



## Young & New Members Committee

### ABI Committee News

In This Issue:

Volume 10, Number 2 / March 2012

- [The Need for Uniform Bankruptcy Legal Ethics Provisions](#)
- [Does § 1129\(a\)\(10\) Impose a Per Debtor or Per Plan Requirement?](#)
- [Exploring the Limits of the \*In Pari Delicto\* Defense](#)
- [Courts Critical of Critical-Vendor Motions](#)
- [ABI's Next Discover Webinar to be Held on March 15th - Register Now!](#)
- [Download Now: Business and Consumer "Best of ABI" Publications Are Available in Kindle and Nook Format](#)

### Courts Critical of Critical-Vendor Motions

by [Veronique A. Urban](#)  
Farrell Fritz, P.C.; Uniondale, New York

The recent decision by Eastman Kodak Company to reschedule the hearing on its critical vendor motion provides a good reminder to bankruptcy practitioners that such motions are not treated lightly by bankruptcy judges.<sup>[1]</sup> At its core, the Bankruptcy Code strives to ensure that all creditors that are similarly situated are treated equally. The Code accomplishes this, in part, by providing a specific priority scheme for the payment of creditor claims. Such scheme establishes the basic principle that, upon the commencement of a bankruptcy case, a debtor may not make any payments to creditors on account of pre-petition debts without a bankruptcy court order authorizing such payment, unless such payments are made as a result of a confirmed plan.

Critical-vendor motions are generally filed in large bankruptcy cases as part of a debtor's first-day motions. First-day motions are used by debtors to obtain various relief from the bankruptcy court on an expedited basis in order to minimize the effect of the filing on the debtor's business and allow it to continue its day-to-day business operations. At the outset of a bankruptcy case, a debtor may be concerned that its business cannot operate successfully without the support and continued business of its key suppliers and vendors, who could refuse to provide services and/or goods to the debtor due to the filing. As a result, a debtor may file a critical-vendor motion in order to obtain authorization to pay its critical vendors before its other, similarly situated unsecured creditors.

The Bankruptcy Code does not specifically provide for the payment of critical vendors. As a result, debtors generally rely on the "doctrine of necessity" and § 105(a) of the Code when requesting critical vendor relief. Section 105(a) provides that "[t]he court may issue any order, process or judgment that is necessary or appropriate to carry out the provisions of the [Code]."<sup>[2]</sup> Bankruptcy courts are split, however, as to whether § 105(a), or any other Code section for that matter, authorizes the payment of pre-petition critical-vendor claims. Some bankruptcy courts have determined that no such authority exists,<sup>[3]</sup> while other courts, such as those in the Second and Third Circuits, have generally accepted the rule that a debtor may honor pre-petition obligations of critical vendors if such payments are necessary to the debtor's reorganization.<sup>[4]</sup> In addition, at least one bankruptcy court has set forth a three-part test to determine when a vendor should be deemed a "critical vendor."<sup>[5]</sup> Although a bankruptcy court will ultimately decide whether to grant a critical-vendor motion, there are a number of steps that a debtor can take in order to put it in the best position to obtain approval of its motion.

First, prior to filing its critical-vendor motion, a debtor should prepare a list of *all* of its vendors and suppliers that includes the name of the vendor, the nature of the goods or services rendered and the amount outstanding to such critical vendor as of the petition date. From that list, the debtor should remove vendors and suppliers that are either not critical to the continuation of the business or, even if critical, that will continue to do business with the debtor despite the outstanding pre-petition balance due. The analysis should not end there, however. The debtor should then go through each vendor or supplier remaining on the list and be able to articulate why such vendor is critical to the debtor's business. If the debtor is unable to state with particularity why the vendor is critical, then that vendor should be removed from the list. When narrowing its list, the debtor may find it useful to review certain facts about the vendor in question, such as (1) whether a vendor is a sole- or limited-source provider, (2) whether the debtor receives advantageous pricing or other terms from the vendor such that losing or replacing the vendor post-petition would be detrimental to the debtor, (3) the overall impact on the debtor's operations if the vendor ceased or delayed shipments and (4) whether the vendor would be obligated to continue to perform services for the debtor after the commencement of the chapter 11 case, such as in those circumstances where the debtor and a vendor are parties to an executory contract.

