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Vendors to Chapter 11 Debtors Are at Risk of Having to Return Post-petition Payments

Trade vendors BEWARE – in addition to having to worry whether chapter 11 debtors will pay for goods and services if a vendor extends credit post-bankruptcy, vendors must now also consider whether they will be ordered to return post-petition payments received. Similarly, lessors should be concerned when debtor tenants pay rent, because those payments received may have to be returned.

In *In re Delco Oil, Inc.*, 2010 WL 918058 (11th Cir. March 16, 2010), the Eleventh Circuit affirmed the avoidance of payments, under 11 U.S.C. Section 549, to a vendor for amounts paid for goods sold to the debtor post-petition, because the debtor lacked consent or court authorization to use cash collateral (where cash collateral was the source of the funds paid to the vendor). The good faith of the vendor and real value of the goods provided were not defenses to the avoidance action.

The bankruptcy court determined that these payments were recoverable by the estate notwithstanding that the payments had been made by the debtor in the ordinary course of its business and in consideration for post-petition goods sold to, and received and used by, the debtor. Instead, in exchange, the vendor was granted only an administrative claim for the value of its goods sold. The Eleventh Circuit Court of Appeals affirmed the bankruptcy court's decision.

This is highly significant for vendors providing post-petition goods and services to a debtor and puts at risk all payments made to the vendor post-petition; if the debtor's use of cash collateral is ultimately denied, the vendor may be required to disgorge all payments received. This decision is complicated by the fact that the vendor's performance under executory contracts can be compelled notwithstanding the threat of disgorgement.

Honigman's Commercial Law, Bankruptcy and Reorganization attorneys can counsel and assist trade vendors in navigating these difficult issues.

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