

## MANAGING COUNTER-PARTY RISK IN THE PANDEMIC – PART 3

### SUPPLIER CONSIDERATIONS: ASSESSING AND LEVERAGING YOUR LEVERAGE

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As most global markets attempt a return to normal (or a new form of normal) business, it is hard to imagine a sector or an industry that isn't already reeling from the effects of the past three months. Getting back on your feet is hard enough in the current environment, without having to worry about further setbacks impacting your business. But how would you react if your key supplier called tomorrow to let you know that they were insolvent and unable to provide you with goods or services? Worse, what if you had already placed (and paid for) a large order with them that was critical to your ability to continue business?

In addition to the customer risk mitigation measures we looked at in [Part II](#) of this series, management needs to have in place systems and options to avoid the impact of supply-chain risk. Continuously monitoring your supply chain is essential during this period, to avoid the risk of your suppliers' misfortunes infecting your own business (particularly for your critical suppliers and those for which there doesn't appear to be a possible replacement).

But what is the legal position? What can (and can't) you do if you catch wind that your key supplier is about to pull down the shutters? In the US, a termination provision in your supply agreement allowing you to terminate for insolvency or bankruptcy events (so-called *ipso facto* clauses) is completely unenforceable. In fact, any purported post-bankruptcy terminations for "non-bankruptcy" events will be closely scrutinised by the courts to ensure the real rationale for termination isn't the insolvency or bankruptcy of the supplier. As such, any minimum purchasing requirements or pricing can be fully enforced by your supplier going through a Chapter 11 (while you should be able to ensure payment as part of that process – although it may require bankruptcy court intervention, which may also cost you legal fees).

The position is currently broadly similar in the UK. Recent changes to UK insolvency legislation mean that, for the time being, there is a blanket prohibition on the enforcement of *ipso facto* clauses.

Set out below are some risk mitigation strategies that should be put in place to ensure continuity of supply and that you aren't held to ransom by your suppliers:

1. **Assess impending supply chain risks:** make sure that your team is continuously assessing your suppliers to ensure the risk of disruption is foreseen where possible (particularly for global companies with multinational suppliers, going through the pandemic and associated lock down at differing times). Which suppliers are critical? Can you diversify your supplier base? Are there any possible backup or replacement suppliers should they go down? What are the contingency plans? Do any of your contracts give "exclusive" rights to any distressed suppliers?
2. **Leverage. If you've got it, use it.** In practice, this means:
  - Avoid paying in advance to the extent possible. The only thing worse than not getting your key supplies is not getting your key supplies that you have already paid for.
  - Identify and provide notice of existing defaults as soon as they arise. You don't necessarily need to terminate now, but providing notice of a default as soon as it arises provides you with optionality. Don't forget, even if you call a non-bankruptcy/insolvency default, the presumption will be that any post-bankruptcy attempt to terminate is because of the Chapter 11 filing. However, if every major media outlet is reporting your supplier will file for bankruptcy/insolvency tomorrow, you are positioned to quickly terminate prior to bankruptcy which changes the leverage dynamic in your favour.
3. **Keep your products/equipment ("your kit") separate:** If your supplier is in control of some of your inventory or equipment, make sure it is properly identified and kept separate (to the extent possible). If your kit isn't easily identifiable, you will have an uphill battle to establish that the good or equipment are not property of the bankruptcy estate and subject to the liens of lenders.

## **RELATED PRACTICE AREAS**

- Retail & Consumer Products

## MEET THE TEAM



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