

How to Handle a Chapter 11 Bankruptcy Filing

Special arrangements can be made to retain key suppliers and employees

By Martin C. Daks

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Suppliers that continue to work with the debtor company are often given a priority when it comes to getting paid, says Thomas S. Onder. [Steven J. Dundas]

As the local and national economy remain mired in the doldrums, local attorneys say they're seeing more companies filing for bankruptcy protection. While the procedures for filing a Chapter 11 petition, which envisions a sale or other reorganization and continuation of the business, are fairly uniform, bankruptcy lawyers say that the way a company treats its key suppliers and employees can make a big difference in the debtor-firm's future.

"A bankruptcy filing does not necessarily mean that a supplier will automatically stop shipping goods or providing services to the company that's filing Chapter 11, but it may add some uncertainty to the process," says **Thomas S. Onder**, a senior associate and member of the bankruptcy and creditor's rights group at **Stark & Stark**, a law firm with offices in Lawrenceville. "That's because a bankruptcy filing places an automatic stay on creditors' attempts to collect their pre-bankruptcy billings from the debtor company."

If that were the end of the issue, suppliers would have no incentive to keep working with the company. But the debtor firm may be able to favor some creditors and employees over others.

“Bankruptcy laws are designed to offer an equitable distribution to as many creditors as possible,” says Onder. “Suppliers that continue to work with the debtor are often provided an administrative priority, which moves them up in line when it comes to getting paid.”

A debtor can also ask the court to make special arrangements so the company can retain key people and offer certain incentives to work with important suppliers, he adds.

“Of course, any such arrangement must be specifically approved by bankruptcy court officials,” says Onder.

A string of companies have filed for Chapter 11 in recent months. The roster includes the May filing by the parent of Clifton-based retailer **Linens ‘n Things**, and the early August filing of **Ascendia Brands Inc.**, a Hamilton-based consumer health and beauty products company.

“I looked at the Ascendia filings, and one of the first things the company did was to advise its employees and suppliers that it planned on continuing to operate, even though it hopes to sell itself to new investors by Sept. 30,” says **Karen A. Giannelli**, chair of the financial restructuring and creditors' rights group at **Gibbons P.C.**, a Newark law firm.

Giannelli, who was not involved in the Ascendia filing, says corporate bankruptcies are slowly rising in the face of a troubled economy.

“Ascendia says [in its filings] it has already obtained debtor-in-possession, or DIP, financing, and plans on using those funds to pay suppliers that continue to do business with the company,” she adds. “Court documents also indicate that Ascendia plans to keep paying its employees, even though some payroll claims may be denied based on when they were incurred. It’s a good idea to keep talking with your key suppliers and your employees, since they’re more likely to stay with you if there’s a good chance they’ll get paid.”

Ascendia is “clearly sending a message” that it wants to continue to operate, and wants to have employees and vendors on board, Giannelli notes.

In contrast, some suppliers of **Boscov’s** and **Mervyns**, two regional retail chains that filed Chapter 11 recently, have been less patient. Some of the suppliers have already contacted Gibbons P.C. seeking help to reclaim any unpaid goods that they shipped to the two companies, according to Giannelli.

“The outcome of a supplier-debtor relationship in a bankruptcy can vary from case to case,” she says.

A company may be able to tip off a key supplier in advance about its plans to file for bankruptcy protection, says **Stacey Meisel**, a bankruptcy attorney and founding member of the Livingston-based law firm **Becker Meisel**.

“If you tip off your key supplier beforehand, and perhaps get current on any outstanding bills [to them], they may be more willing to work with you in bankruptcy,” she says. Some attorneys, however, say that a publicly held company that does this may violate federal securities laws.

“If you accelerate payment to certain suppliers, the bankruptcy court may try to get the money back from them, claiming it is a preferential payment that may be voided,” cautions Meisel. “But when I’m

representing a creditor in a Chapter 11 filing, I'd rather have the money in my client's pocket and fight to keep it, rather than not to have anything and fight for a piece of whatever's left."

A company may be able to ask the bankruptcy court to approve a key employee retention plan, adds Meisel.

"The debtor company can even ask the court to approve a so-called stay-on bonus to retain key employees," she notes. "In the case of certain managers, however, the stay-on bonus generally needs to be tied to achieving certain milestones.