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BEST PRACTICES FOR DOING BUSINESS WITH A FINANCIALLY TROUBLED CUSTOMER POST-BANKRUPTCY

Presented to:
NACM WESTERN CREDIT CONFERENCE


Presented by:
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Jason M. Torf is a bankruptcy and creditors' rights partner in the law firm Tucker Ellis LLP, a 240-attorney, full-service law firm with offices throughout the United States. Jason regularly represent clients in helping them solve their problems with troubled customers, both in bankruptcy proceedings and otherwise. He is a frequent speaker to NACM, CFDD and other credit and finance groups to help them understand practical steps their companies can utilize to minimize risk and maximize their recovery when dealing with a financially troubled customer.

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DOING BUSINESS WITH A DEBTOR IN BANKRUPTCY
PROTECTING YOUR POST-BANKRUPTCY SHIPMENTS TO A CUSTOMER

- TRUE OR FALSE
 - DIP financing is a guarantee of payment

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DOING BUSINESS WITH A DEBTOR IN BANKRUPTCY
PROTECTING YOUR POST-BANKRUPTCY SHIPMENTS TO A CUSTOMER

- TRUE OR FALSE
 - DIP financing is a guarantee of payment

FALSE!!!!

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DOING BUSINESS WITH A DEBTOR IN BANKRUPTCY
PROTECTING YOUR POST-BANKRUPTCY SHIPMENTS TO A CUSTOMER

- DIP financing is not guarantee of payment
 - Debtor will try to get you to believe that DIP financing and administrative claim sufficiently cover you
 - NOT TRUE!!!
- DIP financing and administrative claim are good, but not guarantee of payment
 - Administrative insolvency problem

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DOING BUSINESS WITH A DEBTOR IN BANKRUPTCY
 PROTECTING YOUR POST-BANKRUPTCY SHIPMENTS TO A CUSTOMER

- Check DIP financing or cash collateral order
 - Review budget to ensure debtor has ability to pay you
 - If you are uncertain, ask questions
 - Which line item in budget covers you
 - What is the term of DIP financing or cash collateral usage?
 - If your invoice terms extend beyond DIP financing or cash collateral term, consider shipping on terms that get you paid before DIP financing or cash collateral usage expires

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DOING BUSINESS WITH A DEBTOR IN BANKRUPTCY
 PROTECTING YOUR POST-BANKRUPTCY SHIPMENTS TO A CUSTOMER

- If shipping on terms:
 - If any payment is late, strongly consider stopping any further shipments
 - Immediately file motion for allowance and payment of administrative expense claim
 - If debtor wants additional goods, make them pay outstanding invoice and switch to cash in advance or shortened terms for further shipments

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SHIPPING TO YOUR CUSTOMER POST-BANKRUPTCY
 CASH IN ADVANCE IS BEST ALTERNATIVE

- Questions often arise regarding the best way to protect post-bankruptcy shipments
- Cash in advance / COD is best
 - Give us the cash, we'll give you the goods
 - No risk
 - **Proactive Pointer:** If switching to cash in advance, make sure to get paid by wire, not by check. Payment by check still presents risk due to possibility of dishonored check after goods are shipped.

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SHIPPING TO YOUR CUSTOMER POST-BANKRUPTCY
 WHAT IF CUSTOMER WILL NOT PAY CASH IN ADVANCE?

- What options are available if customer refuses to pay cash in advance
 - I still want to ship
 - We place a large volume of goods with this customer and do not want to lose the revenue
 - At the same time, we want to maximize the likelihood of collection

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SHIPPING TO YOUR CUSTOMER POST-BANKRUPTCY
 WHAT IF CUSTOMER WILL NOT PAY CASH IN ADVANCE?

