

## Orders and collections as usual in a pandemic? Looking ahead while addressing current needs



Maria G. Carr | Tuesday, April 7, 2020

Thousands of businesses across the country are looking at months of extended business distress due to the spread of COVID-19, and many companies are reevaluating their books and accounts receivable to determine cash flow issues. With some revenue streams delayed or entirely dried up, companies may be looking to delay certain payments while also pushing to collect from long past-due customers. Given the unknown amount of time until business resumes as usual – and the likely increase in potential restructurings or bankruptcy filings by many businesses in the months ahead due to financial distress – your company may want to consider the following when planning for cash flow issues and determining strategies for orders and collections in the coming months.

Initially, your company may be hesitant to continue doing business with a customer that you know is in current financial distress due to the coronavirus pandemic. Past orders may go unpaid, and future orders from that company may be uncertain. Your company may want to consider the current climate before abruptly changing payment terms or requiring cash in advance for orders, however. If one of your customers files for bankruptcy in the coming months, your company may later face a lawsuit to recover a “preference” payment under the Bankruptcy Code, which is an action to recover payments made during the 90 days during prior to the filing of the company’s bankruptcy case. In a nutshell, the Bankruptcy Code allows the company in bankruptcy (or a later trustee of the company’s estate) to sue to recover payments

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made to the insolvent company on account of prior debt, and which allowed the company to receive more than it otherwise would have received in the company's bankruptcy case. However, if a company can prove that a preference payment is not out of the ordinary – and the payments made during the 90 days prior to the preference period were very similar to other payments prior to the 90-day period – the preference claim will likely not be viable and will be easily resolved or not pursued by the trustee.

If your company has traditionally operated on 30-day, 45-day, or 60-day payment terms, for example, suddenly changing payment terms for customer orders may detract from the “ordinary course of business” defense for a potential a preference case. Requiring cash in advance for orders or changing the payment type (i.e., requiring a credit card or cashier's check instead of a regular check) also may detract from this defense. Finally, aggressive collection actions that are out of the ordinary, like constant emails, phone calls, or threats to litigate (if your company did not previously employ these tactics to collect on past due accounts) also may be viewed as outside of the normal course of business. Of course, if your own company is facing financial distress and must take extraordinary measures to maintain healthy cash flow, changing payment terms or ramping up collection efforts may be unavoidable; however, you may also risk irritating a regular customer and losing future business after the current crisis. Ultimately, careful considerations of strategies to collect whatever payments possible during the next few months will be better than not receiving regular payments from struggling customers. Awareness of a potential preference claim and the ordinary course of business defense for a potential preference claim if the customer eventually files for bankruptcy may simply help your company plan ahead during uncertain times.

Further, to the extent that your company is able to continue to fulfill orders and provide new product to a company in financial distress during the COVID-19 pandemic, however, it may be important to continue to do so to the extent possible. Although changing payment terms may not be ideal, continuing the customer relationship is likely the ultimate goal. Requiring a distressed customer to prepay or provide cash in advance for orders prior to delivery provides you with certainty about receiving payment – and also reduces your liability for potential later preference claims. If your company provides critical goods or services to a customer that eventually files bankruptcy, your company may also be listed as a “critical vendor” in a bankruptcy filing, and your company may be able to get orders fulfilled and paid at the same rate as usual during a customer's bankruptcy case. Companies that provide goods during the twenty days immediately prior to a company's bankruptcy filing also enjoy priority in later distributions and may be paid in full. Finally, fulfilling additional orders also may serve as a potential additional defense to a later preference action. Continuing to satisfy new orders after a company receives a potential preference payment provides “new value” to a customer in distress, and may reduce or entirely negate any later preference claims on a dollar for dollar basis (even if those orders are not paid for in full, in certain circumstances). For example: if your company receives a \$10,000 payment from a customer who files bankruptcy two months later, you may later face a lawsuit to claw back that payment as a preference. However, if you continue to do business with the customer and provide \$9,000 worth of goods one month prior to the bankruptcy filing, that \$9,000 order is “new value” and would be a valid defense for all but \$1,000 of an eventual preference claim (and would likely not be pursued by the trustee). If your company cannot provide new orders or does not desire to continue business with a customer based on the risk of non-payment, however, attempting to collect on past due orders expediently and wrapping up the relationship may be the best defense given the uncertain times ahead.



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