

# HAVE AUTOMOTIVE SUPPLIERS TRADED IN FOR A NEW MODEL? ALTERNATIVES TO CHAPTER 11 BANKRUPTCY IN THE POST-COVID ERA



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Market disruptions caused by the Covid-19 pandemic led many experts in the US financial and legal industries to predict record Chapter 11 bankruptcy filings<sup>1</sup>. However, outside of certain sectors, such as retail, Chapter 11 bankruptcy filings have continued to decrease since 2020.<sup>2</sup> Specifically, Chapter 11 business filings fell 27.9% from September 2020 to September 2021.<sup>3</sup> Although there have not been as many Chapter 11 bankruptcy filings as predicted, businesses and industries as a whole are still facing supply chain challenges, employment shortages, and general uncertainty in the markets.

For instance, the automotive industry continues to be challenged by supply chain issues, labour shortages, liquidity issues, rising costs of raw materials, strict lender standards, and a dwindling reserve of federal aid funds. Although many of these challenges would traditionally be factors leading to Chapter 11 bankruptcy filings, companies along the automotive supply chain are opting for alternatives to the traditional relief sought through Chapter 11 bankruptcy, such as:

- Article 9 of the Uniform Commercial Code;
- Assignments for the Benefit of Creditors; and
- Out-of-Court Wind-Downs (Structured Dissolutions) or Restructuring.

Original Equipment Manufacturers, suppliers, and lenders should seek to understand the benefits and risks associated with alternatives to Chapter 11 and how they can impact all parties involved in an insolvency or financially distressed situation.

## Chapter 11 is not always the best option

The benefits of conducting a section 363 sale, liquidation, or restructuring under Chapter 11 of the Bankruptcy Code include the automatic stay, bankruptcy court supervision (and the transparency associated with that supervision), the Bankruptcy Code’s priorities and protections for creditors, as well as the binding nature of orders entered by the bankruptcy court.

While Chapter 11 offers significant benefits and protections to both debtors and creditors alike, it comes with increased burdens and significant costs in the form of legal fees, filing fees, and fees to the Office of the United States Trustee, which reduce recoveries to creditors. Moreover, the requirements

of the Bankruptcy Code and requirements of the bankruptcy court, such as seeking approval for various forms of relief by way of motion, can be strenuous and time-consuming.

Congress has attempted to address some of these challenges by enacting Subchapter V of Chapter 11 of the Bankruptcy Code, which allow businesses with debts less than \$2,725,625<sup>4</sup> to file a streamlined Chapter 11 case. The goal of Subchapter V was to make small business bankruptcies faster and cheaper. However, due to certain limitations on the size of companies that are permitted to file under Subchapter V, as well as similar constraints from an ordinary Chapter 11 bankruptcy case still present in Subchapter V cases (e.g., Bankruptcy Code and bankruptcy court requirements), many companies in the automotive industry are still opting for alternatives to bankruptcy.

Alternatives to Chapter 11 bankruptcy offer the benefits of being more time and cost efficient, and companies are given more control over the restructuring or liquidation processes. However, the bankruptcy alternatives are not without their issues. Below, we provide a brief and high-level explanation of certain alternatives to Chapter 11 bankruptcy that have been increasingly utilized by companies along the automotive supply chain. Of course, each company must carefully assess the pros and cons of filing Chapter 11 bankruptcy versus seeking an alternative to a bankruptcy filing by analyzing its specific facts, circumstances, and business goals, as well as speaking with professionals specializing in insolvency and financial distress.

## 1. Sales under Article 9 of the Uniform Commercial Code

Companies frequently utilize section 363 of the Bankruptcy Code to effectuate a sale of the company’s assets pursuant to the provisions of the Bankruptcy Code and order of the bankruptcy court. Such sales generate funds for distribution to creditors, and so long as the sale is in good faith and certain other requirements are satisfied, purchasers obtain ownership of the debtor’s assets free and clear of any lien or claim. Of note in the automotive context, in 2009, GM effectuated a section 363 sale during its bankruptcy case in the US Bankruptcy Court for the Southern District of New York.<sup>5</sup> More recently, in 2020, Dura Automotive Systems, LLC, a manufacturer of automotive components, effectuated a section 363 sale in the United States Bankruptcy Court for the District of Delaware.<sup>6</sup>

1 [https://www.csbj.com/premier/businessnews/attorneys-say-a-wave-of-bankruptcies-is-coming/article\\_7d8e6af0-722a-11eb-9681-039563b99c3f.html](https://www.csbj.com/premier/businessnews/attorneys-say-a-wave-of-bankruptcies-is-coming/article_7d8e6af0-722a-11eb-9681-039563b99c3f.html).

2 <https://www.uscourts.gov/news/2021/11/08/bankruptcy-filings-continue-fall-sharply>.

3 <https://www.uscourts.gov/news/2021/11/08/bankruptcy-filings-continue-fall-sharply>.

4 During the Covid-19 pandemic, this amount was temporarily raised to \$7.5 million. In addition, on April 7, 2022, the United States Senate passed S. 3823 by unanimous consent, which seeks to extend the \$7.5 million debt cap for an additional two years. If S. 3823 is passed by the United States House of Representatives, it will then be sent to President Biden for signature before the increased debt cap becomes law.