- Reducing terms combined with credit limit as a technique to manage credit risk
 - Helps keep exposure low while keeping flow of goods to bankrupt customer open
- Letter of credit
 - Good credit enhancement utilizing creditworthy third party as payment backstop
- Guaranty
 - Is there a non-debtor entity or individual who can act as guarantor?
 - Who is the best guarantor?
 - For closely-held companies, principal is often best guarantor to enhance chances of receiving payment

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SHIPPING TO YOUR CUSTOMER POST-BANKRUPTCY
 HEDGING ALTERNATIVES

- Opportunities to hedge post-bankruptcy shipments exist
 - Receivables Put Agreement
 - Receivables Assignment Agreement
- There are financial counterparties, such as banks and hedge funds, that in some, but not all, circumstances will take the opportunity to enter into these arrangements

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SHIPPING TO YOUR CUSTOMER POST-BANKRUPTCY
 RECEIVABLES PUT AGREEMENT

- Your company pays a negotiated fee (a “put premium”) for the right to “put” (i.e., sell) receivables owed by a bankruptcy counterparty
- Put right arises upon occurrence of certain predetermined events by specified deadlines
 - Examples (all of which are negotiated):
 - Conversion to chapter 7
 - Dismissal of bankruptcy case
 - Failure to file a plan by a certain date
 - Appointment of a trustee or receiver

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SHIPPING TO YOUR CUSTOMER POST-BANKRUPTCY
 RECEIVABLES PUT AGREEMENT

- Can cover any number of shipments, present and future
 - Negotiated between you and put counterparty
 - Can be subject to restrictions, such as an aggregate dollar cap
- If any of the predetermined events occur by the deadline stated in the put agreement, your company has the absolute right to sell to the put counterparty all of the receivables covered by the put agreement for 100% payment of face value of invoices supporting those receivables

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SHIPPING TO YOUR CUSTOMER POST-BANKRUPTCY
 RECEIVABLES PUT AGREEMENT

- Ensures payment in full if buyer runs into deeper trouble during bankruptcy case and cannot pay
 - But only so long as contingencies triggering put right occur by specified deadlines
 - Otherwise, you are still stuck with the potentially uncollectible receivables and you will have paid the put premium

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SHIPPING TO YOUR CUSTOMER POST-BANKRUPTCY
 RECEIVABLES PUT AGREEMENT

- **Proactive Pointer:** Make sure that your contract with your buyer does not prohibit sale or assignment of receivables owed by your buyer
 - Could create a defense by your customer to collection efforts by your put counterparty
 - If you provided your put counterparty with a representation that the receivables are valid and collectible, you could be in breach of warranty and could be forced to return the cash and take back the receivables

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SHIPPING TO YOUR CUSTOMER POST-BANKRUPTCY
 RECEIVABLES ASSIGNMENT AGREEMENT

- Financial counterparty agrees to buy, at a discount, receivables owed to you by bankrupt counterparty immediately upon shipment
- Percentage to be paid is negotiated between you and the financial counterparty
- Specific receivables are identified in assignment agreement
- Usually negotiated at the time of each shipment
 - In other words, covers only one shipment, not a series of shipments

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SHIPPING TO YOUR CUSTOMER POST-BANKRUPTCY
 RECEIVABLES ASSIGNMENT AGREEMENT

- No collection risk
 - Because receivables are sold immediately upon shipment
- No loss for time value of money
 - Because payment is immediate

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SHIPPING TO YOUR CUSTOMER POST-BANKRUPTCY
 RECEIVABLES ASSIGNMENT AGREEMENT

- Absolute assurance of payment
 - So long as you do your own due diligence on receivables purchaser to ensure its financial viability and ability to pay
 - You don't want to ship the goods, then find out that your receivables purchaser cannot pay
- Your cost to ensure collection in this manner is losing some of your profit margin on the shipment
 - Because receivables are sold at a discount
 - But enables you to ship (i.e., receive the revenue) while eliminating collection risk

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SHIPPING TO YOUR CUSTOMER POST-BANKRUPTCY
 RECEIVABLES ASSIGNMENT AGREEMENT

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SHIPPING TO YOUR CUSTOMER POST-BANKRUPTCY
 RECEIVABLES PUT AGREEMENT vs. RECEIVABLES ASSIGNMENT AGREEMENT

