Avoid Becoming an Unwary Creditor in your Business Partner’s Bankruptcy Proceeding

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The COVID-19 pandemic has created not just a health crisis, but a financial crisis as well. Several companies, that you may be doing business with currently, are treading water trying to avoid drowning in a sea of unfulfilled obligations. As the current disruption to the business market continues to create financial distress for a number of companies, businesses may be days away from initiating bankruptcy proceedings – actions that may blindside partners who rely on them.

Proactive parties who want to avoid becoming unwary creditors in their business partner’s bankruptcy proceedings, can take action now in order to salvage worthy business relationships, secure peace of mind and (perhaps) preemptively rescue the business/project.

- First - learn to identify the tell-tale signs of Financial Distress
- Second - take proactive steps to mitigate your risk
- Finally - strategize cooperatively to see the project thru to successful completion

Warnings of Financial Distress

Although there are several indicators which may point to imminent financial distress, the following signs are some of the most commonly identified warnings:

1. **Termination or Resignation of Key Management/Leadership/Board Members** - If your business partner is letting go of high-performance/high-salary personnel, you might need to do some additional investigation into the partner's financial well-being. While turnover is not always a critical sign, it is possible that your partner is trying to conserve cash, avoid accountability or worse.

2. **Look for Liens** - Different types of public record liens can mean different things - if there is a mortgage, a second mortgage, a new UCC financing statement on existing inventory or equipment, or a construction lien claiming non-payment - all of these could be advance warning of your business partner experiencing financial distress.

3. **Search the News and Internet for Information Specific to your Business Partner** - Look for evidence of significant financial problems that your partner's industry might be facing – for example, certain sectors of the real estate market are undergoing severe compression. Similarly in the construction industry, if current are projects being shut down via Stop Work Orders, if certain projects have even been abandoned, or if it appears that planned future projects might
not be moving forward – these may be signs of disruption in future business. If your business partner is in a segment that is experiencing disproportionate impact due to COVID-19 and resulting government and community shutdowns, it is very likely that they will be financially impacted by these problems. Bad news about an industry doesn't necessarily mean your business partner is going to experience financial distress as a certainty, but it might be enough to look a little deeper, stay alert, or to even pick up the phone.

4. **Relationship/Business Changes** – Are there changes in your business partner’s behavior and performance? Have payment terms changed? Are they servicing customers they may not normally service? Did they suddenly expand or retract? Are other people in the industry expressing concerns or talking? Is your service representative the same person, are they happy, over worked, do they have any complaints? Subtle cues that happen over time will often tell you more than you may realize and it does not need to be actions of executives, the people on the frontline often reveal the most.

5. **Social Media and Client Comments or Reviews** - Today, nothing escapes social media - whether good or bad - and people are constantly sharing their opinions about everything. While most take social media comments and reviews with a grain of salt, multiple comments about unresponsiveness, lack of follow-thru or decreased quality of work may be a sign that your business partner is experiencing some sort of financial distress.

**Mitigating Your Risk**

When facing a business partner's financial distress, you should take immediate preventative action to mitigate your own risk by contacting a competent business attorney who can capably assess your level of risk and advise on work-out solutions. Business attorneys at Shutts & Bowen have substantial experience in proactively and practically handling the challenges and potential pitfalls related to industry challenges and financial distress. We can provide the due diligence and the strategies to hedge unnecessary losses and to prevent unnecessary exposure if your business partner files for bankruptcy, including securing debts, utilizing third-party obligors, and changing billing practices. Our attorneys can help avoid possible disruption to existing business and long-term relationships, while keeping cost-efficiencies top of mind. The attorneys at Shutts & Bowen continue to closely monitor the rapid developments taking place in connection to the current crisis and offer guidance to clients in these uncertain times on all areas impacted by the COVID-19 global pandemic, from construction and development related issues, such as *force majeure*, to nuanced issues involving creditors’ rights and bankruptcy, government, government contracting and loan programs; federal and state tax-related questions; significant labor and employment questions and concerns; all aspects of financial services and real estate matters; and health care.

Additionally, if you have a strong relationship with your business partner, providing them the space to openly discuss the current economic climate, mutual challenges that everyone is facing, or particular concerns that you might have - may open up excellent opportunities for dialogue, to find
Effective Strategies for Dealing with Financial Distress

Solid legal counsel can be a huge help in the strategic management of financial distress - particularly if you are in the real estate investment, construction and development space. The most effective strategies involve a thorough understanding of business relationships and dynamics of the assets at stake. Experience and skill in discovery, work-outs and bankruptcy proceedings, and alternative dispute resolution strategies can also prove to be invaluable. Proactive measures taken by you (the relationship counterpart) in tandem with solid legal counsel can help you avoid becoming an unwary creditor in your business partner’s bankruptcy proceeding.

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