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Necessary but Not Immune: Securing Avoidance Action Protections for Chapter 11 Critical Vendors

Critical vendors are often essential to a debtor's ability to continue operating while pursuing chapter 11 restructuring because of their capacity to support the debtor's operations and help preserve the debtor's going-concern value. Without critical vendors' continued engagement, the debtor's reorganization may fail entirely, reducing recoveries for all creditors. For instance, a debtor in the retail space might be reliant on shipping vendors to continue timely movement of the debtor's goods (perhaps to keep stores stocked or to fulfill direct orders to customers), thus providing such vendors with incentive to continue services for the debtor post-bankruptcy filing may be critical for the debtor's ability to successfully reorganize and emerge from chapter 11.

In exchange for agreeing to continue to provide services for the debtor and assuming the risk of potential future nonpayment by the debtor amidst the inherent uncertainty of bankruptcy, critical vendors, with the court's authorization, will typically receive payment in part or even in full for their pre-petition unsecured claims. As such, critical vendors will often realize greater recovery than what they would eventually receive from a *pro rata* distribution on their unsecured claims.

While receiving payment on unsecured claims can be a big boon for critical vendors during the early stages of a chapter 11 case, critical vendors might not realize that simply agreeing to be a critical vendor might not resolve all potential issues. In particular, critical-vendor status alone does not protect the vendor from a later preference action despite their operational importance. A post-confirmation trustee or litigation trust — which might have little interest in the debtor's operations

— may pursue preference claims up to two years after the bankruptcy filing, even when the debtor has designated a vendor as critical. While critical-vendor orders may authorize payments of pre-petition claims, these do not automatically constitute releases from preference liability absent additional negotiated agreements.

Statutory Framework and Overview

Critical-vendor relief is generally sought by debtors under §§ 363(b)(1) and 105(a) of the Bankruptcy Code.¹ The U.S. Supreme Court has observed that authorizing payments to critical vendors on account of pre-petition claims can be necessary to protect and preserve the estate.² Chapter 11 debtors, in their fiduciary capacity as debtors-in-possession, must establish a sound business purpose for making critical-vendor payments. To this end, courts have long recognized the “necessity of payment” to critical vendors where such payment is essential to the debtor's continued operations.³ If authorized by the court to make critical-vendor payments, debtors often will enter into agreements with critical vendors governing the terms of the business relationship during the bankruptcy, including typically a requirement that by accepting a critical-vendor payment, the creditor agrees to continue to provide goods or services to the debtor.

A creditor's acceptance of court-authorized critical-vendor payments, however, does not

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¹ 11 U.S.C. §§ 363(b)(1) and 105(a).

² See *Czyzewski v. Jevic Holding Corp.*, 580 U.S. 451, 468 (2017).

³ See, e.g., *In re Lehigh & New Eng. Ry. Co.*, 657 F.2d 570, 581 (3d Cir. 1981).

by itself create a safe harbor from potential preference claims against the creditor under § 547 of the Bankruptcy Code.⁴ Under § 547(b), a trustee or debtor in possession may avoid a pre-petition transfer made to or for the benefit of a creditor, on account of an antecedent debt, while the debtor was insolvent, during the 90 days prior to the petition date,⁵ if the transfer enabled the creditor to receive more than it would have received in a hypothetical chapter 7 liquidation.

The hypothetical liquidation requirement of § 547(b)(5) is central to a potential critical-vendor defense. A vendor may argue that it did not receive a preference because if the vendor had not been paid the payment(s) in question, the debtor would have paid the same amount under a court-approved critical-vendor agreement.⁶ However, this argument confuses chapter 11 necessity with chapter 7 liquidation, as a liquidation would not ordinarily involve continuing critical-vendor payments because the debtor would no longer need to preserve its operating business.

Governing Caselaw on Critical-Vendor Preference Defenses

The Bankruptcy Code does not provide critical vendors with an automatic defense to preference claims, and courts have recognized only limited defenses. The primary question is often whether, absent the challenged transfer, another binding legal obligation would have required payment of the same claim. The decisions below trace the limited circumstances in which that defense has succeeded and the more common circumstances in which courts have rejected it as speculative.

The Third Circuit's decision in *In re Kiwi International Air Lines Inc.*, demonstrates a narrow form of critical-vendor protection.⁷ Here, critical vendors were insulated from preference liability because contract assumption under § 365 barred a trustee's preference claims.⁸ Even if the pre-petition payments had not been made, the creditors would have received those same amounts post-petition when the debtor cured arrears upon assumption.⁹ Because the creditors would have received the same amounts post-petition, the trustee could not establish that the pre-petition payments produced a greater recovery than a hypothetical chapter 7 liquidation.¹⁰