	Put Agreement	Assignment
Fee / Discount:	Put premium likely lower than discount for assignment	Discount generally greater than put premium
What Is Being Sold:	Usually all receivables from specific customer (but might be subject to limitations)	Receivables as to one specific shipment – must be separately negotiated for each shipment
Contingencies:	Put right does not arise until and unless specified contingencies occur by set deadlines	None
Likelihood of Collection:	Lower than assignment because subject to occurrence of specific events by set deadlines	Absolute – subject only to counterparty's ability to pay
Subject to Due Diligence by Counterparty:	Yes	Yes

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SELLING TO A DEBTOR-IN-POSSESSION
OVERVIEW

- Rights and obligations of parties depends upon whether there is a contract
- No contract – answer is straightforward
 - Non-debtor party is under no obligation to continue doing business with a debtor where there is no contract
 - As a business matter, though, you might wish to continue selling to debtor (making sales is good!), but with appropriate safeguards to ensure payment:
 - Revoke credit terms and sell on COD or CIA basis
 - Ask for deposit
 - Ask for a letter of credit
- But what if there is a contract?

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SELLING TO A DEBTOR-IN-POSSESSION
CHANGING TERMS POSTPETITION

- Ascertain whether you have a contract with the debtor
- If not (i.e., shipments on open purchase orders), then you have the freedom to impose any payment terms you deem fit
- Even if you do have a contract, you probably have the right under UCC Article 2 to shorten or revoke credit terms due to debtor’s lack of creditworthiness
- If you are not comfortable with extending credit postpetition, you can impose COD or cash in advance terms or elect not to ship at all

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EXECUTORY CONTRACTS
OVERVIEW

- It is important that:
 - When a customer files bankruptcy, you consider whether you have an executory contract with that customer
 - You understand your rights and the debtor’s rights with respect to those contracts

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UNDERSTANDING EXECUTORY CONTRACTS
WHAT DOES "EXECUTORY" MEAN?

- What is an executory contract:
A contract with material performance obligations still owed by both parties.

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UNDERSTANDING EXECUTORY CONTRACTS
DEBTOR'S OPTIONS WITH RESPECT TO EXECUTORY CONTRACTS

- Assume
- Assume and assign
- Reject
- Do nothing

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UNDERSTANDING EXECUTORY CONTRACTS
RIGHTS AND OBLIGATIONS UNDER EXECUTORY CONTRACT PRIOR TO ASSUMPTION OR REJECTION

- Non-debtor counterparty cannot compel performance – debtor has discretion whether to perform
 - Some exceptions apply
 - Intellectual property license agreements
- But if debtor performs, then non-debtor counterparty must also perform

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UNDERSTANDING EXECUTORY CONTRACTS
TIMING FOR ASSUMPTION OR REJECTION OF EXECUTORY CONTRACTS

- **Chapter 7:** Within 60 days after order for relief
 - Can be extended for cause on order of court
- **Chapter 11:** Before plan confirmation

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UNDERSTANDING EXECUTORY CONTRACTS
WHAT CAN YOU DO

- What if you have a contract under which you have to have certain inventory volumes on-hand for your customer?
 - File a motion asking the court to compel the debtor to assume or reject the contract sooner
 - Court might be sympathetic
 - Based on facts and circumstances in each case

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UNDERSTANDING EXECUTORY CONTRACTS
EFFECT OF ASSUMPTION

- Reinstates contract such that rights and obligations of both parties exist irrespective of bankruptcy
- As a condition to assumption, debtor must:
 - cure any defaults; and
 - provide adequate assurance of future performance

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UNDERSTANDING EXECUTORY CONTRACTS
EFFECT OF ASSUMPTION

- As an example, debtor might assume a contract if it entitles debtor to purchase goods at below-market rates
- Benefit to non-debtor counterparty is payment of cure – absent assumption and a cure, non-debtor counterparty would be left with a prepetition, general unsecured claim
 - Therefore, try to leverage your way into the debtor assuming your contract – a cure payment is good!
 - But maybe not if you are selling at below market prices

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UNDERSTANDING EXECUTORY CONTRACTS
ASSUMPTION AND ASSIGNMENT

- Debtor can assume and assign an executory contract to a third party
- Non-debtor counterparty to contract is entitled to adequate assurance of future performance from assignee, which can include:
 - Access to financial information of assignee
 - Deposit
 - Letter of credit
 - Personal guaranty

