

DEALING WITH SUPPLIERS AND CUSTOMERS IN AN UNCERTAIN ECONOMY

The economic turmoil, tight credit conditions, and collapsing scrap markets bring with them greater levels of uncertainty. Business transactions carry more risks—even transactions you have completed countless times before now require higher levels of scrutiny. On top of all that, businesses have become a source of financing to suppliers and customers, making cash management more critical than ever. So, how do you deal with suppliers and customers in this uncertain economy?

ONE LEGAL REMEDY

A legal tool companies can use, under specific conditions, is the Uniform Commercial Code, a comprehensive code addressing most aspects of commercial law. One provision—Section 2-609—allows either party of a sales contract to demand adequate assurance that the other party can satisfy the contract's obligations if it has reasonable grounds for concern. Until that level of assurance is met, the company making the request can suspend—if commercially reasonable—its contractual obligations. The meaning of *reasonable grounds* and *adequate assurance* is determined according to customary commercial standards on a case-by-case basis.

The benchmark for commercial standards is whether “a reasonable merchant in the position of the promisee [would] feel that his expectation of receiving full performance was threatened by activities or inactivities of the promisor or by external circumstances that do not, however, excuse the promisor from his duty to perform,” according to *Hawland's Uniform Commercial Code Series*. Even if you've accepted delivery of goods or payment, you still have a right to demand assurance. The party receiving the demand must provide adequate proof within 30 days that it is fulfilling the contract; if it does not provide proof, the other party can consider that a refusal to honor its obligation.

SEEING THE LIGHT

Aside from legal remedies, greater transparency can mitigate some of the inherent risk of doing business in today's uncertain economy. For example, with today's credit conditions, some businesses are financing their supply chain. Seeking certain disclosures from suppliers could lessen some of the risk that entails. Externally, businesses need greater detail about their business partners, such as their

financial strength and the conditions of their marketplace. Internally, a company's sales, credit, purchasing, accounting/finance, and legal departments must communicate with each other continuously.

Business leaders should discuss financial issues such as potential supply-chain disruptions. Lenders are requiring much greater levels of disclosure and imposing much tighter borrowing parameters. Businesses, therefore, need to rely on and have confidence in their supply chain to ensure they can meet their obligations. They should make inquiries to assess a customer's current and future financial condition as well as its ability to perform under the supply or sales agreement.

To help avoid major disruptions, companies can share a significant amount of information. They might not want to reveal exact dollars, but they can discuss financial data in terms of sales and cost percentages, today's performance compared with historical levels, and whether material flow meets requirements and/or expectations. Public companies have disclosure requirements, but they do not always disclose some essential information their business partners could use to determine buying or selling conditions. Although they produce quarterly reports, the speed with which disruptions occur can easily outpace such reporting. Private companies should provide similar information, even if it's not required.

Communication and transparency can go a long way. Knowing in advance a customer's physical or financial capacity can avoid a catastrophe. Losing a source of material because of some disruption higher up the supply chain can have a devastating impact. On the other hand, knowing that a supplier will have less product available can help a company and its customers shift to other supply sources.

DOING BUSINESS TODAY

These suggestions might seem elementary, but sometimes the simpler approach is what works. Given today's risks, companies need to review what they are doing and rethink approaches to the supplier-customer business chain. More communication and greater transparency now can help businesses avoid legal expenses later. ■

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