

# What Is a Critical Vendor?

## Creditor's Rights Toolkit

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This article discusses the benefits and drawbacks to serving as a critical vendor in a Chapter 11 Case.

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A critical vendor is a vendor so critical to the debtor's business operations that the failure of the vendor to provide goods or services to the debtor would have a material adverse effect on the debtor's business and its ability to reorganize in bankruptcy.

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### WHY SHOULD I SIGN ON AS A CRITICAL VENDOR?

While a company in bankruptcy is required to pay its vendors in the ordinary course of business for goods and services provided after the bankruptcy is filed, in general, a debtor is not permitted to pay vendors for goods and services provided before the bankruptcy case without authorization from the bankruptcy court. By signing on as a critical vendor, a vendor will get paid all or some of the outstanding pre-petition balance owed to it.

### IS THERE A DOWNSIDE TO SERVING AS A CRITICAL VENDOR?

#### ENFORCEABLE CONTRACT

Unless there is an enforceable contract between the parties, a debtor in bankruptcy cannot force a vendor to continue to provide goods and services to it. In exchange for payment of its pre-petition claim, a critical vendor is often required to sign a contract with the debtor under which the vendor agrees to continue providing goods or services to the debtor under the terms of any pre-filing arrangement (including credit terms) or other terms favorable to the debtor. If the vendor thereafter fails to comply with the terms of the critical vendor agreement, the debtor will have a breach of contract claim against the vendor. Often the critical vendor agreement requires the vendor to repay all pre-petition amounts received per the agreement where a breach has occurred.

#### WAIVER OF RIGHTS

The critical vendor agreement may require the vendor to waive some rights, including, for example, the right to file a claim in the bankruptcy case where the vendor receives less than full payment of the pre-petition balance.

#### CLAW-BACK ACTIONS

In general, serving as a critical vendor will not shield a vendor from a claim by the debtor to claw back funds paid to the vendor in the period immediately preceding the filing of the bankruptcy case.

## TAKEAWAY

Careful consideration should be given to the terms of the critical vendor agreement, including the amount to be paid, the timing of payments, and what rights, if any, are being waived by the critical vendor.

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