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UNDERSTANDING EXECUTORY CONTRACTS
ASSUMPTION AND ASSIGNMENT

- Debtor is generally permitted to assume and assign an executory contract to a third party
 - This is true notwithstanding an anti-assignment provision in a contract, subject to limited exceptions
- Non-debtor counterparty to contract might be entitled to block assignment under certain circumstances:
 - Adequate assurance not provided
 - Cure not provided
 - Applicable non-bankruptcy law prohibits assignment of:
 - Personal services contracts
 - Government contracts
 - Patent licenses

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UNDERSTANDING EXECUTORY CONTRACTS
 ASSUMPTION IN THE CONTEXT OF 363 SALES

- When debtor sells assets, debtor often must decide whether to assume and assign contracts or reject them, in consultation with buyer
- Debtor usually serves an omnibus cure notice identifying proposed cure amount for contracts that might be assumed
 - Short notice (e.g., two days) before sale hearing
 - Cure notice goes out before debtor knows who the winning bidder at auction will be, so typically all contracts are listed
 - Often lists many pages of cure amounts
 - **Proactive Pointer:** Look out for the zero dollar cure!
 - **Proactive Pointer:** Respond promptly to preserve rights

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UNDERSTANDING EXECUTORY CONTRACTS
 EFFECT OF REJECTION

- Non-debtor party to an executory contract is entitled to file a rejection damages claim if the debtor rejects the contract
- Deemed to be a prepetition claim if the rejected contract existed prepetition
- Asserts state law contract damages as a claim in the bankruptcy case
- In some cases, a rejection procedures order exists that sets forth the amount of time the non-debtor party has to file its claim after rejection of the contract
- Otherwise, the court must set a deadline

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UNDERSTANDING EXECUTORY CONTRACTS
 RIGHTS OF NON-DEBTOR COUNTERPARTY TO EXECUTORY CONTRACTS

- As a general rule, the non-debtor counterparty to an executory contract may not unilaterally terminate the contract once a bankruptcy is filed by the other party to the contract
- Non-debtor counterparty may file a motion to modify or terminate the automatic stay to permit termination (e.g., if contract cannot be assumed because cure is impossible)

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UNDERSTANDING EXECUTORY CONTRACTS
 RIGHTS OF NON-DEBTOR COUNTERPARTY TO EXECUTORY CONTRACTS

- Cure may be impossible if default is non-monetary and consists of debtor's failure to act or abstain from acting at or by a certain time in the past rather than a monetary default
 - Theory: cannot turn back the clock
 - Examples:
 - » Requirements contract
 - » Must supply certain goods in certain volumes by certain deadlines
 - » A tenant "going dark" under a commercial lease for a period of time
 - » Failure to go operational by a date certain
 - » Failure to close by a specified date under a real estate purchase agreement where time is of the essence

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USEFUL PROACTIVE REMEDIES

- Reclamation
- 503(b)(9) claim, also known as "20-day" administrative claims
- Critical vendor status

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UNDERSTANDING RECLAMATION RIGHTS

- Reclamation is a seller's right to recover possession of goods sold to debtor:
 - in the ordinary course of seller's business;
 - that debtor received:
 - while insolvent; and
 - within 45 days before bankruptcy filing

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UNDERSTANDING RECLAMATION RIGHTS
HOW TO ASSERT

- Reclamation rights are asserted by issuing demand letter to debtor
- Manner of transmission same as outside of bankruptcy context

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UNDERSTANDING RECLAMATION RIGHTS
TIMING

- Demand must be made within 20 days after bankruptcy filing or rights are lost
- But demand letter should be issued as soon as possible because reclamation rights are only valid to the extent debtor still has those goods in its possession
 - If you wait until 20 days after bankruptcy filing, given 45-day lookback, the chance that goods delivered over two months earlier are still in customer’s possession is smaller than if demand issued quickly after bankruptcy filing

