

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

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Dorsey & Whitney Bankruptcy Team for Foreign Suppliers

We hope that you enjoyed Series One of our Q&A regarding what to do when a U.S. customer files for Chapter 11 bankruptcy protection. This Series Two will address questions relating to how suppliers and their supply contracts are impacted by a bankruptcy filing and the benefits and concerns of continuing to do business with a company in bankruptcy.

1. Question: We supplied goods to the debtor in the days or weeks leading up to the bankruptcy filing. Does that give us any special rights in the bankruptcy case?

Yes. Bankruptcy Code § 546(c) preserves a supplier's right to reclaim goods supplied to a debtor within 45 days of the bankruptcy filing, but only if the supplier has the right to do so under applicable U.S. state or other non-bankruptcy law. Such applicable non-bankruptcy law may include the United Nations Convention on Contracts for the International Sale of Goods (CISG), which is a multilateral treaty that establishes a uniform framework for international commerce and provides suppliers with a right of restitution of goods under certain circumstances. As of the date of this article, the CISG has been ratified by 94 countries, representing a significant proportion of international commerce.

Notwithstanding whether a supplier has non-bankruptcy law reclamation or restitution rights, Bankruptcy Code § 503(b)(9) gives administrative expense priority status to a supplier's claim for goods received by a debtor within 20 days before the date of commencement of a bankruptcy case and within the ordinary course of business. This means that suppliers of such goods are entitled to priority of payment in the bankruptcy case.

2. Question: Can we offset the debt owed against a cash deposit we are holding or suspend the debtor's line of credit?

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The automatic stay prohibits any act to collect against a prepetition debt after the commencement of the bankruptcy case and is broadly interpreted in favor of debtors. Applying a cash deposit to a prepetition debt without prior court approval may constitute an act to collect a prepetition debt in violation of the automatic stay. It would be worthwhile to consult with a U.S. bankruptcy attorney to determine whether to apply a cash deposit or suspend a line of credit to a debtor in bankruptcy.

3. Question: Can we terminate our contract with the debtor or demand more favorable payment terms?

The Bankruptcy Code prohibits counter-parties to contracts with the debtor from terminating or modifying their contracts solely because a debtor has gone into bankruptcy. This limitation does not apply to contracts to make a loan or extend financing; rather, the Bankruptcy Code provides that a creditor cannot be compelled to continue advancing credit to a debtor in bankruptcy. However, a U.S. bankruptcy attorney should be consulted if you wish to modify credit terms.

4. Question: Should we continue to supply goods and services to the debtor while it is in bankruptcy?

A Chapter 11 debtor is required to continue performing contract obligations during its bankruptcy case. Claims on account of goods supplied during a bankruptcy case are entitled to administrative expense priority and will, in most instances, be paid in cash in the ordinary course notwithstanding the bankruptcy filing. To the extent such claims are not paid in the ordinary course, they must be paid in full in connection with a plan in order to satisfy Chapter 11 plan confirmation requirements.

In some instances where the Chapter 11 case does not successfully reorganize and the debtor does not have sufficient funds to pay all administrative claims, even holders of administrative claims may not be paid in full. Accordingly, as you continue to supply goods and services to the debtor during its bankruptcy case, it is worthwhile to have a U.S. bankruptcy attorney carefully monitor the bankruptcy case as it progresses.

5. Question: Does the bankruptcy filing of an affiliate or parent company impact the contract a supplier has with a non-debtor entity?

So long as no debtor is a party to or has guaranteed the contract, the bankruptcy filing will generally not affect the relationship of a non-debtor affiliate or subsidiary entity with its suppliers. And, even if a debtor is a party to your supply contract, you have many rights in the bankruptcy case, such as administrative expense claims for goods supplied immediately before the filing and those supplied during the bankruptcy case.

6. Question: Do we still need to file a claim in the bankruptcy case if the debtor listed our debt in its bankruptcy schedules?

That depends. In a Chapter 11 case, if the debtor lists your debt in its schedules, does not designate such debt as contingent, unliquidated, or disputed, and you agree with the

amount of the debt listed, then you do not need to file a claim. Rather, it will be recognized as described on the debtor's schedules. In any event, because filing a claim is a relatively uncomplicated process, we recommend you file a claim even if so recognized. If the debtor does designate your debt as contingent, unliquidated, or disputed, or if you do not agree with the amount or classification of your claim (such as secured, unsecured, or priority), then you need to file a proof of claim in order to assert the amount that you believe is due.

If the debtor does not list you in its schedules, but you have a claim against the debtor, you should file a claim in the bankruptcy case.

Please keep an eye out for Series Three which will return to questions relating to the bankruptcy process more generally, including what disclosures debtors must make, what relief debtors will generally seek at the outset of the case, and how "critical vendors" are treated.

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