



VENDOR ISSUES

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I. Introduction and Practical Problems:

The success of any chapter 11 proceeding depends in large part on a healthy, balanced relationship between the debtor and vendors, many of whom will also be creditors in the upcoming reorganization. Some vendors supply key materials or services; other have placed the debtor on COD terms or otherwise restricted its access to credit. Ongoing communication and careful analysis is required with respect to each substantial vendor both to insure a proper source of supply and to limit potential abuses by creditors.

Dealing appropriately with vendors requires a careful analysis of both practical and legal problems. The most significant practical problems include:

- A. Maintaining good communication with key vendors so they know in advance of the upcoming Chapter 11 filing and understand the Debtor's goals.
- B. Evaluating cash reserves, cash flow and the extent to which vendors are likely to insist on COD terms or to assert administrative claims under section 503(b)(9).
- C. Determining the extent to which there are alternative sources for certain good and services; identify unique or truly indispensable vendors.
- D. Outlining a strategy to address key legal issues, chiefly potential reclamation and critical vendor payment issues.

II Reclamation Issues:

Prior to the enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA), effective October 17, 2005, reclamation existed largely as a function of state law. Applicable provisions of the Bankruptcy Code simply set forth additional procedures to be followed in bankruptcy cases. Section 2-702 of the Uniform Commercial Code, in effect in most jurisdictions, gives sellers of goods certain rights of reclamation. Section 546 of the bankruptcy code simply provided that a Trustee's avoiding powers, as otherwise set forth in 11 U.S.C. §§ 544, 545 et seq, are limited by the reclamation rights of sellers.

Prior to the enactment of BAPCPA, §546 (c)¹ provided:

Except as otherwise provided in subsection (d) of this section, the rights and powers of a Trustee under Sections 544 (a), 545, 547 and 549 of this title are subject to any statutory or common law right of a seller of goods that has sold goods to the debtor, in the ordinary course of such sellers business, to reclaim such goods if the debtor received such goods while insolvent, but – (1) such a seller may not reclaim any such goods unless such seller demands in writing reclamation of such goods (A) before 10 days after receipt of such goods by the debtor; or (B) if such 10 day period expires after the commencement of the case, before 20 days after the receipt of such goods by the debtor; and (2) the Court may deny reclamation to a seller with such a right of reclamation that has made such a demand only if the Court:

(A) Grants the claim of such a seller priority as a claim of a kind specified in section 503(b) of this title; or

(B) Secures such claim by a lien.

¹ Except as otherwise stated, all statutory references are to the Bankruptcy Code, 11 U.S.C. §§ 101 et seq.

In typical pre BAPCPA chapter 11 cases, debtors requested and obtained from bankruptcy courts Reclamation Procedures Orders establishing deadlines and procedures for the assertion and handling of reclamation claims. A vendor's right to assert such a claim depended upon a debtor actually receiving the goods within the statutory time frame and upon the fact those goods had not yet been sold by the debtor at the time the reclamation notice was made. Bankruptcy courts had the ability to give reclamation claimants administrative priority claims or liens in lieu of the return of the goods.

The revised section 546 (c) provides:

(1) Except as provided in subsection (d) of this section and in section 507 (c), and subject to the prior rights of a holder of a security interest in such goods or the proceeds thereof, the rights and powers of the trustee under sections 544 (a), 545, 547 and 549 are subject to the right of a seller of goods that has sold goods to the debtor, in the ordinary course of such seller's business, to reclaim such goods if the debtor has received such goods while insolvent, within 45 days before the date before the commencement of a case under this title, but such a seller may not reclaim such goods unless such seller demands in writing reclamation of such goods:

(A) Not later than 45 days after the date of receipt of such goods by the debtor; or

(B) Not later than 20 days after the date of the commencement of the case, if the 45 day period expires after the commencement of the case.

(2) If a seller of goods fails to provide notice in the manner provided in paragraph (1), the seller may still assert the rights contained in section 503 (b) (9).

Section 503 (b) (9) is an entirely new section of the bankruptcy code which creates an administrative priority claim for "the value of any goods received by the debtor

within 20 days before the date of commencement of a case under this title in which the goods have been sold to the debtor in the ordinary course of such debtors business.”

At first glance, the expanded time period to which the reclamation rights apply would appear to give vendors holding reclamation rights greater opportunities to assert them.