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UNDERSTANDING RECLAMATION RIGHTS
CONTENT OF DEMAND LETTER

- Demand letter must properly identify goods sought to be reclaimed
 - Attach invoices and purchase orders that identify goods
 - Proper identification of goods is necessary to ensure valid reclamation demand. Therefore, do not try to list goods in letter. Simply attach invoices and purchase orders that identify goods by description, item number and quantity.
- Letter should demand immediate return of goods and state that seller will pick up goods

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UNDERSTANDING RECLAMATION RIGHTS
MANNER OF TRANSMISSION OF DEMAND LETTER

- Demand letter should be transmitted in a manner that can be tracked:
 - Overnight delivery via reputable carrier
 - Fax
 - E-mail
- Ensures that proof of delivery can be made if evidentiary hearing becomes necessary
- Send to both debtor (i.e., CFO and account manager) and debtor’s counsel

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UNDERSTANDING RECLAMATION RIGHTS
RECLAMATION RIGHTS VERSUS SECURED LENDER

- Reclamation rights are subject to rights of a secured lender
- If there is a security interest on goods sought to be reclaimed, reclamation rights are not valid
- Because most debtors have a secured lender with a blanket lien on assets, reclamation rights frequently are rendered valueless, BUT.....

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UNDERSTANDING RECLAMATION RIGHTS
RECLAMATION RIGHTS VERSUS SECURED LENDER

- A reclamation demand is fairly easy to do
- Do not forgo these rights simply because they might not have any value
- Issue the demand and you might discover that the lender does not have a security interest in those assets
- Or the secured lender may not have properly perfected its security interest

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UNDERSTANDING RECLAMATION RIGHTS
WHAT YOU GET

- What do you get for your valid reclamation claim?
 - Return of goods
 - Administrative claim
 - Payment
- Timing

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503(b)(9) ADMINISTRATIVE CLAIMS

- Significantly improves recovery by trade creditors in a bankruptcy
- Known as a “20-day” administrative claim
- A debtor sometimes will time bankruptcy filing around these 20-day claims
- Could make or break bankruptcy strategy due to obligation to pay 20-day claims in full
- Self-perfecting, but requires enforcement

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503(b)(9) ADMINISTRATIVE CLAIMS
ELEMENTS OF A 20-DAY CLAIM

- 503(b):
“After notice and a hearing, there shall be allowed, administrative expenses . . . including –
(9) The **value of goods received** by the **debtor** within **20 days** of the date of commencement of a case under this title in which the **goods** have been sold to the debtor in the **ordinary course** of such debtor’s business.”

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503(b)(9) ADMINISTRATIVE CLAIMS
ADD-ON CHARGES

- Other “add-ons” such as freight, handling, etc.
 - Generally are excluded from 503(b)(9) claim
 - 503(b)(9) claim only covers the value of goods provided

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503(b)(9) ADMINISTRATIVE CLAIMS
RELATIONSHIPS WHERE BOTH GOODS AND SERVICES ARE PROVIDED

- What if both goods and services are being provided?
 - *Sklar Exploration Company, LLC* (Bankr. D. Col.) (March 14, 2022)
 - Service contract at issue had servicer provider selling goods in connection with the provision of services
 - At time of bankruptcy filing, debtor owed creditor under the same service contract:
 - App. \$643,000 for services; and
 - App. \$62,000 for goods
 - The \$62,000 owed for goods otherwise met all of the other requirements for a 503(b)(9) claim
 - Debtor argued that 503(b)(9) claim should not be allowed because the “predominant purpose” of the contract was for services
 - Service provider argued that it was entitled to a 503(b)(9) claim for the value of the goods sold under the service contract
 - Colorado bankruptcy court held that service provider was entitled to a 503(b)(9) claim for the \$62,000 of goods sold
 - VERY BENEFICIAL FOR TRADE CREDITORS!

