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Strategies in Anticipation of a Customer's Bankruptcy

The deteriorating financial performance of businesses within the automotive industry has created significant demand for information on potential customer bankruptcies. Following are:

- a description of the effects of a customer bankruptcy on its suppliers; and
- several tactics to consider implementing when a customer bankruptcy seems inevitable.

When an OE Files for Bankruptcy:

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1. **Automatic Stay:** Filing for bankruptcy immediately suspends virtually all actions against the customer by means of an "automatic stay". This includes attempts to collect from the customer on accounts receivables booked prior to the filing. Ultimately, the customer may pay cents on the dollar against those accounts receivable, or it may pay nothing at all.
2. **Administrative Claim:** A supplier is more likely to collect on accounts receivables pertaining to the 20 days of shipments preceding the filing than other receivables. They are treated as an "administrative claim" with a high payment priority.
3. **Reclamation Claim:** A supplier can attempt to reclaim goods shipped within 45 days of the filing, to the extent that goods have not been absorbed into the customer's products. Because a supplier would not actually want to take back most goods, this claim might only serve as a source of leverage for other accommodations.
4. **Assumption or Rejection of Contracts:** A customer in bankruptcy can assume or reject its outstanding contracts, including POs. A customer may use the threat of rejection as leverage for obtaining accommodations such as lower prices.
5. **Avoidable Payments:** Any transfer of money or goods from the customer to a supplier within 90 days prior to filing for bankruptcy may be scrutinized and ordered returned to the customer as a preference if the transfer was made outside the ordinary course of business of the parties. Payments can also be recovered as fraudulent conveyances if made for unfair value to the paying entity. Therefore, transfers of money or goods from a customer whose bankruptcy seems imminent should be carefully considered from a legal perspective.

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When Bankruptcy Seems Inevitable:

1. **Payment Terms:** The customer may extend its payment practices. Because the extended terms may persist through the bankruptcy proceedings, any extension should be resisted.
2. **Credit Risk Coverage:** A supplier may be able to obtain credit risk insurance or put options on customer receivables.
3. **Critical Vendor List:** A supplier can attempt to be added to the customer's critical vendor list in order to receive favorable treatment during the bankruptcy proceedings.
4. **Payment Origination:** A supplier should monitor for payments from entities other than the customer contracting party, as such payments could be deemed a fraudulent conveyance (see above). When detected, the supplier should consider demanding payment from the customer contracting party instead.
5. **Administrative Claim:** A supplier should ensure that detailed information about shipments and payments is easily accessible so that an administrative claim for payments relating to shipments made within 20 days before a customer's bankruptcy filing can be promptly made.
6. **Reclamation Claim:** A supplier can evaluate the potential strategic benefit of a reclamation claim relating to goods shipped within 45 days before a customer's bankruptcy filing.

In addition, legal strategies can be developed that are specific, for example, to an automotive supplier's agreements with customers, product leverage, additional commercial disputes, and commercial and strategic objectives.

If you have questions regarding the above information, please call your Butzel Long attorney or one of the following:

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