

Insights

Commercial Collection Issues in a COVID-19 Economy

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The daily news reminds us of the growing grim economic toll wrought by the COVID-19 pandemic. As discussed in some of our prior Alerts, federal, state and local governments have adopted various measures to moderate some of these effects, including offering stimulus payments and loans, and restraining certain types of creditors' collection activities. Despite the latter restraints, there still are some things creditors can do to try to enhance the collectability of past-due commercial payment obligations.

Communicate, communicate, communicate

Understanding the debtor's reasons for nonpayment is key to formulating a realistic plan for repayment:

- Don't let receivables get too old, or pile-up, without discussing with the debtor the reasons for the nonpayment.
- Ideally, provide a single point of contact to ensure a delinquent debtor can get accurate and consistent information about the status of its account and repayment options.
- Remember the adage that "you can catch more flies with honey than with vinegar" – especially in these tough times, be polite and kind in your conversations with delinquent debtors (many of whom may never previously have had problems timely paying their bills).
- Follow any legal prerequisites applicable to collection of the debt (such as timely sending periodic statements and following contractual default notice requirements).

Steps to enhance collectability

If the creditor has security (collateral) for the debtor's obligation, then:

- Make sure any mortgages are properly recorded.
- Make sure any UCC financing statements are current, complete and filed in the correct place.
- Monitor floating liens on accounts receivable and inventory to see if IRS liens have been filed (note that an IRS lien may trump a pre-existing UCC security interest in accounts receivable and/or inventory on the 46th day after the IRS lien's filing).

If the creditor has no security for the debtor's obligations, then the creditor should consider asking the debtor for security. If the debtor later files a bankruptcy petition for relief, a secured creditor has greater protections than an unsecured creditor. If you are an unsecured creditor, often you just are along for the ride in a bankruptcy case.

Where a review discloses “holes” in the creditor’s position, the creditor should consider seeking the debtor’s cooperation in fixing them. Note if the debtor later files bankruptcy, it is possible the debtor (or the debtor’s trustee in bankruptcy) may seek to avoid these fixes as constituting either preferential transfers and/or voidable transactions (the latter formerly known as fraudulent transfers). However, since a creditor cannot know when its debtor may seek bankruptcy relief, most creditors usually determine that pursuing such fixes is worth the risk.

Follow any applicable federal, state or local restraints on collection activities

Bear in mind that federal, state, and local rules now restrict certain collection activities during the pandemic:

- As discussed in some of our prior Secured Lender Alerts, the Governors of Indiana and Illinois, the Supreme Courts of each state, and some local municipalities have instituted temporary freezes on foreclosures, bank account garnishments, and evictions on commercial and/or residential properties.
- Access to some trial courts currently is limited for civil matters during the pandemic, making it difficult to pursue any but the most urgent legal remedies.
- The federal Coronavirus Aid, Relief, and Economic Security Act (“CARES Act”), enacted March 27, 2020, prohibits a servicer of a federally-backed mortgage loan (e.g., those purchased by Fannie Mae or Freddie Mac, or insured by HUD, VA, or USDA) from initiating foreclosure proceedings, moving for orders for foreclosure or sale, or executing on foreclosure-related evictions or sales, for a period of 60 days starting on March 18, 2020.

Even where permitted to do so, repossessing or liquidating real or personal property of a delinquent debtor may not result in collection of a debt, given that potential buyers may be hard to find in the current pandemic-depressed market.

Takeaway: With some forethought and patience, a creditor may be able to reduce the pandemic’s potential negative effect on collections.

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