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503(b)(9) ADMINISTRATIVE CLAIMS
RELATIONSHIPS WHERE BOTH GOODS AND SERVICES ARE PROVIDED

- Other bankruptcy courts have rejected the applicability of the “predominant purpose” test for purposes of 503(b)(9) claims
 - *In re Plastech Eng’rd Prod., Inc.*, 397 B.R. 828 (Bankr. E.D. Mich. 2008)
 - *GFI Wis., Inc. v. Reedsburg Utility Comm’n*, 440 B.R. 791 (W.D. Wis. 2010)
 - *In re Erving Industries, Inc.*, 432 B.R. 354 (Bankr. D. Mass. 2010)
 - *In re Pilgrim’s Pride Corp.*, 421 B.R. 231 (Bankr. N.D. Tex. 2009)

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503(b)(9) ADMINISTRATIVE CLAIMS
RELATIONSHIPS WHERE BOTH GOODS AND SERVICES ARE PROVIDED

- One bankruptcy court has applied the “predominant purpose” test for purposes of 503(b)(9) claims
 - *In re Circuit City Stores Inc.*, 416 B.R. 531 (Bankr. E.D. Va. 2009)
- The *Circuit City* ruling sets forth an all-or-nothing test
 - The *Circuit City* court denied a 503(b)(9) claim where the predominant purpose of the contract was for the provision of services, even though goods were provided under the contract
 - Under *Circuit City*, if the predominant purpose of the contract is for the sale of goods, then a 503(b)(9) claim can be allowed

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503(b)(9) ADMINISTRATIVE CLAIMS
HOW IS “RECEIVED” TESTED?

- Term is not defined in the Bankruptcy Code
- What *Circuit City* (4th Circuit) and *World Imports* (3th Circuit) say
 - Receipt occurs when buyer takes physical possession of goods
 - FOB terms are irrelevant
 - Thus, if goods are shipped on FOB terms outside of 20-day period and buyer receives physical possession of the goods within 20-day period, goods are deemed to have been “received” within 20-day period for purposes of 503(b)(9)
- 4th Circuit (Virginia) and 3rd Circuit (Delaware) are two major venues for bankruptcies currently
 - Thus, their holdings are impactful and are highly beneficial to sellers of goods seeking 503(b)(9) claims

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503(b)(9) ADMINISTRATIVE CLAIMS
HOW IS “RECEIVED” TESTED?

- Constructive possession (i.e., goods in possession of freight forwarder)
 - If freight forwarder is acting as buyer’s agent, then buyer may be deemed to receive physical possession of goods once freight forwarder, acting as buyer’s agent, possesses them
 - If freight forwarder is just a third-party common carrier, *World Markets* case says that goods are not “received” until buyer has physical possession of them, even if goods are shipped on FOB terms

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503(b)(9) ADMINISTRATIVE CLAIMS
HOW IS "ORDINARY COURSE OF BUSINESS" TESTED?

- Objective approach
- Look to history as critical guide
- What happens if long-term history does not mirror immediate history?
 - Case-by-case approach based upon the facts

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503(b)(9) ADMINISTRATIVE CLAIMS
ARE DROP SHIPMENTS COVERED?

- Some cases say yes
- Other cases say no

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503(b)(9) ADMINISTRATIVE CLAIMS
HOW TO ASSERT 20-DAY CLAIM

- Self-perfecting, but not automatic in enforcement
- Subject to notice and hearing – general rule requires you to file a motion
- Except in rare cases (usually very large cases with a procedures order in place), no technical deadline to assert claims
 - Look at specific bankruptcy case for deadline, if any
- **Proactive Pointer:** Check the local rules and any orders in the bankruptcy case that permit or require the filing of 503(b)(9) claims by proof of claim form rather than by motion

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503(b)(9) ADMINISTRATIVE CLAIMS
PAYMENT TIMING

- First, must obtain order approving 20-day claim
- Timing may be:
 - Immediate
 - Possibly contingent upon future extensions of credit to debtor
 - Unlikely unless you are a critical supplier with leverage
 - **Most common:** Upon Plan confirmation
 - Upon conversion or dismissal of case
- Consensual resolution of 20-day claim - do you have leverage to push debtor to pay early (e.g., critical supplier)?

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503(b)(9) ADMINISTRATIVE CLAIMS
CAN DEBTOR ASSERT DEFENSES?