The small number of cases decided under the new section of 546 (c) (1), however, strongly suggest that the revised reclamation provisions have not inured particularly to the benefit of those asserting reclamation rights. Although the expansion of the reclamation period may be helpful in certain cases, 45 days is long enough that goods received by the debtor 30-45 days prior to the reclamation notice will in most cases have been sold before a tardy vendor asserts its claim. In addition, the revised section 546 (c) makes reclamation rights expressly subject to senior liens, thus altering slightly the balance of power between secured creditors and substantial vendors around the time of the petition date. In addition, the court is no longer required to provide reclamation claimants with an administrative claim or a lien as a substitute for a reclamation claim.

As is discussed in more detail *infra*, Section 503 (b) (9) provides some comfort to vendors, but its interpretation is far from certain. Disputes arise with respect to the valuation of goods, the timing of payment and the management of the Debtor’s cash flow.

The primary cases decided under the revised reclamation provisions of Section 546(c) are as follows:

- A. In re: Advanced Marketing Services, Inc., 2007 WL 162685 (Bankr. D. Del 2007);
- B. In re Dana Corporation 2007 WL 1199221

These cases are analyzed below:

- A. In re Advanced Marketing Services, Inc

In Advanced Marketing Services publisher Simon and Schuster asserted reclamation rights relative to books supplied to the Chapter 11 debtor, a wholesale seller of books. Simon and Schuster sought a temporary restraining order with respect to its reclamation claim.

In evaluating the reclamation claim and the request for a temporary restraining order under the revised section 546 (c) (1), the court found that Simon and Schuster could not establish the standards for temporary restraining order. Simon and Schuster had filed a reclamation claim seeking the reclamation of goods in the amount of approximately \$5, 105,000.00. On the same day the reclamation claim was filed, debtor filed a motion seeking interim post petition financing. The interim financing consisted of a DIP loan under 11 U.S.C. section 364 (c), secured by a lien on all debtor's pre-petition, post-petition, present and future assets. The DIP order did not provide for the payment of pre-petition secured claims or the extinguishment of pre-petition liens.

The Court denied the Simon and Schuster request for temporary restraining order, finding the goods were subject to the senior lender's first priority pre-petition and post petition liens and claims and as a result, the revised provisions of section 546 (c) (1) prevented Simon and Schuster from successfully asserting the reclamation claim. The court also found that unsecured creditors such as Simon and Schuster could not force the debtor to marshal its assets or prioritize Simon and Schuster over the major secured lender. In light of the new section 546 (c), the court found that Simon and Schuster had no likelihood of success on the merits. Moreover, the court found that Simon and Schuster had failed to establish irreparable harm because its claim could be satisfied by

money damages. The court found that the balance of equities was roughly neutral and that the public interest was not implicated.

B. In re Dana Corporation 2007 WL 1199221

In Dana, the Chapter 11 debtor, a manufacturer and supplier of modules, systems and components used in cars, vans, sport utility vehicles and certain trucks, filed a motion with the court seeking a determination that the value of certain reclamation claims pursuant to a prior reclamation order was zero. Debtor based its argument on the existence of prior liens on the goods subject to the reclamation claims and the application of the prior lien defense under section 546 (c) of the bankruptcy code, as amended by BAPCPA. In the Dana case, the debtor was a borrower under a pre-petition credit facility which consisted, inter alia, of a \$400,000,000.00 revolving line of credit, a portion of which could be used for letters of credit. On the petition date, the court entered an interim DIP financing order authorizing secured post-petition financing and a super priority lien for the lender. As part of the collateral for that DIP facility, the lender was granted a fully enforceable, fully perfected first priority senior priming lien on all pre-petition and post petition property of the debtor. The DIP financing facility did not provide for the satisfaction of the pre-petition facility, only the continuation of prior liens.

In Dana, the bankruptcy court analyzed the prior lien defense as set forth in the revised provisions of 11 U.S.C. section 546 (c) and contrasted the results reached under prior law in In re Dairy Mart, 302 B.R. 128, 134-136 (Bankr. S.D. N.Y. 2003) and In re Phar Mor 301 B.R. 482 (Bankr. N.D. Ohio 2003). The Court conducted a useful analysis of reclamation law, both under section 2 -702 of the uniform commercial code and under section 546 of the bankruptcy code, both under prior law and as amended by BAPCPA.

Among other things, the Court found that the revised bankruptcy code reclamation provisions did not create any federal right of reclamation but merely modified the extent to which section 546 limited the trustee's avoiding powers.

