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A Customer Files for Bankruptcy, What Now?

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In light of Westinghouse's bankruptcy filing, do you know what to do if a major customer of your company files for bankruptcy protection? If you have a customer file for bankruptcy, you may need to prepare a strategic plan as a direct result. This involves evaluating how short-term cash flows may be affected and how the long-term resources of your company are deployed.

It is imperative to understand your company's exposure with the bankrupt entity and prepare for the reality that payments on "pre-petition" claims may be delayed for months or years, or may never be made. Depending on the size of your outstanding receivables with the bankrupt entity, there could be a substantial cash shortfall over the next several months. For the bankrupt entity's vendors that finance its account receivables, the ability to borrow against the bankrupt entity's receivable will evaporate quickly, if not immediately. Add to this the long-term implications of potentially losing a major customer, and a company can start to feel powerless.

The key to regaining some stability is preparing your company for each scenario. Below are some basic steps that a company should consider taking to develop both a short-term and long-term plan:

Short-term

- Understand what the bankrupt entity owes. This will probably include services provided before bankruptcy, that have yet to be billed. If you are listed as a "critical vendor" by the bankrupt entity, this may allow not only payment on current accounts receivable, but also guarantees of contractual work moving forward. In the case of Westinghouse, a "critical vendor" designation signifies Westinghouse would like to continue to work with that vendor, under current terms, for the next 24 months.

- Contact the bankrupt entity to affirm that services will continue for the short-term. It is possible the bankrupt entity will not be able to give a clear answer, but pry for as much information as possible, and continue to ask for frequent updates.

- Map out your company's cash flow over the next two to six months and remove any payments from the bankrupt entity on services provided before the petition date (e.g, March 29, 2017 for Westinghouse). You may be able to assume payments will be received for work provided to the bankrupt entity after bankruptcy was filed, but check with your legal advisor in advance of continuing to sell to the bankrupt entity.

- Identify pinch points, or times the budget shows cash will either be tight (or negative).

- If cash is tight or negative, work with your own creditors to see if they can help your company by extending payment terms. In addition, assess the company's value to the bankrupt entity. If you have negotiating power, you may get exemptions for past payments or be able to renegotiate new terms to help cash flow.

- If you are borrowing money, talk to your bank. Be proactive and show you have identified issues related to the bankruptcy, so if the lender's help is needed, it understands and has had time to digest the information.
- If you have a receivable, contact your attorney and make sure you have filed a proof of claim and other important items. Additionally, you will want to discuss other items such as preference claims, new value and other legal classifications that can affect your claim.
- In addition, your company may have the ability to file a reclamation claim. Reclamation is the right of a seller of goods to have those goods returned from an insolvent buyer. There are specific rules regarding these type of avoidance claims in bankruptcy, so legal counsel should be sought immediately. A vendor must make a demand for the goods within a specified time frame, which may be as short as 20 days from the day of receipt.

Long-term

- Understand the impact of potentially losing the bankrupt entity as customer. If the bankrupt entity is your largest customer, more energy will need to be dedicated to assessing the situation. If the bankrupt entity is a small customer, the loss may not be any different than the average customer you lose or gain on a regular basis.
- Identify what assets and resources would no longer be needed without the bankrupt entity as a customer. The easiest to identify are assets and resources directly linked to servicing the bankrupt entity. It is harder to determine, but equally important, to understand how much overhead should be reduced to maintain margins without the bankrupt entity's revenue.
- Prepare an outline or action plan for various scenarios, including (a) an immediate loss of, (b) a staged loss of or (c) a reduction in services for the bankrupt entity as a customer. The goal is to develop alternative plans that minimize your company's response time to any the bankrupt entity movement.
- Identify what opportunities might exist without the bankrupt entity as a customer. Questions such as "was servicing the bankrupt entity keeping you from exploring new opportunities?" should be answered.

When a large company such as Westinghouse declares bankruptcy, the immediate reaction is to the direct effect the filing will have on the bankrupt company and its employees. What gets lost in the news coverage is that a lot of vendors can be thrown into disarray, for no other reason than the bankrupt entity was a customer. A small company that has a large percentage of its staff and resources dedicated to the bankrupt entity is now in danger of suffering the same fate.

That small company cannot control the outcome of a customer's bankruptcy, but it can make sure that it is fully prepared to manage through both the short-term and long-term impacts of each possible outcome.

For more information or assistance, Schneider Downs Meridian is available to answer any questions.

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