

# Bankruptcy - Not Necessarily an End to Construction Payments



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Ask any construction professional what is one of the biggest concerns during a construction project and it is certain to be the threat of ongoing payment becoming stalled due to a bankruptcy filing. Whether the bankrupt party is an owner, contractor or any other party in a construction project, a bankruptcy petition has an immediate impact on the progress of work, payments and fulfillment of obligations. Understanding the mechanics of bankruptcy law is essential to containing the fallout from a bankruptcy filing, as well as aggressively pursuing alternative theories of recovery.

### **1. An automatic stay is in effect once a bankruptcy petition is filed.**

Section 362(a) of the Bankruptcy Code dictates that as soon as a debtor files a bankruptcy petition, an automatic stay goes into effect. This means that no one can file any type of action or continue any other type of legal proceeding to collect amounts due from the debtor, or to enforce any claims against the property of the debtor. The stay is enforced to protect the debtor while pursuing bankruptcy and to allow the debtor a period to exhale and to regroup.

### **2. Certain parties can file for a relief from an automatic stay.**

Generally, the automatic stay does not prevent suits against co-debtors and guarantors of obligations owed by the debtor, as long as such pursuit does not affect property that is a part of the bankruptcy estate. Even if the co-debtors are co-defendants with the debtor in a lawsuit, the automatic stay does not prevent the continuation of an action against the non-debtors.

### **3. Suppliers can reclaim materials from a debtor.**

Even if a debtor files a petition, Section 546(c) of the Bankruptcy Code provides a materialman or similar type vendor the right to reclaim goods used in the construction of a project. All that the materialman needs to do is to make a written demand for the return of the construction materials. The demand must be filed no later than 45 days after a debtor receives goods or 20 days after a bankruptcy petition is filed if the 45th day expires after the date of filing. Also, the goods must have been sold in the ordinary course of business and received by the debtor up to 90 days prior to the date that the petition is filed.

### **4. File an administrative claim.**

## Bankruptcy - Not Necessarily an End to Construction Payments (Cont.)

Section 503(b)(9) of the Bankruptcy Code provides that, after proper notice has been provided to a debtor and a hearing has been conducted, the Bankruptcy Court shall allow as an administrative expense "the value of any goods received by the debtor within 20 days before the date of commencement of a case under this title in which the goods have been sold by the debtor in the ordinary course of such debtor's business." Under Section 503(b)(9), even if a seller of goods fails to demand the return of the materials, the seller may still assert an administrative claim in the bankruptcy case equal to "the value of any goods received by the debtor within 20 days before the commencement of a case." Section 503(b)(9) focuses on the value of the goods and not the goods themselves and provides relief that is not available even if the goods are not available to be reclaimed.

The advantage of filing an administrative claim is that such claims are paid for up to 100 percent of its value prior to any payments on proofs of claim for general unsecured claims. Often, unsecured claims are paid at only a fraction of the value, making an administrative claim an attractive alternative for the contractor who is diligent in pursuing recovery.

### **5. Mechanic's liens may continue to be perfected.**

The automatic stay provision of the Bankruptcy Code provides that the filing of a bankruptcy petition shall act as a stay of any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title.

Notwithstanding the automatic stay provisions of Section 362(a), under Section 362(b) (3), creditors are permitted to file liens for the purpose of continuing the perfection of an existing lien. Section 362(b)(3) is an exception to the general prohibition against any post-petition efforts to obtain property of the estate or to perfect a lien. As long as there is some action that is required to perfect a creditor's interest in the property, Section 362(b)(3) gives a creditor an alternative to pursue mechanic's lien rights.

While a bankruptcy petition can present a real threat to a creditor obtaining payment from a debtor, prompt action can minimize adverse outcomes. Consult with a bankruptcy attorney for a complete understanding of available remedies.