

## Effectively Using Demands for Adequate Assurance of Performance

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Leading economic indicators, coupled with significant reductions in product lines and current political uncertainty over tariffs, CAFÉ standards, monetary, trade and energy policies, among other issues, are placing significant stresses on manufacturing supply chains. These stresses highlight the need for suppliers to be increasingly vigilant in identifying and dealing with troubled customers. This article will help you to recognize some of the early warning signs of trouble, and identify certain legal options to help you to stay ahead of a troubled customer situation.

There are numerous warning signs that a customer is or may be in financial trouble; some obvious, some less so. Among the more obvious signs are slow or irregular payments, changes in long standing payment terms, and changes in purchasing patterns. Some of the less obvious signs include discovering that accounts receivable are being paid to a lockbox, that other suppliers have changed payment terms to cash on delivery or cash in advance, that your customer is under a forbearance agreement with its principal lender, and that your customer has retained crisis management/turnaround professionals.

If you have reasonable grounds for insecurity about your customer's financial condition and ability to perform, consider submitting detailed information requests, coupled with an executed standard non-disclosure agreement, to explore these issues. Examples of items to request are:

- Financial statements for the trailing 12 months
- Performance vs. budget for the trailing 12 months
- Projections for the next 12 months
- Purchasing records to confirm that purchases have not been delayed due to an inability to pay
- Audited financial statement for the most recent fiscal year

Regardless of what you receive from your customer, do not rely on this data alone. Explore other sources of financial and operational information, including:

- Federal and State court records for lawsuits and judgements
- If your customer is a public corporation, public filings such as 8-k's, 10-k's, etc.
- Press and industry reports
- Other vendors who may be experiencing similar problems

Once you have analyzed this information, you can elect to proceed informally, meeting with your customer's purchasing and finance people, in an effort to assuage performance or payment concerns or to negotiate alternative contract payment terms. If an informal approach is unworkable or inadvisable, or if your customer refuses to provide information or to meet with you, a formal written demand for adequate assurance of performance under Uniform Commercial Code section 2-609 may be necessary. In that regard, your customer's refusal to meet or provide timely information can provide the grounds for demanding adequate assurances of performance. Your written adequate assurance demand should detail the commercial grounds giving rise to your insecurity and provide a specific deadline by which such assurances must be received. A failure to receive adequate assurances may give you the right to suspend your performance. The failure to provide assurances that are adequate under the circumstances is a repudiation of the contract.

If your customer is insolvent, as defined in Uniform Commercial Code section 1-201(b)(23), you do not need to make a formal adequate assurance demand or wait for assurances that are likely to be unsatisfactory in any event. Rather, under Uniform Commercial Code section 2-702, you can stop shipping and refuse delivery except for cash (COD or CIA), including payment for all goods previously delivered. In addition, you can stop shipment of goods in transit and make demand to reclaim goods delivered in the previous 10 days.

While suppliers naturally expect that their customers will honor their contractual commitments, it is essential to remain vigilant so that you can act quickly and prudently. Familiarity with the adequate assurance provisions of the Uniform Commercial Code will help you to quickly craft thoughtful business and legal solutions.