



# FINANCIALLY-DISTRESSED CUSTOMERS?

## *How to minimize impacts on your business*

Financial distress among businesses large and small is widespread and expected to increase as a result of the ongoing COVID-19 pandemic. The following are some suggestions for trying to minimize the impacts of your customers' or potential customers' financial challenges on your business during these extraordinary times.

Certain measures can be taken before extending credit to any **new customer** to help assess that prospective customer's ability to make timely payments:

- Obtain credit reports
- Request financial statements
- Set realistic credit limits tailored to each customer's financial position
- Closely monitor credit limits throughout the course of the relationship

For **existing relationships**, the following steps can be taken to ensure payments continue to be made in a timely manner:

- Diligently track all accounts receivable
- Send prompt, friendly payment reminders in response to any delinquencies
- Incentivize timely payment by offering prompt payment discounts or charging interest on unpaid balances
- Adjust or cut off credit for customers who fall behind

Additional actions to encourage payment of substantial delinquent balances or to avoid additional potential harm to your business include:

- Cash-on-delivery or cash-before-delivery arrangements for any further products or services
- Personal guaranty of customer's owner(s), other third-party guarantees or collateral as a condition to continued product shipments or services
- "Catch-up" plans offering discounts on amounts payable in exchange for significant upfront payments to facilitate expedited recovery

When such measures fail to result in payment, legal action may be necessary. Bringing a **legal action** can have important **benefits**, including:

- A lien or attachment on the customer's business assets or bank accounts early in the litigation
- Potential lien priority which can later be an advantage over other creditors in the context of a bankruptcy or other insolvency proceeding

However, litigation is not without **drawbacks**. Important factors to consider before commencing litigation include:

- The effort and expense of litigation relative to the likelihood of any potential recovery
- Can claims be pursued by a collection agency or attorney on a contingency basis?
- Are there any defenses (i.e., defective product or deficient service) counterclaims?

Finally, **if a customer does file for bankruptcy protection**, any and all collection activity and any pending lawsuit against the debtor must cease as a result of the “**automatic stay**.” However, certain types or relief may be available within the context of a bankruptcy proceeding provided prompt action is taken. For example, if products have recently been shipped to the debtor, it may be possible to reclaim those products or be granted a claim having priority over other creditors. Also, if your company’s products or services are essential to a successful reorganization of the company in bankruptcy, it may be possible to obtain “**essential vendor**” status that could entitle your company to be paid amounts owed prior to the bankruptcy filing.

**Bottom line:** Heighten diligence and prompt decisive action in response to financial distress are often the keys to minimizing any potential adverse impacts to your business during economically-challenging times.



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