Second, prior to filing the critical-vendor motion with the bankruptcy court, a debtor should ensure that the major constituents in the chapter 11 case, such as the debtor's post-petition lenders, the official committee of unsecured creditors and the U.S. Trustee, support the critical-vendor motion. A court will be much more likely to grant the relief if such parties do not object to the relief being sought. In addition, the debtor should explain in its critical-vendor motion why it is that other general unsecured creditors in the bankruptcy case won't be harmed as a result of the payments made to critical vendors.

Third, a debtor should prepare a rolling budget that shows the payments it expects to make during the bankruptcy case.

[Committee Officers](#)

[Upcoming Events](#)

[Contribute to the Newsletter](#)

[ABI World](#)

[Newsletter Archives](#)

The budget should include, for example, payments to be made on account of employee wages, customer programs, taxes and loan repayments. The budget should also reflect the anticipated payments to be made to critical vendors, and show the court that the debtor has the financial wherewithal to make the requested payments to the critical vendors, making it more likely that the court will grant the critical-vendor motion. In addition, the debtor should explain the source of the funds that it will use to make the payments to critical vendors. For example, the debtor may describe whether such funds come from post-petition financing, cash reserves on hand, anticipated accounts receivables or some other source.

Fourth, a debtor may want to request that any allowance provided by the bankruptcy court for the payment of critical vendor claims be made in two stages through the use of an interim and final order. In this way, the debtor will be afforded time to begin making payments to critical vendors and determine whether it still requires the remaining amount to be distributed under the final order. For example, a debtor may find that its critical vendors are more willing to negotiate on payment terms than the debtor expected, thus allowing the debtor to use fewer of the critical vendor funds allotted in the interim order and thereby reducing the amount requested by the debtor in its final order. Most critical-vendor motions will also require that the vendor and debtor enter into a form agreement, to be approved by the bankruptcy court, which will generally bind the vendor to certain trade terms upon its acceptance of a payment from the debtor.

Lastly, a debtor should ensure that it tracks each payment it makes to critical vendors, including the date the payment was made, the amount of the payment and the invoice number paid, if any. Providing the bankruptcy court with updates at subsequent hearings as to the amount of critical vendor payments made will also provide the bankruptcy court with an understanding as to how the debtor is progressing in its negotiations with creditors.

While it does not appear that bankruptcy courts will stop granting critical-vendor motions in the future, they will likely require evidence that clearly shows that the payment of such pre-petition debts is necessary to a debtor's reorganization. As such, proper preparation by a debtor can help it to stand on solid ground when making its request to the court.

- [1.](#) *In re Eastman Kodak Co.*, Case No. 12-10202 (ALG) (Bankr. S.D.N.Y.).
- [2.](#) 11 U.S.C. § 105(a).
- [3.](#) See, e.g., *In re Kmart Corp.*, 359 F.3d 866, 874 (7th Cir. 2004); *B & W Enters. Inc. v. Goodman Oil Co.* (*In re B & W Enters. Inc.*), 713 F.2d 534, 538 (9th Cir. 1983).
- [4.](#) See, e.g., *In re Just for Feet*, 242 B.R. 821, 826 (D. Del. 1999); *In re Ionosphere Clubs Inc.*, 98 B.R. 174 (Bankr. S.D.N.Y. 1989); *Michigan Bureau of Workers' Disability Comp. v. Chateaugay Corp.* (*In re Chateaugay Corp.*), 80 B.R. 279 (S.D.N.Y. 1981).
- [5.](#) See *In re Coserv LLC*, 273 B.R. 487, 498 (Bankr. N.D. Tex. 2002) (adopting three-part test for "necessity" that debtor must meet before bankruptcy court will approve payment of general unsecured pre-petition claim such as critical-vendor claim).

