YLD Perspective

by Adine S. Momoh

Caveat Trade Vendor? Going Beyond Bankruptcy 101 to Add Value to Your "Client"

When I tell people that I am a litigator and bankruptcy attorney, the most common reaction I get is, "You must be really busy, given the economy and all." I often respond, "That's correct to some extent, but not because many people are filing for bankruptcy nowadays." I do not handle consumer bankruptcy matters, but rather commercial bankruptcy matters (where I represent both creditors and debtors) and other sorts of business and commercial disputes. Then, I am often asked if I have worked on bankruptcy matters as large as the Tom Petters and Bernie Madoff bankruptcies. I have, but the majority of my bankruptcy work falls in the middle of these two endpoints, where oftentimes the bankruptcy debtor is a less notorious character. Given that the value of many commercial bankruptcy matters can range from the low thousands to the millions, it is important for attorneys (and especially associates) to figure out how they can add value to their clients (not only external clients, but also internal clients within the firm, such as shareholders and more senior associates). One way attorneys can add value is to go the extra mile for their clients and to learn who the key players really are in the business transaction at issue before the transaction is finalized and before the client is advised.

We have all heard of *caveat emptor* and *caveat venditor*, Latin for "let the buyer beware" and "let the seller beware," respectively, especially in the bankruptcy context. Take for example what could have been known as the infamous bankruptcy of Women's Apparel Group, whose more known subsidiary brands include Chadwicks of Boston and Metrostyle (each having its own shopping catalogs).[1] As can be imagined, dealing with a bankrupt business can be frustrating, even more so when the business that is reorganizing under bankruptcy protection fails to preserve its customer relationships along the way.[2] That was the case with Women's Apparel Group. When Women's Apparel Group went bankrupt, unsuspecting consumers never received items that they had ordered, despite having paid its subsidiaries.[3] The bankrupt company also did not honor refund requests.[4]

Suppose the situation were a bit different. Suppose that instead of a consumer you have a trade vendor that sold goods and/or services to a business, and unbeknownst to the trade vendor, the business is a Chapter 11 (or Chapter 7) debtor. Suppose also that the debtor paid the trade vendor for those goods and/or services *after* it filed for bankruptcy. One would think that the trade vendor is safe because it was paid. But did the trade vendor really escape the bankruptcy? Not exactly. After the 11th Circuit's 2010 holding in *Marathon Petroleum Co. v. Cohen* (*In re Delco Oil Inc.*),[5] a new Latin catch phrase for "let the trade vendor who delivers goods or services to debtors post-petition beware," should be coined.

In *In re Delco Oil Inc.*, the U.S. Court of Appeals for the Eleventh Circuit affirmed the district court's holding that a bankruptcy trustee may, pursuant to 11 U.S.C. §§ 363(c)(2) and 549(a), avoid post-petition payments by a debtor as unauthorized transfers of cash collateral. The debtor, a distributor of motor fuel and associated products, purchased such goods from the creditor Marathon pursuant to a 2003 sales agreement. The debtor had also entered into a financing agreement with creditor CapitalSource Finance (CapitalSource) in which CapitalSource agreed to provide financing to the debtor in exchange for the debtor's pledge of all rights to its personal property, including inventory, collections, and cash payments.[6] Three years after the debtor and Marathon entered into their sales agreement, the debtor filed for Chapter 11 bankruptcy protection and filed an emergency motion with the bankruptcy court requesting authorization to use cash collateral to continue its operations. Cash collateral, otherwise known as secured property, is defined in the Bankruptcy Code as "cash, negotiable instruments, documents of title, securities, deposit accounts, or other cash equivalents whenever acquired in which the estate and an entity other than the estate have an interest. ... "[7] The bankruptcy court authorized the debtor to continue its business as a debtor-in-possession *but denied* the debtor's emergency motion.[8] Despite this negative ruling, the debtor distributed over $1.9 million in cash to Marathon in exchange for petroleum products pursuant to their sales agreement.[9]

In December 2006, the debtor voluntarily converted its bankruptcy to a Chapter 7 proceeding, and the appointed Chapter 7 trustee subsequently filed an adversary proceeding and motion for

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summary judgment against Marathon to avoid the post-petition cash transfers. The bankruptcy court, granting the trustee's motion for summary judgment and entering judgment for $1,960,088.91 against Marathon, held that the debtor used CapitalSource's cash collateral to pay Marathon without either the court's or the Bankruptcy Code's authorization.[10] The bankruptcy court's grant of summary judgment was the basis of Marathon's appeal to the district court and, ultimately, its appeal to the Eleventh Circuit.

