

## MANAGING COUNTER-PARTY RISK IN THE PANDEMIC - PART 2

CUSTOMER CONSIDERATIONS: RISK MITIGATION = SMARTER SALES

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In the coming months, very few companies, whether public or private, will be able to avoid including statements in their quarterly reports or financials that attribute single or double digit percentage declines in revenue to doubtful accounts and insolvencies of major customers caused by the pandemic. For many, if not most, that disclosure will continue beyond Q4 of 2020 and through 2021.

In prior periods, lenders and other key stakeholders may have been tolerant to these one-off, non-systematic declines due to unanticipated insolvencies of customers (and the ability to replace the revenue/income either through liquidation of collateral or replacement of customers). After all, none of us have a crystal ball, and many of the insolvencies were unforeseen (or unexpected). To the extent they had it, lenders and other creditors didn't have to worry about being able to liquidate collateral – a market was almost always available to sell collateral (or sell their products elsewhere), and there was plenty of money in the market to facilitate transactions (and curb the downside risk).

Post-pandemic, while companies may still not have crystal balls, they at least have tarot cards and Ouija boards – and the signs are strong that market participants will be impacted across industries on a global basis. Lenders and other key stakeholders will want to know what measures were taken to mitigate those reported declines, particularly if the secondary markets to mitigate risks of nonpayment will be stretched (or perhaps non-existent) in the near term.

In [Part I](#), we provided a Heat Grid for triaging counter-party risk that could be used as a playbook to get Legal, Finance, and the Business (Sales/Operations/Logistics) on the literal and figurative “same page”. For this Part II, we will identify counter-party risk mitigation measures that can be applied now to address those demands from lenders and other key stakeholders. Importantly, each of these recommendations could have a real time impact on: (1) getting paid now and keeping it from a claw back in a future insolvency proceeding; (2) preventing an increase in new exposure; and (3) creating negotiating leverage to get paid in the future, even where there is a subsequent

insolvency proceeding. For purposes of this article, we'll spare you from the technical bankruptcy benefits and focus on the practical implications, i.e. getting paid.

To keep things simple and memorable, we'll follow the four **Ps**:

- **Pause** – In too many instances, the logistics team is the last group to be brought into the fold. As a consequence, you inadvertently release goods, thereby, deepening A/R exposure and decreasing negotiating leverage, i.e. the customer now has your goods and can continue ignoring you. By including your logistics team, you can push “pause” on the release of goods.
- **Process** – If applicable law grants a lien or possessory interest (i.e. consignment, mechanics, agricultural, maritime, etc.) or your contracts grant a lien, make sure you have been (i) enforcing those rights and (ii) complying with the requirements for those rights to be enforceable. If you identify defects, implement immediate remediation steps as these lien/possessory rights will increase your ability to get paid, including in some instances, ahead of secured lenders. Even for sophisticated companies, these protections are prone to being overlooked and/or forgotten.
- **Payment Terms** – If customers ask for an extension of payment terms, get something in return that protects your exposure – letters of credit, full (or partial) advance payment, deposits, or third party guaranties. These protections will ensure you get paid now with less risk of being subject to claw back in a subsequent insolvency proceeding.
- **Pivot** – Review your contracts or terms and conditions for existing defaults and place your counter-party on notice. For U.S. counter-parties, this is particularly important for brand owners or licensors as the lapse of applicable notice period will permit you to quickly pivot and terminate in advance of a bankruptcy filing where the automatic stay will prevent you from doing so.

## MEET THE TEAM



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