

# Supply agreements in the pressure cooker: Texas court splits vendor's contract in two

David Conaway and Julia Ferreira discuss the recent ruling in the Instant Brands case



DAVID H. CONAWAY  
Attorney at Law, Shumaker,  
Loop & Kendrick, LLP



JULIA FERREIRA  
Senior Counsel, Shumaker,  
Loop & Kendrick, LLP

**O**n 26 March 2025, in connection with the Instant Brands Chapter 11 case, the US District Court for the Southern District of Texas upheld the Bankruptcy Court's ruling that a supply agreement and purchase orders issued under the supply agreement were separate contracts.

This ruling has significant implications for the rights of suppliers/creditors in Chapter 11 cases, specifically in this case for the Chinese-based supplier to Instant Brands.

Foreign companies (and their counsel) doing business with companies that file for insolvency under Chapter 11 of the US Bankruptcy Code need to be aware of how US court decisions may impact cross-border contracts and supply relationships.

## The context of the case

The context of this ruling is a supply contract between Instant Brands and GuangDong Midea Consumer Electric Manufacturing Company Limited (based in China), that manufactured InstaPots for Instant Brands. Though the supply agreement had product warranty and indemnity provisions, Instant Brands purchase orders had provisions that were more favourable to Instant Brands.

In connection with Instant Brands' Bankruptcy Code section 363 sale of all of its assets, the buyer purchased assets including the InstaPot brand and related

intellectual property rights. However, the buyer excluded any and all associated liabilities, including any InstaPot product liability claims. In fact, since Instant Brands had no assets after the sale, it was in the buyer's best interest to ensure that Midea remained responsible for product defect claims pursuant to the warranty and indemnity provisions. Thus, Instant Brands (no doubt with the buyer's encouragement) asserted that the purchase orders, and their warranty and indemnity provisions, were not transferred to the buyer, even though the supply agreement was.

While the Court's ruling in the Instant Brands case was in the context of warranty and indemnity provisions, the logical next step of the separate contract theory is that debtors (and their financiers) will take the position that the debtors can assume a supply agreement but reject purchase orders and invoices as separate contracts. The debtors get the benefits of the supply agreement, but avoid the costs of cure arising under the purchase orders and invoices. Paying the cure costs was not an issue in Instant Brands since Midea had been paid as a critical vendor.

## US Bankruptcy Code on executory contracts

Under section 365 of the Bankruptcy Code, a debtor has the right to assume, assume and assign, or reject executory contracts – agreements in which both parties have material obligations to perform. If a debtor rejects an executory

contract, the supplier is left with an unsecured claim for unpaid invoices and breach of contract damages, which usually has little value. Conversely, if a debtor assumes such a contract, it must cure any pre-petition defaults, including payment of unpaid invoices.

In *Instant Brands*, the debtor argued that it could assume and assign the overarching supply agreement while rejecting the related purchase orders, as separate contracts. By separating the agreements, the debtors retained the purchase orders, which preserved Midea's warranty and indemnification obligations relating to defective InstaPots.

In siding with *Instant Brands*, the Texas court noted that the supply agreement allowed the debtor to issue purchase orders at its discretion, resulting in corresponding invoices from the creditor that contained the specific terms of each transaction. The court also observed that the parties had consistently treated purchase orders as distinct commitments that were each issued, negotiated, and fulfilled independently, often incorporating separate terms and conditions from those in the master supply agreement. In some instances, the debtor had modified purchase orders with additional terms that deviated from the original agreement, and Midea had continued to supply goods under those modified conditions.

The Texas court's analysis of these factors to reach its conclusion of separate contracts is not particularly compelling.

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Will bankruptcy courts in other jurisdictions such as Delaware or the Southern District of New York take a similar approach in future cases?

On 9 April 2025, Midea filed a Notice of Appeal to the US 5th Circuit Court of Appeals. We anticipate that the 5th Circuit's reconsideration of the lower courts' rulings will be robust. Stay tuned for further developments.

#### Takeaways

1. When a customer or supply chain partner becomes insolvent and files for Chapter 11, a supply agreement and its underlying investments are at risk. The Bankruptcy Code provides debtors the unfettered choice to assume or reject executory contracts. In many Chapter 11 cases, significant issues such as financing and the sale of assets to a third party are
2. The Texas Instant Brands ruling creates even more risk by allowing debtors to separate supply agreements from underlying purchase orders and invoices, and avoid paying cure amounts otherwise owed to suppliers when a contract is assumed.
3. To mitigate this risk, suppliers' agreements should make clear that supply agreements and purchase orders and invoices issued pursuant to the supply agreement constitute a single, indivisible contract, that are all interdependent, and cross-defaulted.
4. Additionally, suppliers should consider strong anti-

negotiated before the Chapter 11 filing. At "first day" hearings, Chapter 11 debtors will seek court orders that eliminate or limit the rights of vendors. To avoid erosion of rights, it is critical for creditors to engage immediately.

assignment provisions to ensure that contracts can only be assigned in toto, including all commercial documents issued pursuant to the supply agreement. While Bankruptcy Courts generally do not enforce simple anti-assignment clauses in the context of a section 363 sale, courts will enforce compliance with anti-assignment provisions that contain material and economically significant terms. ■

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