On appeal, Marathon argued that the payments should not be avoided because Marathon had (1) received payments that were free of CapitalSource's security interest and thus, did not constitute cash collateral; (2) accepted the debtor's payments in good faith and in the ordinary course of business without collusion; and (3) provided petroleum products to the debtor of reasonably equivalent value to that of the payments it received, and, therefore, CapitalSource, as the secured lender, was adequately protected.[11] Marathon also argued that the petroleum products it provided were necessary for the continued operation of the debtor's business and thus, helped to preserve the value of its noncash property in which CapitalSource held a security interest.

Although Marathon brought forth the aforementioned arguments supporting reversal of the district court's and bankruptcy court's rulings, the unpersuaded 11th Circuit rejected each one of them, concluding that to succeed in its avoidance action, the trustee only needed to prove that (1) a post-petition transfer occurred, (2) the transfer consisted of estate property, and (3) the transfer was not authorized by the Bankruptcy Code or court.[12] No dispute existed as to the first and third elements.

The reach of *In re Delco Oil Inc.* is unclear. The case did not specifically address whether a trade vendor who sells without knowledge of a cash collateral dispute—or for that matter, without notice of a debtor's recent bankruptcy—would be equally vulnerable to the transfer being avoided. However, cases post *In re Delco Oil Inc.* have at least held that when a trustee brings an adversary action to avoid an unauthorized post-petition transfer from a debtor to a trade vendor, and recovery of that avoided transfer would not benefit the bankruptcy estate, that action will be denied and the trade vendor can escape liability.[13]

Nonetheless, *In re Delco Oil Inc.* provides at least four important lessons to attorneys. First, once put on notice of a debtor customer's bankruptcy filing, trade vendors should monitor the debtor's bankruptcy filing and confirm the Bankruptcy Code procedures for doing business before delivering goods to the debtor. Second, trade vendors should delay any post-petition sales until the debtor either provides a cash collateral order that protects trade vendor payments or can confirm that its secured lender consents to the use of the cash collateral. Third, trade vendors should consider requiring adequate assurance even if sales are cash on delivery. This would entail the filing of a motion pursuant to 11 U.S.C. § 366, seeking that the debtor be required to provide adequate assurance that the supplier of goods or services be paid.[14] Lastly, the trade vendor might want to consider foregoing the sale rather than accepting payment that might have to be returned. However, in the case of a creditor that is obligated to continue performing under a contract, it might have little option but to accept the risk associated with selling to the debtor.

In sum, the lesson of *In re Delco Oil Inc.* is that even if a creditor (whether it be an individual or a business) receives property (such as a form of payment) from a debtor post-petition, that property is not safe and can be subject to avoidance. A Chapter 11 debtor must obtain the consent of certain parties or the permission of the bankruptcy court before it can do many things it was able to do on its own prior to filing a petition for bankruptcy. Chief among these is that if anyone has a lien on the debtor's property (including a blanket lien on accounts receivable, as is often the case with a secured lender), the debtor must obtain either the lender's consent or bankruptcy court approval in order to use that property (that is, the cash collateral) for any purpose, including to pay for goods received in the ordinary course of business.[15]

