News from the Hill

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Bankruptcy changes may help repair stations get paid

If you perform installation, alteration or repair services on an aircraft and the owner refuses to pay you, can you keep the aircraft pending payment? Can you sue? Can you win a lawsuit?

These were the sort of questions I heard at the AEA Annual Convention in Dallas this year; I hope to answer some of these questions in a series of articles on these subjects over the course of the remainder of 2005.

Many AEA members are reporting that they are experiencing fantastic business in 2005, but recent years have left them wary of extending too much credit for fear that insolvencies may jeopardize their receivables. Changes in the bankruptcy rules are particularly important to repair stations that extend credit to their customers because the bankruptcy laws could mean the difference between whether a repair station gets paid or not.

Bankruptcy on the Hill

Bankruptcy has been in the news as Congress considered new legal provisions that would make it more difficult for bankrupt consumers to escape their debts. The normal rule of bankruptcy is that it seeks an equitable balance between paying off the creditors fairly, and giving the bankrupt a fresh start. Often this can mean that unsecured creditors will get little or nothing and that the debts they are owed will be extinguished by the bankruptcy court (so there is no future possibility of recovery).

In my Fast-Trak session on commercial law at the Convention, we spoke about ways to protect yourself against non-payment through a number of strategies, including establishing liens that help ensure that the repair station gets paid for the work it performed and the avionics it installed. Copies of that presentation are available to any AEA member on the internet at http://www.washingtonaviation.com.

The New Bankruptcy Law

The recent bankruptcy bill on Capitol Hill was S.256—it was signed into law as Public Law 109-8. It would prevent families with 'adequate income' from declaring bankruptcy—instead they would be required to establish a plan for paying their creditors. Although the legislation would not do much to prevent companies from declaring bankruptcy, it would make significant changes to the preference rules that currently vex many in our industry.

Under the current preference rules, there is a presumption that any payment made to a creditor within 90 days before a bankruptcy filing is a 'preferential payment' made to benefit the creditor to the detriment of other creditors. Since bankruptcy seeks to treat all similarly-situated creditors fairly and equally, it is common for these preferential payments to be recalled. The money is added to the estate, which will then be used to pay off certain secured creditors before returning money to the unsecured creditors (if there is any money left over by the time the trustee turns to the unsecured creditors, then the sum is divided on a pro rata basis among the unsecured creditors—if there is any recovery for unsecured creditors then it is likely to be insignificant in amount, but significant in time delay.) A number of repair stations have seen letters from bankruptcy trustees recalling their 'preferential payments' because the customer paid within 90 days before a bankruptcy filing.

There is an "ordinary course of business" defense to preference actions. Under this defense if a repair station (or any other payee) can show that the payment was made under standard business terms (i.e. according to the written agreement between the parties, or according to industry standard practices) and furthermore made in the ordinary course of business (i.e. that there was a pattern and practice of payments of this sort), then the repair station can keep the money that was paid (this is an over simplification, but you get the idea).

The New Law on Preferences

S.256 proposed that the recipient of a preferential payment would not have to return the prior payment if the payment met only one of the two require-

ments—either it was made in accordance with ordinary business terms or it was made in the ordinary course of business between the parties. It would not require that both of these findings be made. Thus, the bill proposes that a payment could be outside of the ordinary course of business between the debtor (customer) and the creditor (repair station) but, if it was made under the terms of the agreement, then the repair station would be permitted to keep the sum.

Critics of this provision argued that the amendment would effectively eviscerate the preference provisions Congress enacted to balance the needs of ordinary commercial transactions with the goal of equality of distribution among similarly-situated creditors. They claim the provision would insulate most pre-petition transfers from preference recovery, thereby encouraging debtors to favor large or important suppliers at the expense of other creditors. In essence, it "unlevels" the playing field.

Another benefit for repair station creditors is a provision that dictates that for business bankruptcies (defined as bankruptcies in which the debts are not primarily consumer debts), payments of $5,000 or less would not be subject to preferences. Often, repair stations that are faced with a preference letter for a very small amount (e.g. in the $5,000 or less range) will just go ahead and pay the amount (even if the law provides them with an excellent defense against paying) because the legal fees would be more than the payment that is being recalled.

The final product of this debate, Public Law 109-8, provides some protection to our industry from non-payment, but there are still concerns remaining for repair stations that extend credit (and remember—every time you give the customer an extra day to pay, you are extending credit). Because of these remaining concerns, you may want to use some of the strategies that AEA has brought to your attention in the past—like seeking cash-on-delivery, establishing liens or otherwise securing your right to be paid—in order to make sure that you do not become a victim of your customer's economic folly. ❑