5 <https://dm.epiq11.com/case/mlc/dockets>.

6 <https://cases.ra.kroll.com/duraautomotive/Home-DocketInfo?DocAttribute=5323&DocAttrName=SALEDOCUMENTS&MenuID=13412>.

Article 9 of the Uniform Commercial Code (the “UCC”), which has been adopted by all fifty states, offers an out-of-court alternative to a sale under section 363 of the Bankruptcy Code. A UCC Article 9 sale allows a secured creditor to utilize self-help remedies provided under the UCC to foreclose on and liquidate its collateral to satisfy its debt. Importantly, a UCC Article 9 sale requires some level of cooperation between the lender and borrower to effectuate the sale.

#### UCC Article 9 sale v. Chapter 11 sale

| <i>Benefits of a UCC Article 9 Sale Compared to Chapter 11</i>   | <i>Cons of a UCC Article 9 Sale Compared to Chapter 11</i>   |
|--|--|
| <ul style="list-style-type: none"> <li>• Less time consuming (section 363 of the Bankruptcy Code requires 60 days minimum)</li> <li>• Typically, fewer professional fees</li> <li>• Sale can be private or public</li> <li>• Allows easier transfer of assets with the benefit of stripping junior liens or interests in the collateral</li> </ul> | <ul style="list-style-type: none"> <li>• No claim mechanism for unsecured creditors, meaning unsecured creditors are less likely to receive payment</li> <li>• Lack of court involvement could lead to litigation over sale</li> <li>• Requires either cooperation by borrower or repossession without a “breach of the peace”</li> <li>• More robust bidding process in bankruptcy</li> <li>• More secured creditor control</li> <li>• Section 363 sale order offers broader buyer and lender protections and allows for assignment of certain contracts without consent</li> </ul> |

## 2. Assignment for the Benefit of Creditors

An Assignment for the Benefit of Creditors (“ABC”) is a state-law insolvency proceeding, which assigns the debtor’s assets to a third-party assignee to liquidate the assets for the benefit of the debtor’s creditors. ABCs are typically a function of state statutes; however, in some states, such as Illinois, they are a function of common law. ABCs can be used as an alternative to either a Chapter 11 or Chapter 7 liquidation.

#### ABC v. Chapter 11

| <i>Benefits of ABC Compared to Chapter 11</i>  | <i>Cons of ABC Compared to Chapter 11</i>  |
|--|--|
| <ul style="list-style-type: none"> <li>• Faster than bankruptcy proceeding</li> <li>• More cost effective</li> <li>• Assignor can choose the assignee who oversees the liquidation</li> <li>• Typically, less court oversight</li> </ul> | <ul style="list-style-type: none"> <li>• Assignor does not receive discharge</li> <li>• No reorganization, just liquidation</li> <li>• No automatic stay</li> <li>• Fewer protections for unsecured creditors</li> </ul> |

## 3. Out-of-court wind-downs (structured dissolutions) or restructuring

An out-of-court wind-down typically involves the company seeking buyers for its assets, reducing its workforce, and formally dissolving its business according to state law guidelines. In an out-of-court restructuring, or “workout,” a company seeks to work with its suppliers, lenders, landlords, etc. to infuse capital into the company and restructure its debts. Note that both a wind-down and a workout can be effectuated in conjunction with a UCC Article 9 sale. The pros and cons of each versus a Chapter 11 bankruptcy are similar.

#### Out-of-court process v. Chapter 11

| <i>Benefits Compared to Chapter 11</i>  | <i>Cons Compared to Chapter 11</i>  |
|---|---|
| <ul style="list-style-type: none"> <li>• More control over process and negotiations</li> <li>• Less time</li> <li>• Cost effective</li> <li>• No public filings or disclosures</li> </ul> | <ul style="list-style-type: none"> <li>• Requires creditor cooperation</li> <li>• Company needs to have enough liquidity to navigate winddown or restructuring</li> <li>• No discharge</li> <li>• No automatic stay</li> <li>• For a restructuring, it may be more difficult to obtain financing comparable to debtor-in-possession financing without certain lender protections provided by Bankruptcy Code</li> </ul> |

## Conclusion

Chapter 11 bankruptcy is no longer the default option for financially distressed companies and suppliers in the automotive industry. Original Equipment Manufacturers, suppliers, lenders, and other interested parties need to understand how each bankruptcy alternate may impact their rights and interests. UCC Article 9 Sales, ABCs, Out-of-Court proceedings, and other alternatives<sup>7</sup> give insolvent companies more autonomy and can provide major cost savings compared to filing for Chapter 11 bankruptcy while still providing comparable benefits to the buyer and lender. If more companies continue to opt for bankruptcy alternatives, it remains to be seen how it could impact the ability of a company to successfully restructure or liquidate. Further, Congress could take note of the trends and propose changes to the Bankruptcy Code to reduce the costs and bureaucratic burdens associated with Chapter 11 bankruptcy, similar to Subchapter V.

Financially distressed companies assessing the above alternatives to bankruptcy, and other parties impacted by such companies, should speak to a restructuring professional to assess their options and evaluate their risks.

<sup>7</sup> In addition to the alternatives discussed herein, receiverships appoint a third party under federal or state law to administer assets while a secured lender is assessing a possible liquidation.