Dairy Mart involved reclamation claims asserted in the context of a refinancing transaction similar to the one presented in the Dana case. The Dairy Mart court held that when the claim of a pre-petition secured lender with a floating lien on inventory is paid out of the proceeds of a post petition credit facility secured by a new floating lien, the "reclaimed" goods which secured the pre-petition lender's debt had been disposed of in satisfaction of that debt, rendering valueless the reclamation claims for those goods. In Phar-Mor, by contrast, the court held that the debtor's pre-petition secured lenders had been paid in full through the post petition DIP facility rather than from the sale of goods, and that as a result, the liens were released and the reclamation right was not affected by the claims of the secured creditors. The Phar-Mor court separated the pre-petition and post petition lending transactions and treated them as two separate loans. The facts in Phar-Mor were not substantially different from those in the Dairy Mart or Dana cases. The Dana court found the Dairy Mart approach more appropriate, even with respect to prior law. The Dana court found that the pre-petition and post petition financing should more properly be viewed as an integrated transaction in which goods subject to reclamation claims were arguably "paid" to post-petition lenders and the prior liens now specifically mentioned in section 546 (c) had not been released.

Although it was not an issue raised by the reclamation claimants, the Dana court also made reference to the alternative remedies now available under new section 503 (b) (9) and the problems of valuation and payment that might be presented.

Section 503(b)(9) cases

In light of the changes to section 546 (c), many vendors with eligible reclamation claims have invoked section 503(b)(9), avoiding the senior lien defense and elevating pre-petition claims to post-petition administrative priority status. Some have been so bold as to request immediate payment. In most of these cases, the Court conducted an evidentiary hearing both with respect to the valuation of goods subject to the reclamation claims and with respect to the impact of the claim on the debtor's cash flow. To date, Courts facing this issue have held they have discretion to control the timing of payment, that section 503(b)(9) does not address the timing of payment or require immediate payment, and that impact on the debtor's cash flow must be balanced against hardship to the claimant. See In re Global Home Products LLC, 2006 WL 3791955 (Bankr. D. Del. 2006) (Bakeware Company; aluminum supplier with section 503(b)(9) claim filed a motion requesting immediate payment. Court held it had discretion to control timing and obligation to balance hardship to claimant with impact on debtor's cash flow; motion was denied.); In re Bookbinders Restaurant, 2006 WL 3858020 (Bankr. E. D. Pa. 2006) (Five restaurant suppliers sought immediate payment of section 503(b)(9) claims; Court held evidentiary hearing and denied requests based on an analysis similar to that of the Global Court). This issue continues to be litigated, and the law remains in a state of flux.

C. Debtor Strategies

1. Evaluate exposure to possible reclamation claims, especially those eligible for section 503(b)(9) treatment and the importance to debtor's operations of the possible reclaiming parties.

2. Understand and control inventory turnover to minimize the ability of reclaiming parties to assert reclamation claims under the extended time frames of BAPCPA.
3. Negotiate with the secured lender, as part of cash collateral or DIP financing discussions to moot reclamation issue. Be sure to limit or at least quantify the extent to which reclamation parties can assert potential administrative claims under new section 503 (b) (9) and thus pose cash flow problems.
4. Promptly file a reclamation procedures order and obtain a Court ruling as to the value of reclamation claims; try to anticipate and manage section 503(b)(9) valuation issues.
5. Address any outstanding reclamation claims as administrative claims in the Chapter 11 Plan.
6. Evaluate the extent to which parties who might assert reclamation claims are vulnerable to avoidance actions under 11 U.S.C. sections 542-550 and if appropriate, assert Debtor's rights under 11 U.S.C. 502(d).

III Critical Vendor Issues

One of the many decisions to be made by a debtor heading into a bankruptcy proceeding is the extent to which it needs to protect the interest of key vendors and further, the extent to which the local bankruptcy court is likely to permit such payments. With the exception of priority claimants such as employees, most key vendors will have general unsecured claims. They may also hold critical tooling, proprietary information or inventory important to the debtor. Historically, to the extent "critical vendor" payment orders have been entered by bankruptcy courts, the courts have relied on the equitable

powers available under 11 U.S.C. 105 and on the so called “doctrine of necessity ” or “necessity of payment “ rule. Critical vendor orders permit the advance payment of pre-petition unsecured claims outside the priority scheme set forth in the Code and outside the context of a Chapter 11 Plan.

The Seventh Circuit decision in In re Kmart 359 F. 3066 (7th Cir. 2004), cert. denied, 543 U.S. 986 (2004) cast considerable doubt on the legitimacy of the doctrine of necessity, and critical vendor payments in general.

