

## Are “Critical Vendors” Safe?

In general, when a company declares bankruptcy and starts the process of reorganization, it must put a hold on payments to creditors until the bankruptcy is complete and the plan for reorganization is finalized. However, in many instances, for a company to remain in business and stay afloat during the bankruptcy process, certain of its creditors must continue to be paid. To accomplish this, the bankrupt company files an Order Requesting Critical Vendor Status with the bankruptcy court. Applying “Critical Vendor” status to a company or companies may be beneficial for the debtor, but is it safe for these Critical Vendors to accept payment and provide goods or services to the debtor without fear that those payments will be forfeited as preference claims at a later date?

It is relatively simple for a debtor to cause certain of its vendors to obtain Critical Vendor status, but what can a Critical Vendor do to protect these payments from future preference claims?

There are key factors that courts look at when determining whether a post bankruptcy petition payment to a critical vendor can stand up against a preference claim. The first critical issue is whether the debtor and critical vendor reached an agreement which specifically releases the critical vendor from potential preference liability. *Fultonville Metal Products Co., v. Howell Electric Motors*, 330 B.R. 305, 312 (Bankr.M.D.Fla.2005). A second key element is whether each of the other unsecured creditors were given notice of certain creditors receiving critical vendor status and given the opportunity to object. *In re Phoenix Restaurant Group, Inc.*, 2004 WL 3113719, at 19 (Bankr.M.D.Tenn.). Finally, the specific terms of the Critical Vendor Order must establish that the vendor is insulated for the entire amount of its pre-petition transactions with debtor. If an amount, less than the full amount owed is listed on the Order, the critical vendor will be protected only up to that amount referenced on the Order. *Hayes Lemmerz International, Inc. v. Export Corp.*, 313 B.R. 189, 193 (Bankr.D.De.2004).

For all of the companies who may potentially do business with another company undergoing a bankruptcy, there are several important lessons to take from this. Before blindly continuing to service the debtor while taking comfort in the fact they have named you as a “Critical Vendor,” insist to be in the process, or at least have the opportunity to review the documentation declaring you a Critical Vendor. Make sure the Order specifically says that the intention of this order is to prevent future preference claims. Remember, that courts do not like to play favorites between creditors, so make certain the creditors not receiving critical vendor status understand what is going on and agree that they will receive more money in the end if the bankrupt entity is able to keep doing business. Finally, have the debtor list a specific amount that may be paid to you in the Order, and understand that if no amount is listed, it will be up to the bankruptcy court to come up with a figure they deem appropriate.

If the language in the Critical Vendor Order is drafted properly, you should take comfort in knowing you have substantially minimized the risk of having to surrender those invoice payments you have been accepting from a bankrupt company. Hopefully these tips will ease the uncertainty of how to handle business dealings with clients or customers who are involved in bankruptcy proceedings.