The U.S. Bankruptcy Court for the District of Delaware extended that reasoning to a critical-vendor agreement in *In re AFA Investment Inc.*¹¹ The creditor was specifically identified in the essential-supplier order and had entered into a binding continued-services agreement that required payment of its pre-petition claim.¹² The court concluded that the creditor would have received the same amount post-petition and therefore had not received more than it would have in a hypothetical chapter 7 liquidation because

of the binding term in the supplier order.¹³ Therefore, under *In re AFA*, the payment obligation must be binding, and the amount must be sufficiently connected to the approved arrangement to avoid speculation.¹⁴

In 2021, the Delaware Bankruptcy Court again addressed critical-vendor preference liability in *In re Insys Therapeutics Inc.*¹⁵ The case arose from an adversary proceeding brought by the liquidating trustee appointed after confirmation of the debtors' plan against McKesson Corp., RelayHealth Pharmacy Solutions and McKesson Specialty Arizona, Inc. (MSAZ) to avoid and recover allegedly preferential and fraudulent transfers.¹⁶ The court held that the customer order, which authorized but did not require payments to designated "critical customers," did not bar the trustee's preference claims under 11 U.S.C. § 547.¹⁷ The defendants moved to dismiss, arguing that the customer order established that they would have received the same payments even if the transfers had not occurred before the bankruptcy.¹⁸ Because the payments occurred before the order was entered, and the order expressly preserved all claims and causes of action, the order did not establish that the critical vendors would have received the same amount in a hypothetical chapter 7 liquidation.¹⁹

In *In re Insys Therapeutics*, the court emphasized that the customer order was permissive rather than mandatory, authorizing but not compelling the debtors to pay pre-petition amounts owed to the defendants.²⁰ The defendants also held general unsecured claims rather than priority claims.²¹ Accordingly, the question of whether the defendants received more through the pre-petition transfers than they would have received in a hypothetical chapter 7 liquidation could not be resolved on a motion to dismiss, allowing the preference claim to proceed.²² The court distinguished cases in which a critical-vendor defense succeeded because payment of pre-petition claims was required by court order, stipulation, agreement or statute, or because the creditor held a priority claim.²³

Other decisions likewise rejected speculative defenses. In *In re Hayes Lemmerz International Inc.*, the court held that a permissive order did not protect payments made before the order's entry or payments to parties not identified in the order.²⁴ Hayes Lemmerz International, Inc. and its affiliates filed for chapter 11 on Dec. 5, 2001, and obtained a Dec. 6, 2001, critical vendor order authorizing — not requiring — the payment of certain pre-petition shipping and warehouse charges.²⁵ Export Corp., a warehouseman, argued that payments it received during the preference period were protected because it was allegedly a critical vendor and because the order constituted the law of the case.²⁶ The court rejected that argument, reasoning that the challenged

¹³ *Id.*

¹⁴ *Id.* at 244.

¹⁵ *In re Insys Therapeutics Inc.*, No. 19-11292(JTD), 2021 WL 3083325, *1 (Bankr. D. Del. July 21, 2021).

¹⁶ *Id.*

¹⁷ *Id.* at *4.

¹⁸ *Id.* at *1.

¹⁹ *Id.* at *4.

²⁰ *Id.* at *3.

²¹ *Id.*

²² *Id.*

²³ *Id.* at *5.

²⁴ See *In re Hayes Lemmerz International Inc.*, 313 B.R. 189 (Bankr. D. Del. 2004).

²⁵ *Id.* at 189, 193.

²⁶ *Id.* at 192.

⁴ 11 U.S.C. § 547.

⁵ The look-back period extends to one year for insiders.

⁶ See 11 U.S.C. § 547(b)(5).

⁷ *In re Kiwi International Air Lines Inc.*, 344 F.3d 311 (3d Cir. 2003).

⁸ *Id.*

⁹ *Id.*

¹⁰ *Id.* at 321.

¹¹ *In re AFA Investment Inc.*, 538 B.R. 237 (Bankr. D. Del. 2015).

¹² *Id.* at 243.

payments were made before the critical-vendor motion was filed and before the order was entered, and that neither the motion nor the order identified Export as a critical vendor.²⁷ The court further held that the permissive order neither required the debtors to pay Export's pre-petition claims in full nor prevented the recovery of previously made preferential payments.²⁸ Accordingly, Export's motion to dismiss the preference complaint was denied.²⁹

In *In re Zenith Industrial Corp.*, the court declined to assume that a hypothetical critical-vendor request would have been approved.³⁰ Zenith Industrial Corp., a chapter 11 manufacturing debtor, sued Longwood Elastomers Inc. to recover alleged preferential transfers made during the 90-day preference period.³¹ Zenith had obtained an "essential vendor order" authorizing — but not requiring — it to pay, in its discretion, up to \$1 million of certain essential vendors' pre-petition claims.³² Longwood asserted that it qualified as an essential vendor and that the order therefore protected the challenged payments.³³

The court struck the defense as legally insufficient, holding that it was speculative to assume that no creditor would have objected to paying Longwood or that the bankruptcy court would have approved such a request.³⁴ Even if Longwood could establish that it was an essential vendor, the court held that hypothetical approval of a payment request could not defeat recovery of the alleged preferential transfers, ultimately holding that an "essential vendor defense" alone could not bar recovery.³⁵ More recently, courts have focused on whether the disputed preference amount materially exceeds the approved payment cap, making full payment too uncertain to establish under § 547(b)(5).³⁶

Implications for Prospective Critical Vendors

Because critical-vendor status alone does not provide an independent defense to preference liability, vendors should address avoidance risk as part of the initial critical-vendor negotiation rather than after confirmation. The practical question is not merely whether the debtor needs the vendor, but whether the proposed arrangement creates an enforceable protection against a later trustee or litigation trust. Critical-vendor orders typically authorize but do not require payment of pre-petition claims, and courts have consistently held that such orders do not insulate recipients from subsequent preference actions.

