

Demystifying the Bankruptcy Process – Part Two

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The COVID-19 pandemic created a lot of turmoil in every industry and every company. From March to September 2020, more than 200 companies in the energy, transportation, entertainment, health & personal care, retail, travel, lodging, and leisure industries cited COVID-19 as a factor in their decision to file for bankruptcy.

The risk of dealing with a company in financial distress was at an all-time high. Understanding the bankruptcy tools available to a company that is on the path to or already in a court-supervised reorganization (known as a Chapter 11 proceeding) can help you to manage and reduce this risk.

Chapter 11 filers choose to opt for bankruptcy relief for various reasons: to stop debt collection action, to revise unworkable capital structure, to address overwhelming litigation, to facilitate the sale of major assets to a prospective buyer, and to reject burdensome contracts, to name a few.

Chapter 11 brings all stakeholders to one forum and facilitates global resolution of claims and liabilities. It may have different impacts on the different stakeholders, and these mini-series will cover the impact of a bankruptcy proceeding on trade creditors, distressed asset buyers, landlords, and the art world. The final summary is intended to help small business owners better understand how valuable a tool Chapter 11 can be during a time of crisis by availing themselves of the new restructuring mechanism for businesses (and individuals with business debt) with undisputed liabilities that do not exceed \$7.5 million.

Post-petition services and goods – What if you are a supplier of goods and services faced with the decision to continue working with a company in a Chapter 11 proceeding?

A business may find itself in a difficult position if prebankruptcy payment default remains outstanding and the debtor still seeks performance post-petition. In general, a Chapter 11 debtor may assume, assign, or reject an unexpired contract or lease at any time prior to confirmation of a plan. The confirmation of the plan may occur six months and (typically) more after the commencement of the case, which creates a lot of uncertainty for the non-debtor party to the contract.

In such a case, a trade creditor remains obligated to perform under the nonterminated contract so long as the debtor complies with its terms. Although the Bankruptcy Code mitigates further exposure by giving the administrative expense priority over even secured claims, payment is not guaranteed.

What is an administrative expense priority? When a company is operating during the restructuring process, post-petition business transactions undertaken at the debtor's discretion – such as the supply of goods and services necessary for the debtor's operations — can receive administrative priority if transacted in the ordinary course of business. Section 507(a)(2) of the Bankruptcy Code provides that each of these kinds of administrative claims is entitled to priority of payment over, among other things, the general unsecured pre-petition claims of creditors.

Under the appropriate set of facts, a contract counterparty may move the bankruptcy court to shorten the long waiting period the debtor company has for assumption and rejection of contracts. Bankruptcy courts have developed a multi-factor balancing test that weighs the harm to the party seeking such relief against the harm to the bankruptcy estate. Courts look at the interests of the creditors collectively and the bankruptcy estate as a whole against the position of one creditor out of many. Counterparties face significant hurdles in prevailing on such motions, but it is not impossible. Trade creditors in this situation should closely monitor the debtor's post-bankruptcy performance and seek relief from the bankruptcy court if necessary.

In case you missed it, read [part one](#), [three](#), [four](#), and [five](#) here.

If you have a question on this topic, please contact [Albena Petrakov](#) at apetrakov@offitkurman.com or 212.380.4106