Conclusion

One can never be too early in thinking of ways that he or she can add value to his or her clients, especially given today's economy and the costs that can be associated with losing a client or possibly damaging a client relationship. Attorneys (including associates) should always be mindful that at the end of the day, a bill will be sent to the client (again, not only external clients, but also internal clients within the firm, such as shareholders and more senior associates) and that bill will need to be justified. Discounting rates and/or billing less of one's time are not and cannot be the sole ways to add value to the client in today's market. Attorneys should go the extra mile for their clients and do their "due diligence" by learning who the key players really are in the business transaction at issue *before* the transaction is finalized and *before* the client is advised. Using *In re Delco Oil Inc.* as a guide, the following are tips that attorneys (and bankruptcy attorneys in particular, especially associates) should consider when going the extra mile to add value to any trade vendor client that will be engaging in a business transaction with a debtor (or former debtor) entity:

- Run a search for the entity's name in PACER's national locator service, or try a Google search and see if any bankruptcy-related hits appear with regard to the entity's name.
- If the entity has filed for bankruptcy, identify which sort of bankruptcy has been filed, e.g., Chapter 7 or Chapter 11.
- Monitor the entity's bankruptcy filing and bankruptcy case by continuing to check the court docket on PACER.
- Identify whether the use of cash collateral is at issue, and if so, whether its use has been denied.
- Confirm the Bankruptcy Code provisions that concern use of cash collateral, which will impact what the client trade vendor can or cannot do when dealing with debtors.

By doing the above, attorneys can feel confident that they have helped to protect their client's interest and helped the client sleep a little better at night. ⊙

Endnotes

[1]*In re Women's Apparel Group*, No. 11-16217 (Bankr. D. Mass. 2011).

[2]Mitch Lipka, *Protect Yourself When Dealing with Bankrupt Business*, Boston Globe, Jan. 15, 2012, at 2.

[3]*Id.*

[4]*Id.*

[5]599 F.3d 1255 (11th Cir. 2010).

[6]*Id.* at 1257.

[7]1 U.S.C. § 363(a).

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voluntarily given. The defendant in *Padilla* had pled guilty based on the erroneous advice that his plea to a drug trafficking offense had no immigration consequences.[13] Since he had abandoned his right to trial he was entitled to advice of competent counsel before he did so.

Noncitizens' rights are also asserted in the area of tax law. The U.S. Court of Appeals for the Second Circuit held that aliens who are not immigrants of the United States that are employees of designated international organizations are entitled to certain privileges, exemptions and immunities by virtue of their occupational status. For example, Congress has allowed them to establish domicile in the United States.[14]

Where does all of this leave us as members of the FBA? I would hope that this article has engendered thought in the reader about the ways in which immigration law impacts the area of law in which she practices. Would the reader's colleagues in her field benefit from more information regarding the impact of immigration issues in their area of practice? How valuable would a CLE be that addresses immigration issues in the practitioner's area of practice? It is the author's opinion that all members of the FBA would benefit from a comprehensive, multi-practice area CLE that would be co-sponsored by the Immigration Law Section and other sections and divisions so that FBA members would have the depth of understanding of immigration issues so that they can better serve their clients and further the mission of the FBA. ⊙

Endnotes

[1]FBA, *FBA Fact Sheet*, www.fedbar.org/For-the-Media/FBA-fact-sheet.aspx.

[2]8 U.S.C § 1101(a)(3) defines an alien as "any person not a citizen or national of the United States."

[3]*Johnson v. Eisentrager*, 339 U.S. 763, 770 (1950).

[4]*Id.*

[5]An LPR is eligible to apply for citizenship if she establishes that she (1) is at least 18 years old; (2) has been lawfully admitted as a permanent resident for at least 5 years (less for some individuals); (3) is a person of good moral character; and (4) has established a residence and maintained continuous physical presence in the United States for a certain period of time. *See* 8 C.F.R. § 316.2(a).

[6]*See United States v. Verdugo-Urquidez*, 494 U.S. 259, 270–71 (1990) (contrasting Fourth Amendment protections of nonresident aliens with aliens resident in the United States); *Graham v. Richardson*, 403 U.S. 365, 376 (1971) (holding that a state statute denying welfare benefits to resident aliens violates the Equal Protection Clause); *Kwong Hai Chew v. Colding*, 344 U.S. 590, 596 (1953) ("It is well established that if an alien is a lawful permanent resident of the United States and remains physically present there, he is a person within the protection of the Fifth Amendment."); *Bridges v. Wixon*, 326 U.S. 135, 148 (1945) ("Freedom of speech and of press is accorded aliens residing in this country."); *Wong Wing v. United States*, 163 U.S. 228, 238 (1896) (concluding that "all persons within the territory of the United States [including aliens] are entitled to the protection guaranteed by [the Fifth and Sixth Amendments]"); *Yick Wo v. Hopkins*, 118 U.S. 356, 369 (1886) ("The fourteenth amendment to the constitution is not confined to the protection of citizens.").

