and do not discard any until after the bankruptcy has been concluded.

*Proof of Claim is filed.* Once the Proof of Claim is filed, you will receive notices from the court. Go through all notices received to determine if further action is needed or not. Some are informational in nature and some will require action. Diligence is required to wade through all the notices and determine when additional action is needed.

*Your vote counts.* Review and vote on any plan received. If your customer is in a Chapter 11 or Chapter 13, a Disclosure Statement and Plan will be submitted for your review and vote. The Disclosure Statement is just as it sounds. It discloses the debtor's assets, liabilities, and financial situation in order to present you the information you need to vote for, or against, the proposed plan. The Plan will spell out the classification of creditors and what they will receive under the reorganization if approved. As with everything in bankruptcy, there is a deadline to vote.

*An Objection to your claim may occur.* If you receive an Objection, determine the deadline to respond and act quickly. Objections can be as simple as moving a Proof of Claim from one case to another in a jointly administered bankruptcy, or as complicated as not recognizing your claim as the debtor did not deal with you directly, but rather they dealt with a third party such as an advertising agency. Regardless of

the reason for the objection, there are strategies and ways to address objections and if you are uncertain, it is best to seek the assistance of your collection professional or bankruptcy counsel.

*Preference demands and adversary actions (preference actions).* If the debtor paid invoices for one creditor but not others within the 90 days prior to filing bankruptcy, that creditor can be said to have received preferential treatment. The bankruptcy statutes allow the debtor's attorney or trustee to make a preference demand to seek recovery of the monies paid. Prepare a days paid analysis going back two years if possible. This is where maintaining good records can make a vital difference.

There are defenses and techniques for answering these preference demands, one of which is that the payment was received in the ordinary course of business. This is where the days paid analysis will offer insight. Regardless, it is important to respond quickly and ask for any additional time needed to counter the demand and to allow you to speak to counsel or your collection professional to determine if one of these defenses will apply to your case.

### Plan of Action.

Protecting your accounts receivable portfolio from losses should always be a top priority. In some cases, the best defense is a good offense and in this case a sound credit and collection policy is the answer. Your policy needs to be adaptable to changes in your business environment, the economy, and your customer composition. And most importantly, it needs to be easily understood and adhered to by all of your staff and agents that are involved (sales, credit, collections) and fully supported by management.

Protection begins with the completion and signing of your credit application agreeing to your liability and payment terms and conditions by all the parties involved in the buy: advertiser, advertising agency, and buying service. Having a signed credit application binding all the parties can be very useful in the event you have to resort to placing the

account for collection, suing to collect, or in the event of a customer bankruptcy filing. The credit decision follows next, and if credit is granted, limits should be set and monitored. Setting limits keeps your customer in check and reduces your exposure to unnecessary risk.

Collection activity is a vitally important part of your plan with the key being to start early no matter if sales or the collection department is the first to initiate communication. Begin with your newest customers, training them to pay you on time, followed by your biggest dollars, then those that are historically slow. Your goal is to contact all your customers through a combination of voice and email weekly until payment or a payment commitment is obtained.

When an advertising agency is involved, try to find out at the time of the buy what terms of payment they have established with the advertiser. Many times they are paid before your bill arrives, so don't wait to contact them about payment in these cases. If they have agreed to extended terms with the advertiser and depending on the dollars being spent and the relationships, negotiate a set payment date that you can live with,

obtain a written guarantee, or require cash in advance. Keeping a good line of communication open with your customer and consistent collection activity, will help you avoid an unforeseen bankruptcy filing.

Additionally, having a good dashboard of information about your accounts receivable portfolio is an easy way to spot potential problems and allow you time to take corrective actions. Information by both the customer and the customer's industry sector will give you a comprehensive view.

Customer information with these real-time data points are essential: credit limit and available credit; open invoices by age; total dollars outstanding and percentage to total A/R; customer concentration percentage; industry segment and concentration percentage; average days paid: rolling 12 months, past 3 months, past month with alerts if days paid increases by 15 days against previous 3-month average; new order amounts rolling 12 months, past 3 months, past month with alerts if amount increases by 25 percent or more against previous 3-month average. Keeping customer concentration diversified helps prevent payment problems when sectors of the economy are slowing or are in bad times, and changes in paying habits and acceleration in buy-