- Yes
- Most common: setoff
- Debtor may “setoff” prepetition claim it has against vendor to reduce vendor’s claim against debtor
 - Depending upon jurisdiction, setoff may be against 503(b)(9) amounts or non-503(b)(9) prepetition claim
 - Creditor benefits more if setoff is against non-503(b)(9) portion of prepetition claim because 503(b)(9) claim would be paid in full and non-503(b)(9) portion of claim likely would not be paid in full

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503(b)(9) ADMINISTRATIVE CLAIMS
WATCH FOR RED FLAGS - CUSTOMER BULKING UP ON INVENTORY

- Beware a customer that orders unusually large volume of inventory
 - Could be sign of expansion or increased sales – good!
 - But could instead be a sign of a looming bankruptcy
 - Customer might be bulking up on inventory now with no plan to order additional inventory for a few weeks
 - This avoids 503(b)(9) exposure
 - Talk to other vendors to common customer to find out if larger volumes are isolated with your company or across many vendors
 - Do this **BEFORE** shipping

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CRITICAL VENDOR TREATMENT
PROS

- May get some or all of your prepetition invoices paid in full
- Preserves ongoing business relationship with debtor
- Likely indicator that your relationship will survive sale of assets and potentially have contract assumed by acquirer of assets
- Possible preference waiver (but see subsequent slides)

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CRITICAL VENDOR TREATMENT
CONS

- Typically requires execution of a critical vendor/essential supplier contract
- Typically have to extend credit terms
- May be subject to potential claw-back if debtor thinks you "misbehave"

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CRITICAL VENDOR TREATMENT
DOES IT INSULATE CREDITOR FROM PREFERENCE LIABILITY?

- Might not insulate from preference liability absent "something more"
 - See *Insys Liquidation Trust v. McKesson Corp.*, Case No. 21-50176 (Bankr. D. Del. July 21, 2021)
 - Delaware bankruptcy court ruled that critical vendor status does not automatically insulate creditor from preference exposure, absent "something more," where
 - creditor was not specifically named in critical vendor order;
 - Debtor was given discretion, but not required, to make critical vendor payments; and
 - critical vendor order expressly stated that it did not constitute "a waiver of any claims or causes of action that may exist against any creditor."

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CRITICAL VENDOR TREATMENT
DOES IT INSULATE CREDITOR FROM PREFERENCE LIABILITY?

- Under *Insys*, “something more” to help insulate creditor from preference exposure could be language in the critical vendor order that
 - **requires** (i.e., not discretionary) the debtor to pay the creditor’s entire pre-bankruptcy balance in full;
 - expressly names the creditor; and/or
 - expressly provides for a waiver of any subsequent preference claims against the creditor
- Express waiver language likely is the best approach
- But.....might not be easy to get Debtor to include any of these provisions in critical vendor order, or creditor might not have a seat at the table before critical vendor order is entered, in which case
 - Might need to deal with preference lawsuit later, even after being paid in full as a critical vendor

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CRITICAL VENDOR TREATMENT
HOW TO OBTAIN

- You know or should know how debtor views you
- Remains debtor’s business decision
- Be careful not to violate automatic stay by blatantly asking to be a critical vendor
 - As a practical matter, the blatant request is very common these days
- **Proactive Pointer:** Obtain a personal guaranty when you sign-up new customer to use as leverage to obtain critical vendor status
 - The individual making the decision regarding who is a critical vendor might be the individual on the hook personally if you obtain a guaranty

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NEGOTIATION STRATEGIES
HOW TO OBTAIN PREFERENTIAL TREATMENT

- Debtor wants you to keep shipping, but you need an inducement to do so
 - Will debtor make you a critical vendor?
 - This can:
 - Provide full payment on prepetition claim
 - Eliminate preference exposure
 - But debtor might be concerned that other vendors will ask for same treatment
 - Alternatively, do you have a contract that can be assumed?
 - This can:
 - Provide a cure (i.e., full payment on prepetition claim)
 - Eliminate preference exposure
 - Specific to your contract, so does not create open opportunity for other vendors to ask for same treatment as with critical vendor

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NEGOTIATION STRATEGIES
HOW TO OBTAIN PREFERENTIAL TREATMENT

– Second alternative – pay at least 503(b)(9) claim up front

- Even if this does not result in payment in full of prepetition claim, perhaps it is a significant enough amount to induce new shipments

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QUESTIONS

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