Before accepting critical-vendor treatment, vendors, particularly those that received significant payments from the debtor during the preference period, should evaluate potential preference exposure comprehensively. This analysis should consider the timing and amount of pre-petition payments received within the 90-day preference period (or one year

if the vendor is an insider), with particular attention paid to whether those transfers satisfy the elements of § 547(b). Additionally, the vendor should evaluate potential affirmative defenses under § 547(c): contemporaneous exchange for new value, ordinary course of business and subsequent new value.

Crucially, the vendor should determine whether the proposed critical-vendor order requires or merely authorizes payment. Orders that authorize but do not mandate payment provide no assurance that pre-petition claims will actually be paid in full, and vendors designated as critical have no guarantee that their entire pre-petition exposure will be eliminated. The vendor should also assess the likelihood that a trustee, plan administrator or litigation trust may later prosecute preference claims, particularly in scenarios where early optimism about reorganization gives way to conversion or where a confirmed plan creates an avoidance action trust.

A vendor seeking meaningful protection should also negotiate an express contractual waiver or release of preference claims as a condition of providing continued post-petition goods or services. The release must identify the covered transfers with precision — including the preference period, the categories of payments at issue, and the legal theories being released. Ideally, the critical vendor will obtain a written agreement from the debtor with language approved by the court whereby the debtor (and any successors or assigns, such as a post-confirmation trustee) release any preference claims against the critical vendor.

Where appropriate, the release should extend to successors in interest, assignees, liquidation trusts, litigation trusts, post-confirmation trustees and plan administrators. Courts have recognized that critical-vendor arrangements can include negotiated waivers of preference liability, but the waiver must be the product of arm's-length bargaining, must be disclosed to creditors and other parties in interest, and must be subject to notice and an opportunity for objection.³⁷ Such a waiver should be memorialized in the critical-vendor agreement, a stipulation, or a separate court-approved order.

As a recent example, the final critical-vendor order in the Sleep Number bankruptcy included language providing that "[t]he Debtors, in their sole discretion, may also provide a waiver of preference and avoidance actions in any Trade Agreement or email agreement, as applicable, without further Order of the Court upon notice to the Committee; *provided that* the Committee agrees to such waiver in writing (email being sufficient)."³⁸

Ultimately, whether to enter into a critical-vendor arrangement is a business decision by the creditor. It must weigh the relative risks and rewards of accepting a payment on account of its pre-petition claim against any concerns and any uncertainty with continuing to do business with a debtor in bankruptcy. A prudent part of that analysis should be to consider potential preference exposure and, if there are concerns, to include an express waiver of preference claims as part of the critical-vendor agreement, ideally with court authorization.

²⁷ *Id.*

²⁸ *Id.* at 193.

²⁹ *Id.* at 194.

³⁰ See *In re Zenith Industrial Corp.*, 319 B.R. 810 (Bankr. D. Del. 2005).

³¹ *Id.* at 812.

³² *Id.*

³³ *Id.*

³⁴ *Id.* at 817, 818.

³⁵ *Id.*

³⁶ See *In re Maxus Energy Corp.*, 615 B.R. 62 (Bankr. D. Del. 2020); *In re HRB Winddown Inc.*, No. 19-12689 (BLS), 2024 WL 4249220 (Bankr. D. Del. Sept. 19, 2024).

³⁷ See *Osborne v. Howell Electric Motors (In re Fultonville Metal Prods. Co.)*, 330 B.R. 305 (2005).

³⁸ See *In re Sleep Number Corp.*, Case No. 26-11399 (KYP) (Bankr. S.D.N.Y. July 10, 2026) (Docket No. 272).

Conclusion

Critical-vendor treatment may be essential to a successful chapter 11 reorganization, but critical-vendor status is a commercial tool, not a legal shield. Vendors that rely on critical-vendor designation alone — without negotiating enforceable waivers, memorializing releases in court-approved orders, conducting rigorous preference analysis, or monitoring plan and trust documents — face significant risk of post-confirmation clawback.

Vendors should therefore treat preference protection as a negotiated term of critical-vendor treatment. Without an express waiver or a demonstrably mandatory payment

obligation, a vendor that was essential during chapter 11 may later face avoidance proceedings at the hand of an entirely separate entity that does not share the debtor's operational objectives. [abi](#)

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