

Dorsey U.S. Bankruptcy Law Q&A Series One

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Dorsey & Whitney Bankruptcy Team for Foreign Suppliers

As the COVID-19 pandemic continues to negatively impact the global economy, the recent surge in Chapter 11 bankruptcy filings in the United States is likely to continue for some time to come. If you are a foreign supplier, what do you do when a U.S. customer files for Chapter 11 bankruptcy protection? This Q&A series aims to provide practical advice to foreign trade creditors of U.S. companies in bankruptcy. The first in the series will address general questions and considerations, many of which will be addressed in greater detail in future series which will cover specific issues relating to claims of suppliers, protecting rights in a bankruptcy proceeding, how bankruptcy works, and the Chapter 11 bankruptcy plan process.

1. Question: What is Chapter 11 Bankruptcy and how is it different from other bankruptcy proceedings?

Chapter 11 bankruptcy allows businesses to reorganize their financial affairs in a court-monitored process whose primary goal is to facilitate businesses to continue operating into the future. Chapter 11 allows debtor businesses to remain “in possession”, that is, the company continues to be operated by the same management as before the bankruptcy case was filed.

The alternative is Chapter 7 which involves the appointment of a trustee and liquidation of the debtor, which ceases operating once the bankruptcy case begins. While relevant statistics reflect that many Chapter 11 cases fail, the larger cases (i.e. companies with over \$10 million in assets) tend to have better rates of success, particularly when various stakeholders support the reorganization, including vendors willing to continue dealing with the debtor.

2. Question: What are the significant transactions and events that occur in a Chapter 11 bankruptcy case?

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A number of significant transactions will take place in any Chapter 11 bankruptcy case, and each case is different, but the following are likely to occur:

- On the first day of the case, the debtor will file “first day” motions seeking authority to do a variety of things that it would have been able to do in the ordinary course of business outside of bankruptcy, but require court permission in bankruptcy. This includes paying “critical vendors” that supply goods and services to debtors and whose continued provision of goods and services is essential to debtors’ ability to operate, and borrowing money to be able to pay those critical vendors.
- The U.S. Trustee (which is part of the U.S. Department of Justice) may appoint a committee of unsecured creditors to act on behalf of all unsecured creditors in the case.
- The debtor will file detailed schedules of assets and liabilities.
- The debtor will file monthly operating reports detailing all receipts and disbursements, as well as outstanding liabilities.
- The debtor may seek to sell property free and clear of all liens, claims, and encumbrances, as provided by the U.S. Bankruptcy Code.
- The debtor may seek to assume or reject executory contracts and unexpired leases, as provided by the U.S. Bankruptcy Code.
- The court will establish a deadline for filing claims, after which the creditor would be barred from asserting claims against the debtor.
- The debtor may commence litigation to claw back certain transfers made prior to the bankruptcy.
- In certain instances, debtors come into bankruptcy with a plan of reorganization already prepared (a “prepack”), but more commonly, debtors will negotiate with parties in interest, such as their secured creditors and the committee of unsecured creditors, to formulate a plan of reorganization. With court approval, the plan will be circulated to creditors who will get to vote on whether to accept or reject the plan. If the plan is confirmed by the court, it will dictate all parties’ rights going forward, how claims will be treated, and the percentage of recovery on creditors’ claims.

3. Question: What is the automatic stay?

Immediately upon the filing of any kind of bankruptcy case, the “automatic stay” comes into effect. The automatic stay prohibits taking any actions to collect debts owed by the debtor and applies to all property owned by debtors wherever located – in the U.S. or elsewhere in the world. The automatic stay only protects entities that have filed for bankruptcy protection. It does not protect non-debtor affiliates.

While the automatic stay may not always be recognized outside the U.S., it does apply the moment a bankruptcy case is filed. Parties that violate the automatic stay may be subject to sanctions by the bankruptcy court.

4. Question: How quickly does the Chapter 11 process play out?

It depends on the facts and circumstances of each case. A successful “prepackaged” Chapter 11 case, where a plan is negotiated prior to initiation of the case, can be completed in a matter of one or two months. Most non-prepackaged cases take at least four months and may last years.

5. Question: What are the biggest challenges to foreign trade creditors and what should we do to protect our rights in a Chapter 11 bankruptcy case?

You should contact trusted counsel promptly upon receipt of notice that a company that you supply has filed a bankruptcy petition. The court will set deadlines for filing claims and for objecting to relief that may affect your rights. If you miss those deadlines, you may not be able to receive a distribution on your claim or be heard on matters affecting your rights.

As a trade creditor, if you continue to do business with the debtor, you may be entitled to reclamation or priority claims on account of goods sold in the ordinary course of business which may entitle you to a full recovery of a portion of your claim.

Please keep an eye out for Series Two which will address questions relating to how suppliers and their supply contracts are impacted by a bankruptcy filing and how to safely keep doing business with a company in bankruptcy.

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