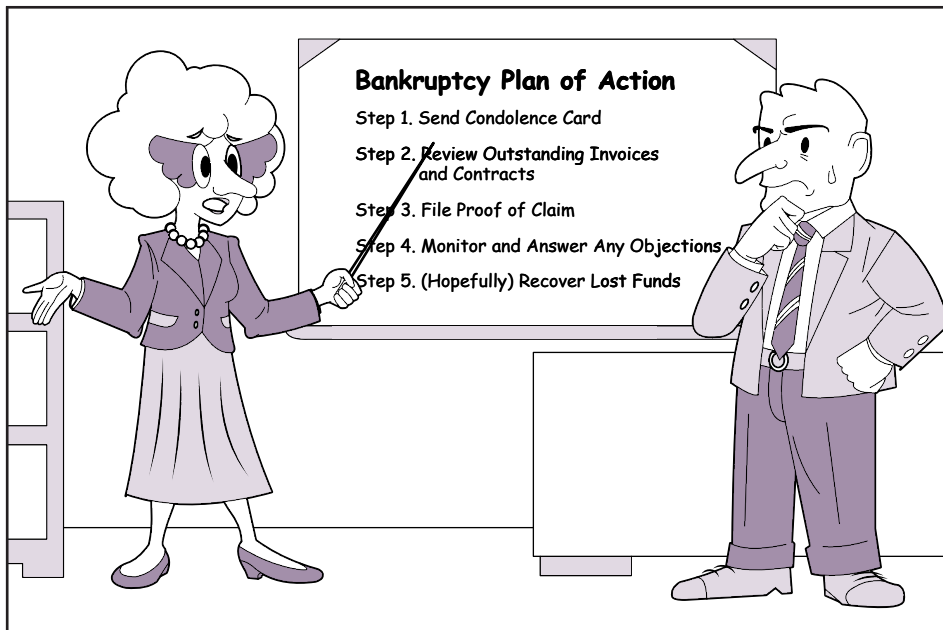
ing are two of the red flags that normally precede a customer's bankruptcy.

Industry sector information with real-time data points helps minimize your risks: average days paid, including rolling 12 months, past 3 months, past month with alerts if days paid increases by 15 days against previous 3-month average and economic data on your industry sectors. The industry sector days paid is compiled from your customer's data that are assigned to a particular industry sector and the economic data on your industry sectors can be found from various published indexes. By comparing your customer days paid average against the industry sector days paid average you can spot individual customer problems within an industry sector and by watching for a rise in the industry sector pay average, you can spot whole sector problems. The economic data on your industry sectors will help determine the growth or lack of in particular sectors helping sales in pursuit of growing areas and your risk assessment of the portfolio.

In short, even with the best credit decisions, collection activity, and information, things go south and one of your advertisers or agencies files bankruptcy. When this happens, your role is now to best preserve your claim in the bankruptcy, handle any objections or adversary actions that may occur, and recover what you rightfully should if a plan allows. These following steps can help with that process:

1) Review your customer to see if any contracts are in force. If there are, determine with the help of your attorney if they are Executory. Executory contracts obligate both parties to continue to perform. If it is not, revoke credit privileges as allowed by your terms and conditions and accept future business as cash-in-advance unless you have a court order or guarantee from another solvent party.

2) Gather any documents you have to support the filing of a Proof of Claim, if allowed. It is a good practice to always file a Proof of Claim in both Chapter 7 and Chapter 11 cases unless you



Now that Suzy's Florist and Greeting Card shop has filed for bankruptcy and closed its doors, our bankruptcy action plan has hit a speed bump. I can't do Step 1. Where else can I find bankruptcy sympathy cards?

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are advised otherwise by the court.

3) Do a days paid analysis going back two years if possible and save this information in the event an adversary proceeding (preference action) is filed against you. Sometimes these actions occur up to two years after the filing of a Chapter 7. Having this analysis might help in defeating an action by utilizing an ordinary course of business defense.

4) Respond quickly to any notices that fall into the categories of objections to your claim, adversary proceedings, and disclosure statements and plans.

5) Keep the court up to date on your address. Cases sometimes take many years until conclusion and if you are entitled to a dividend, you don't want it lost in the mail.

6) Enlist the help of a competent collection firm well versed in bankruptcy practices or your attorney when confronted with objections to your claim or adversary proceedings. These items are time sensitive and

complex, but can be resolved many times with little or no loss.

### Summary.

To summarize, be prepared in the event of a customer filing bankruptcy by understanding how bankruptcies work and what to do, but more importantly having a sound credit and collection policy will keep your accounts receivable young and your bad debt losses minimal. ♦