

Steps to take within the first 48 hours of a supplier filing bankruptcy

When buying your company's supplies on a just-in-time basis, unforeseen breaks in the supply chain can shut down production triggering a catastrophic ripple of customer contract breaches. So what can you do to hedge against the risk of a supplier's bankruptcy filing when it drops from the sky without a moment's notice? More importantly, how do you minimize collateral damage after learning of a supplier's bankruptcy?

"The bad news is that companies on the brink of financial disaster don't give advance notice of their intention to file for bankruptcy," says William I. Kohn, partner and chair of the Business Reorganization Practice Group at Benesch, Friedlander, Coplan & Aronoff LLP in Cleveland. "The good news is that with an understanding of typical trade credit and shipping mechanisms, supplier bankruptcy aftershock can be managed, at least to an extent."

Here is a checklist of what you can do to protect your company:

- Stop accounts payable activity. The filing of a bankruptcy case creates an estate. Cash or other property paid into the bankruptcy estate can be difficult to recoup down the road. Under certain circumstances, withholding payment may increase your leverage to obtain expensive work-in-progress components from your supplier.
- Contact carriers to ensure delivery of goods in transit. A supplier in

Chapter 11 might attempt to stop goods in transit and literally turn the trucks around — something the Uniform Commercial Code (UCC) permits in certain types of payment disputes. Contact the carriers to find out whether a delivery is headed your way. If the supplier calls the truck back, you may be able to secure an emergency court order to stop the truck and have the supplies delivered. If you're successful, this will provide the supplies you need for the time being and buy more time to find a new supplier.

- Assess whether the supplier is staying in business. A bankruptcy filing doesn't necessarily mean your supplier is shutting down for good. In Chapter 11 bankruptcies (reorganizations), the debtor typically stays in business, largely in the same manner before bankruptcy. In Chapter 7 bankruptcies (liquidation), the debtor immediately closes shop while a trustee liquidates the assets. In any event, an experienced bankruptcy attorney can help you better understand the dynamics in your specific case.

- Assess offsets of mutual debts. Bankruptcy law allows for the offset of mutual debts between debtor and creditor under certain circumstances. After accounting for inventory, check for any damaged or inoperable components that would be covered under the supplier's warranty.

- Set up a contingency plan. What would you do in a worse case scenario when a supplier's plant is destroyed by a fire that leads to bankruptcy? A contingency plan with a list of alternate suppliers or other options to get the components you need can be a guide to help you make better decisions in a time of crisis.

- Determine if you have work in progress (WIP) tooling or equipment on site. If the supplier manufactures customized components, you may have a property interest in partially finished pieces, or WIP components, even if they are in the supplier's hands at the time of the bankruptcy filing. An assessment of your rights for WIP components can be critical to maintaining production continuity.

"Having a workable action plan in place can minimize interruption and make for a measurably smoother transition to an alternate supplier or modified purchasing protocol," says Stuart A. Lavin Jr., an associate in Benesch's Business Reorganization Practice Group. "Ultimately, however, each supplier's insolvency crisis presents a unique set of challenges and mandates individualized strategies and priorities." ◀



William I. Kohn



Stuart A. Lavin Jr.