[7]*See* 8 C.F.R. § 1001.1(p) ("The term lawfully admitted for permanent residence means the status of having been lawfully accorded the privilege of residing permanently in the United States as an immigrant in accordance with the immigration laws, such status not having changed. Such status terminates upon entry of a final administrative order of exclusion, deportation, removal, or rescission."); *See generally Vartelas v. Holder*, —— U.S. ——, 132 S Ct. 1479, 1483–85 (2012).

[8]*United States v. Portillo-Munoz*, 643 F.3d 437, 441 (5th Cir.2011) (emphasis added). *See In re Kwong Hai Chew*, 344 U.S. 590, 596 (1953) (holding that an alien is entitled to the Fifth Amendment protection to the extent he "is a lawful permanent resident of the United States and remains physically present there"); *Truax v. Raich*, 239 U.S. 33, 39 (1915) (holding that "the complainant is entitled under the 14th Amendment to the equal protection of its laws" because he is "lawfully an inhabitant of Arizona").

[9]*Kwong Hai Chew*, 344 U.S. at 596 n.5 (emphasis added) (quoting *Bridges v. Wixon*, 326 U.S. 135, 161 (Murphy, J., concurring)).

[10]*Arizona v. United* States, 132 S. Ct. 2492 (2012).

[11]*See generally Hoffman Plastic Compounds, Inc. v. NLRB*, 535 U.S. 137, 149 (2002) (holding that back pay awards to undocumented workers terminated in violation of the National Labor Relations Act ran counter to federal immigration law); *cf. Madeira v. Affordable Hous. Found., Inc.*, 469 F.3d 219, 243 (2d Cir.2006) (noting that majority of courts to address the question have concluded that *Hoffman Plastic* does not preclude FLSA awards for back pay).

[12]*Padilla v. Kentucky*, 559 U.S. ——, ——, 130 S. Ct. 1473, 1486 (2010).

[13]*Id.*

[14]*Ying v. C.I.R.*, 25 F.3d 84, 86 (2d Cir. 1994).

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[8]599 F.3d at 1257.

[9]*Id.*

[10]*See id.*

[11]*See id.* at 1259–63.

[12]*See id.* at 1262 (citing 11 U.S.C. § 549(a)).

[13]*See, e.g.*, *In re C.W. Min. Co.*, No. 08–20105, 2012 WL 3839287, at *9–11, *13 (B.A.P. 10th Cir. Sept. 5, 2012) (denying post-petition transfer action when permitting trustee to avoid unauthorized post-petition transfer, which occurred when bank with security interest in certificate of deposit (CD) executed thereon and applied CD to reduce debtor's obligation on promissory notes, would revive bank's security interest in CD, and there would be no benefit to Chapter 7 estate); *Dill v. Brad Hall & Assocs., Inc.* (*In re Indian Capitol Distrib., Inc.*), No. 09–11558, 2011 WL 4711895, at *11 (Bankr. D.N.M. Oct. 5, 2011) (dismissing trustee's action without prejudice because "injury in fact" is a core requirement of federal jurisdiction under Article III, § 2 of the United States Constitution and where the value of goods delivered by vendor was reasonably equal to the amount paid by the debtor, trustee had "not established (or even alleged) that the estate suffered an injury").

[14]*See* 11 U.S.C. § 366; *see also* § 2-609 (discussing the right to adequate assurance of performance).

[15]Seeking such permission is known as a motion for the debtor's use of cash collateral. For guidance on how to make such a motion, see 11 § U.S.C. 363(c), Fed. R. Bankr. P. 4001(b) and any applicable local bankruptcy rules of the jurisdiction.