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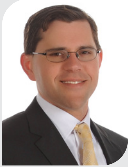
Bright spot for creditors in recent COVID-19 legislation



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On Dec. 27, 2020, President Donald Trump signed the Consolidated Appropriations Act of 2021 (CAA), a $2.3 trillion spending package with provisions meant to respond to the ongoing economic fallout from the 2019 novel coronavirus (COVID-19) pandemic. Besides stimulus payments and an extension of federal unemployment compensation payments, the CAA included a bright spot for some creditors who have accommodated distressed tenants and customers who have been unable to pay their bills in a timely manner.

This bright spot is a temporary exception for preference liability for certain payments made to landlords and parties to some types of contracts.

Preferences

A preference is a payment made to a creditor before bankruptcy, generally within 90 days before filing, on a pre-existing debt. Debtors in bankruptcy or bankruptcy trustees may then recover such payments from creditors, even though the payments were for legitimate, fully enforceable debts. In other words, a creditor who may not even have been paid in full may be forced to defend a lawsuit to claw back payments that a customer made.

Although the Bankruptcy Code contains nine enumerated affirmative defenses to preference lawsuits, none of them clearly protects creditors who have entered into agreements to defer payments with tenants or customers who have been adversely impacted by the COVID-19 pandemic. Even worse is that preference lawsuits are often filed up to two years after a case was filed, which can lead to time-consuming, costly investigations to support affirmative defenses and respond to pre-suit investigations by would-be plaintiffs. Moreover, creditors have the burden of proof to support their affirmative defenses.

Fortunately, the CAA created an exception to preference liability for some creditors who accommodate distressed tenants and customers during the pandemic.

Two new exceptions to preference liability

The exceptions bar recovery of two types of payments:

1. A “covered payment of rental arrearages”
2. A “covered payment of supplier arrearages”

The new legislation defines both terms. As a result, payments that do not fall within these two types are not excepted from preference suits.

Rental arrearages

A “covered payment of rental arrearages” is a payment of arrearages made in connection with “an agreement or arrangement” between the debtor and a lessor to defer payments of rent and other periodic charges under a lease of nonresidential real property entered into on or after March 13, 2020. To qualify

as a covered payment of rental arrearages, the payments may not exceed the amount of rent and charges provided under the lease. Additionally, the payments may not include "fees, penalties, or interest in an amount greater than the amount of fees, penalties, or interest" required under the lease or which the debtor would have owed if it made every payment on time before March 13, 2020.

Supplier arrearages

"[C]overed supplier arrearages," on the other hand, are payments made "in connection with an agreement or arrangement" to defer or postpone payments between a debtor and a "supplier of goods or services . . . under an executory contract for goods or services" entered into on or after March 13, 2020. Just as with rental arrearages, covered supplier arrearages may not include fees, penalties or interest in an amount greater than that scheduled to be paid under the contract or which the debtor would owe if it had made all of the payments on time and in full before March 13, 2020.

In simple terms, an "executory contract" is a contract under which both parties have unperformed obligations. So long-term supply and serve agreements are typically executory contracts, since one party has an obligation to provide goods or services, and the other party has an obligation to pay for the goods or services. As a result, payments for ad hoc purchases of goods and services are not protected under the new legislation, even if a creditor agrees to defer payment and does not exercise its collection remedies.

Sunset provisions

The new provisions are scheduled to sunset on Dec. 27, 2022. Fortunately, they will continue to apply in any case filed before then. As a result, most qualifying payments made through at least Sept. 28, 2022, 90 days before the sunset date, should be protected from preference liability.

Uncertainties

The new legislation raises several questions. For one, what is an "arrangement" to defer or postpone payments? May a creditor unilaterally decide that it will allow tenants or customers to make late payments to protect itself from preference liability without a corresponding agreement by the debtor? Must it announce its policy to tenants or customers? Must there be at least an informal agreement by the debtor? Since the new legislation uses the terms "agreement" and "arrangement," and courts ordinarily ascribe different meanings to different words, it is reasonable to conclude that an "arrangement" does not require an agreement.

Another question is whether creditors can receive partial protection if they agree to defer or postpone payments but, nonetheless, require payment of late charges, interest or attorney's fees? Since the statute does not provide a clear answer, the safer approach would be to not demand payment for anything other than the contractually required payments exclusive of late charges, interest and attorney's fees.

Finally, what is the significance of the requirement that a covered payment not "exceed the amount due under the [lease or executory contract] . . . before March 13, 2020?" Under one reading, that could mean that payments made under leases and executory contracts entered into after March 13, 2020, are not protected. After all, logically, no amounts would have been due without a contract in existence before March 13, 2020. So any payment would necessarily "exceed the amount due under the [lease or executory contract] . . . ." On the other hand, the provision could simply serve as a limitation on agreements that seek to avoid the prohibition on late fees, interest and charges by inflating the amounts of the deferred or postponed payments so as to qualify for the new exception to preference liability.

Document your agreements

Landlords and suppliers should document their agreements with distressed tenants and customers through written agreements. Although the new legislation does not require a written agreement, responding to a preference demand is more efficient when armed with clear documentation, rather than relying on archived email strings and the recollections of employees, many of whom may have left a company by the time the preference action is filed.

Additionally, to ensure protection under the new legislation, creditors who are willing to defer or postpone payments should avoid charging fees, interest or charges that would not have been owed if the payments were made on time.

Creditors may benefit from accommodating distressed tenants and customers

The CAA provides a mechanism for some creditors to insulate themselves from potentially large preference liabilities. Despite the new legislation's uncertainties and limited scope, some creditors will be able to benefit from it if they are willing to accommodate distressed tenants and customers.