Since the enactment of BAPCPA, there has been speculation as to whether or not the expanded administrative claim provisions for reclamation claimants, as set forth in 11 U.S.C. section 503 (b) (9) and elsewhere might give renewed vigor to critical vendor litigation. Based on the limited case law, addressing the issue since 2005, however, that speculation does not appear to be well founded, except to the extent some vendors may use section 503(b)(9) to extract prompt payment.

In any “critical vendor” situation, the debtor must strike a balance between protecting the interests of vendors who truly are critical to the debtor’s reorganization and managing the demands on debtor’s cash reserves. Sometimes, the “me too” effect creates both an abuse of the bankruptcy process and a very substantial drain on debtor’s cash flow.

In Kmart, debtor filed a “first day” motion seeking permission to pay immediately and in full the pre-petition claims of 2300 “critical vendors,” with little specificity as the identity of the vendors to be paid and the amounts of cash involved. The Kmart debtor used a portion of a DIP financing facility to pay those suppliers a total of \$300,000.00. There were approximately 2000 additional vendors who did not benefit from the critical

vendor order, and unsecured creditors generally received a dividend of about 10 %. On appeal, the district court reversed the order authorizing payment, holding that neither 11 U.S.C. section 105 (a) nor any “doctrine of necessity” supported the orders.

Upon review, the Seventh Circuit agreed with the District Court, making the now-famous remark that “a doctrine of necessity is just a fancy name for the power to depart from the Code.” 359 F. 3d at 872. The court expressed little sympathy for the creditors who benefited from the critical vendor payment and now faced avoidance actions. The court also held that neither section 363 nor 364 and the financing authorizations available therein provided a statutory basis for the critical vendor payments. The Court also noted that even assuming there was a statutory basis for a critical vendor order, it could not be issued without proof both that the non-critical vendor creditors would be sufficiently benefited and thus they would be as well off in reorganization as with a liquidation and that the vendors alleged to be critical would have ceased deliveries if old debts were left unpaid.

2. Cases decided since BAPCPA

- A. Howard Delivery Service, Inc. et al. v. Zurich American Insurance Company 126 S.Ct. 2105 (2006)

Strictly speaking, Howard Delivery Service was not a “critical vendor” case. In its opinion, however, the Supreme Court placed substantial weight on the priority scheme set forth in the bankruptcy code and asserted “preferential treatment of a class of creditors is in order only when clearing authorized by Congress. 126 S. Ct. at 2109. Because critical vendor payments so clearly alter the priority scheme of payments to creditors, the

decision provides at least a strong hint as to how the Supreme Court might view a critical vendor case.

B. In re Roland Pugh Construction, Inc. 2007 W. L. 509225 (Bnkr. N.D. Alabama 2007)

The Pugh case involved a liquidating Chapter 11 proceeding arising from certain criminal convictions of the debtor and certain key management personnel. Debtor filed a voluntary liquidating Chapter 11 coupled with a critical vendor motion seeking to pay 32 “vendors and service providers in the ordinary course of business” for a total of \$130,821.00. On those facts, the court rendered the expected result. Debtor had apparently not alleged that any of the vendors were truly critical, particularly in light of the liquidation, and had likewise not requested priority treatment under section 507 or administrative expense classification under section 503 of the bankruptcy code.

Although the Pugh result seems obvious on its facts, the court did spend some time discussing section 105, the doctrine of necessity and the evolution of the case law relative to critical vendor motions. The court concluded that “published cases in which the lower courts have allowed such payments under section 105 (a) appear to have required a fairly detailed factual showing that payment was necessary before doing so and when courts have granted such motions, they have frequently placed stringent rules on the disbursements to optimize chances of debtor’s survival and to protect the interest of all parties.” 2007 WL at 509231, citing by way of example, In re Tropical Sportswear International Corporation et al, 320 B.R. 15 (Bankr. M.D. Fla. 2005).

The court also detailed the manner in which the debtor could have addressed the claims of the so-called “critical vendors” through a Chapter 11 Plan and seemed to place substantial importance on the priority scheme and the Chapter 11 Plan requirements outlined in the Bankruptcy Code.

To date, the bankruptcy code amendments of BAPCPA have had little effect on “critical vendor” jurisprudence. The availability of an administrative claim for reclamation claimants under section 503 (b) (9) may create an alternative remedy and arguably improperly elevates a pre-petition claim to post petition administrative claim status.

3. Status of Circuit Decisions Relative to Critical Vendor Issues

The following is an overview of the status of the law relative to critical vendors, but it is not intended to be an exhaustive survey.

