

Weathering the Storm: Doing Business with Vendors Who File for Bankruptcy Protection

March 4, 2009

Do you have a critical vendor that is in financial trouble or in bankruptcy? If the answer is no, your company is in a very small minority. If the answer is yes, this memorandum may help you negotiate some tricky obstacles.

1. If you are buying from a vendor who is either in bankruptcy or on the verge of bankruptcy, a significant concern will be obtaining assurance that the vendor will be able to perform on a going forward basis. You are entitled to adequate assurance that the vendor will be able to timely deliver the quality and quantity of your order. You also need to be mindful of quality control issues, especially when a vendor liquidates in bankruptcy (which can happen in a Chapter 11, but always occurs if the vendor files Chapter 7). In a liquidation context, you might be able to purchase goods and products at a discount.

a. One way to obtain assurances is for the vendor to quickly ?assume? any contracts it has with your company under Section 365 of the Bankruptcy Code. An assumption elevates performance by the vendor under the contract to administrative claim status (with priority over payment of pre-petition unsecured claims) and assures that the contract(s) will survive bankruptcy.

b. Contracts with vendors often authorize the customer to issue deductions or rebates. As of the petition date, you may have earned rebates or deductions that would ordinarily be offset or recouped against payables to the vendor. The automatic stay imposed when the bankruptcy case is filed prohibits such offsets without bankruptcy court approval. While you cannot unilaterally exercise offset rights in bankruptcy, you may be eligible to deduct from your payable to the vendor an amount equal to the earned rebates or deductions. In certain jurisdictions, you may also be able to utilize ?recoupment? to net those obligations against each other (whether or not they arise under one or more oral or written agreements). Please note, however, that the concept of recoupment varies jurisdiction by jurisdiction. To determine whether your company is eligible to recoup and make a lawful deduction or withhold payments to the vendor, you should confer with counsel.

c. If you provide your customers with discount programs, you may want to consider discontinuing such programs pending receipt of adequate assurance that the vendor will honor those discount programs when passed through to the vendor.

2. Be sure to apply rebates and deductions correctly and consistently with past practices.

3. You may not terminate a written contract or supplier authorization agreement with a vendor once you learn the vendor is in bankruptcy. The filing of the bankruptcy case imposes what is referred to as the automatic stay. This automatic stay prohibits the termination or threats of termination of a contract (whether oral or written). The automatic stay also prohibits any demands against a vendor in bankruptcy with respect to performance obligations, whether the performance obligations arose before or after the bankruptcy case was filed. Such actions could result in sanctions against you. Please contact counsel to discuss what rights and obligations exist for you under the vendor contract or supplier authorization agreement in bankruptcy.

4. If you are not sure whether the vendor you are dealing with is actually in bankruptcy, you should confer with counsel who can quickly confirm the vendor's status.

For more information on the Restructuring, Workouts and Recapitalizations group and its members, go to [Restructuring, Workouts, and Recapitalizations](#).