

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

by Alessandra Glorioso, Catherine X. Pan-Giordano, Rachel P. Stoian, and Abby Fang

Dorsey & Whitney Bankruptcy Team for Foreign Suppliers

We hope that you enjoyed [Series One](#) and [Two](#) of our U.S. Bankruptcy Law Q&As regarding what to do when a customer files for Chapter 11 bankruptcy protection. This Series Three will address questions relating to the early stages of the bankruptcy process, including what disclosures debtors must make, what relief debtors will generally seek at the outset of the case, and how “critical vendors” are treated.

1. Question: What information is the debtor required to disclose in its bankruptcy case and how can a creditor obtain information about the financial status of the debtor?

Disclosure is the hallmark of the bankruptcy process. Along with the Chapter 11 petition, debtors must file a list of their largest unsecured creditors and provide estimates of their assets and liabilities. Early in the case, a debtor must file detailed schedules and a statement of financial affairs, though debtors often obtain extensions of time to file such documents. The schedules include, among other things, lists of all known creditors and equity security holders (along with amounts and types of claims), executory contracts and unexpired leases, and assets of any type or nature. The statement of financial affairs requires disclosure of, among other things, transfers made in the lead up to the bankruptcy filing and all pending litigation. During the course of a Chapter 11 case, debtors are required to file monthly operating reports detailing all receipts and disbursements during each month of the case.

All of these documents are available online through Public Access to Court Electronic Records (PACER), which charges a fee for each page viewed. A U.S. law firm typically has a PACER subscription. In very large cases, debtors may hire a third party service provider to make such information available for free on a website specifically dedicated for this purpose. Given the often voluminous nature of these filings, it is most efficient to consult with a U.S. bankruptcy attorney to obtain and analyze the relevant information

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and monitor the bankruptcy case as it proceeds.

2. Question: What relief will the debtor seek at the very beginning of the case and how can a supplier protect itself?

Soon after filing a Chapter 11 petition, most debtors file a variety of “first day motions” to obtain permission to take certain actions necessary to keep the debtor’s business going that cannot be taken absent permission from the bankruptcy court. First day motions usually include requests to pay certain pre-bankruptcy debts (such as critical and/or foreign vendors, employees, and insurance premiums), to obtain post-bankruptcy financing, and to use cash collateral that is otherwise subject to a secured interest. It would be worthwhile to consult with a U.S. bankruptcy attorney to determine whether and how such motions may impact your rights in the bankruptcy case.

3. Question: What is the impact of the debtor recognizing a supplier as a “critical vendor”?

As noted above, among the first day motions frequently filed in Chapter 11 case are those seeking authority to pay the pre-bankruptcy claims of vendors that the debtor deems to be “critical.” Critical vendors are those that are essential to the debtor’s operations going forward (such as suppliers of important components, parts, or equipment) and with whom the debtor desires to have a continuing contractual or business relationship notwithstanding its bankruptcy filing. Absent authority to pay such critical vendors on account of their pre-bankruptcy claims, no payment would be made on account of such claims until a plan is confirmed which may not provide for payment in full to such claims.

Debtors obtaining authority to pay critical vendors are generally given broad discretion to use their business judgment to determine which vendors qualify as critical for purposes of payment and how much to pay them. Moreover, to the extent debtors are given the authority to pay critical vendors, they are often expressly permitted to condition payments to critical vendors on those vendors agreeing to proceed according to terms as good as or better than those that applied to the relationship between the debtor and the vendor prior to the bankruptcy filing.

4. Question: What is the “Section 341 meeting” of creditors and should suppliers attend?

The Section 341 meeting of creditors involves an examination of the debtor under oath, through its representatives, regarding the debtor’s primary assets, liabilities, and intentions regarding reorganization. In Chapter 11 cases, the meeting is conducted, and the bulk of the questioning is done, by a representative of the Office of the U.S. Trustee (a branch of the U.S. Department of Justice). Creditors are welcome to attend the meeting and are permitted to examine the debtor regarding its finances as well. The judge in the bankruptcy case is not present at these meetings and they are not conducted in a courtroom.

The meeting of creditors must occur between 21 and 40 days after the filing of the bankruptcy petition, although the U.S. Trustee's office may adjourn the meeting. Suppliers should consider having their U.S. bankruptcy counsel attend the meeting, both to get a better sense of where the case is headed and to examine the debtor under oath, if desired.

5. Question: Can a supplier seek to dismiss the bankruptcy case if it believes it was filed in bad faith or other grounds for doing so?

A Chapter 11 bankruptcy case may be dismissed for a variety of reasons, including that the case was filed in "bad faith." When considering whether a Chapter 11 case is filed in bad faith, the bankruptcy court will look at the totality of the circumstances and decide whether the debtor actually needs Chapter 11 protection and intends to use the substantial benefits afforded by bankruptcy law to reorganize its financial affairs. In practice, bankruptcy courts tend to be cautious to dismiss a Chapter 11 case at the outset and usually wait to see whether there are other bases for dismissal, such as failure to comply with a court order or failure to timely provide information or attend meetings.

Please keep an eye out for Series Four which will address questions relating to how claims are filed and dealt with in a Chapter 11 bankruptcy case.

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