First Circuit:

There is no reported decision relative to whether or not and on what basis critical vendor payments are appropriate. At the bankruptcy court level, courts seem to rely substantially on Kmart and require a showing of actual necessity before entering any order that resembles a critical vendor order. At least in Northern New England, such orders are rare and usually limited to isolated creditors holding particular power to undermine the debtor’s business.

Second Circuit

Dudley v. Mealey 147 F. 2^d 268, 271 (2nd Cir. 1945). The Dudley Court granted priority status to supply creditors whose goods or services were necessary to the continued operation of a hotel.

In re CAF Bindery, Inc., 199 B. R. 828, 834-835 (Bankr. S.D. N. Y. 1996). In CAF, the Chapter 11 debtor owed substantial pre-petition rent. Its lease provided rent concessions during the months of March through May, but those concessions only applied if the Debtor was not in default. Debtor filed a motion for permission to pay certain pre-petition rent payments prior to the assumption of the lease under section 365. Debtor relied on the doctrine of necessity. The court found the doctrine of necessity did not entitle the debtor to pay or cure the pre-petition default prior to filing a motion to assume the lease. The rent concession provisions of the lease motivated the debtor to seek Court permission to cure the pre-petition default, presumably outside the context of a motion of assume under 11 U.S.C. 365.

The CAF Bindery decision arose upon the landlord's motion to compel the payment of post- petition rent. That motion was granted.

In re Ionosphere Clubs, Inc. 98 B.R. 174, 175-176 (Bankr. S.D.N.Y. 1989) In Ionosphere, the Bankruptcy Court addressed a portion of the Eastern Airlines bankruptcy case. The matter followed a prior order authorizing the pre-petition payment of wages and benefits to active employees. IAM, the union representing the striking employees and those placed on "no work" status, filed a motion to allow the payment of pre-petition wages due those striking and non working employees. The court engaged in a lengthy analysis of the doctrine of necessity, beginning with the railroad reorganization cases, and

discussed the extent to which it had authority to authorize the payments under section 105 or 363 of the bankruptcy code.

The Court concluded that although the doctrine of necessity was an available doctrine on appropriate facts, and that section 105 could be invoked for that purpose, there was not even business justification, much less true necessity, to make the requested payment. Moreover, the Court found payment would cause a substantial and unwarranted depletion of the debtor's cash.

Third Circuit

In re Just For Feet, Inc. 242 B.R. 821, 826 (Bankr. D.Del. 1999) In Just For Feet, Inc., the bankruptcy court authorized critical vendor payments to numerous footwear vendors on the theory that during the holiday season, the debtor could not realistically operate its wholesale shoe operation without an adequate source of supply on decent credit terms. The Court denied Debtor's motion to pay certain other trade vendors on the grounds that the debtor had not established necessity to the reorganization. The court held that the necessity of payment doctrine authorized the payment when it was necessary to the debtor's survival.

In Just For Feet, the critical vendor payments were made in exchange for ordinary credit terms going forward. See also In re Lehigh New England Railroad Company, 657 F. 2^d 570, 581 (3rd Cir. 1981) (Court can authorize payment of pre-petition claim if such payment is essential to the continued operation of the debtor.)

Fourth Circuit

Courts in the First Circuit are split on whether or not and under what circumstances pre-petition claims may be paid under the “critical vendor” doctrine. See In re Mabey 832 F.2nd 299, 302 (4th Cir. 1987) and compare to In re United American, Inc., 327 B.R. 776, 784 (Bankr. E.D. Virginia 2005). In Mabey, the court held the bankruptcy code did not authorize payment to unsecured creditors prior to or outside the context of a reorganization plan. In United American Inc., the court held that “critical vendor” payments could be appropriate under limited circumstances but on the facts presented, the debtor in that case had not met the test outlined by the court. The United American court discussed the doctrine of necessity and the case law developed relative to that doctrine and articulated a three part test. The test required proof of (1) necessity, debtor must prove the payment is critical to the debtor’s reorganization rather than simply convenient; (2) the transaction must be in the sound business judgment of the debtor; and (3) the favorable treatment of the critical vendor must not prejudice other unsecured creditors.

Fifth Circuit

There is no Fifth Circuit court opinion, but lower courts in the Fifth Circuit are to some extent split on the issue.

