How Do I Deal with Clients Who are in Financial Distress?

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Proceed, but with caution, when dealing with customers or clients in financial distress. You have heard the rumors about one of your clients or customers being on the verge of bankruptcy. Although your instinct may be to suspend all dealings with them for fear of total loss in the event of bankruptcy, you should not over-react. With proper assistance, you can safely navigate as a creditor in even the murkiest waters.

Suspend credit. While there is no reason to suspend dealings with a client in distress, there is ample reason to suspend credit to that client as part of those dealings. Requiring payment in advance or at the time of delivery is the most basic and effective form of protecting your interests as a creditor. Moreover, while there is ordinarily concern about payments received during the 90 day "preference" period before a bankruptcy, a payment made as part of a contemporaneous exchange of goods or services (i.e., COD) is not an avoidable preference.
Protection in the event of bankruptcy.
Once a petition for bankruptcy reorganization is filed, you should have even less concern about selling to the Debtor. To incentivize vendors to continue providing goods and services to Debtors, the Bankruptcy Code gives an "administrative claim" - a claim that is entitled to priority, and that is generally paid in full - to any creditor who provides goods or services to a debtor any time after the petition date. The Code even gives an administrative claim to any vendor that sold goods to the debtor in the ordinary course of business in the twenty days before the date of the bankruptcy.

Contracts in bankruptcy. While you generally remain at risk with respect to any outstanding debt as of the petition date, there are exceptions. The first is for a pre-petition obligation that is owed in connection with "executory contracts," where performance is ongoing in nature (i.e., an equipment lease). To the extent the debtor wants to keep that contract in place throughout and/or after the bankruptcy, the debtor must "cure" any existing defaults under that contract to do so, thereby entitling you to be paid in full. Second, under certain circumstances, you may also
qualify as a "critical vendor," which would entitle you to be paid by the Debtor for some or all of any past due amounts owed as a condition for continuing sales. "Critical vendor" status involves a fact intensive analysis, which varies from state to jurisdiction.

For more resources and LP's response to COVID-19, visit this webpage.