See In re Coserv LLC, 273 B.R. 487 (Bankr. N.D. Texas 2002). In Coserv, the court interpreted very narrowly the necessity of payment rule. In evaluating its authority to enter critical vendor orders under 11 U.S.C. 105 (a), the Court enunciated a three part test. Debtor must show (1) dealing with the claimant was virtually indispensable to the debtor’s profitable operations and to the preservation of the estate; (2) that the debtor

would risk harm or loss of economic advantage disproportionate to the amount of the vendor's claim absent a critical vendor order; and (3) that the debtor had no practical or legal alternative to making the payment. In Coserv, the court found the Chapter 11 debtor had failed, at a minimum, to show there was no practical or legal alternative. Moreover, the court bemoaned the expansion of the doctrine of necessity and held it was a device to be used "only in rare cases."

In American Plumbing and Mechanical , 323 B.R. 442 (Bankr. W. D. Texas 2005), the Court addressed primarily the request of certain former officers for payment of administrative expense claims consisting of incentive bonuses. Neither of the officers at issue were still in the employ of the debtor at the time the motion was filed, which contributed substantially to the result. The Court denied the motion. In a footnote, the Court noted that the propriety of paying any pre-petition claims post-petition had been called into serious question by the Seventh Circuit Kmart decision. The court also noted that critical vendor payments likely would not fall under 11 U.S.C. section 503 as administrative expenses because the administrative expense classification was limited to claims arising from services rendered after the commencement of the case.

Sixth Circuit

Although there is no Circuit level decision, the Sixth Circuit seems to accept the necessity of payment doctrine and the court's authority to enter critical vendor payment orders. Several bankruptcy courts have upheld the "necessity of payment rule." See eg. In re Quality Interiors, 127 B.R. 391, 396 (Bankr. N.D. Ohio 1991); In re Eagle-Picher Industries, Inc. 124 B.R.1021, 1023 (Bankr. S.D. Ohio 1991), In re Structurlite Plastics Corp. 86 B.R. 922, 932 (Bankr. S.D. Ohio 1988)

Seventh Circuit

See In re Kmart Corporation, discussed supra.

Eighth Circuit

There is no decision at the Eighth Circuit level, but bankruptcy courts in the eighth circuit generally follow the practice of the Sixth Circuit bankruptcy courts and authorize payments to vendors outside the context of a Chapter 11 Plan on appropriate facts. See In re Payless Cashways, Inc. 268, B.R. 543, 544-545 (Bankr. W.D. Missouri 2001). The Payless court addresses a situation similar to that presented in Just For Feet. While the court granted the motion, the order was more restrictive than that entered in Just For Feet. The Court required a more detailed factual record and set forth a financial cap on the amount which could be paid the so-called “critical vendors.”

Ninth Circuit

There is an arguably a split within the Ninth Circuit also. See In re Adams Apple, Inc., 829 F. 2nd 1484, 1490 (9th Cir. 1987) and compare with In re B&W Enterprises, Inc., 713 F. 2nd 534, 537 (9th Cir. 1983). The Adams Apple court dealt principally with post petition lending and cross collateralization issues. The court asserted that both section 364 and section 105 might allow certain types of post petition payments. The court also dismissed the appeal as moot under 11 U.S.C. sections 364 (e). In B&W, the court largely rejected the concept that pre-petition critical vendors could be paid pursuant to a necessity of payment rule. In B&W, the debtor had entered into certain agreements with pre-petition creditors to pay off pre-petition claims in exchange for credit terms. These agreements were not approved by the Court or circulated to other parties. After the conversion of the case to Chapter 7, the Chapter 7 Trustee sought the recovery of certain

of these payments under 11 U.S.C. sections 549 and 550 as unauthorized post petition transfers of property.

The B&W court declined to extend the necessity of payment rule to the facts presented and further declined to protect the appealing creditors from lower courts order.

Tenth Circuit

There do not appear to be any reported cases in the Tenth Circuit addressing critical vendor issues.

Eleventh Circuit

See In re Saybrook Manufacturing 963 F. 2nd 1490 (11th Cir. 1992). In Saybrook, the Court held it was not a proper use of Section 105 to alter the priority scheme set forth in the bankruptcy code.

While many of the above cases undoubtedly turn on the own factual idiosyncrasies, it does appear that in the more recent cases decided since Kmart, Courts are at the very least imposing more stringent guidelines for the application of the necessity of payment doctrine, if they are willing to apply it at all. To date, the statutory changes imposed by BAPCPA seemed to have much less effect. As more post-BAPCPA chapter 11 cases move through bankruptcy courts, however, jurisprudence in this area will likely continue to evolve.