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Escheatment in the Spotlight as State Budget Deficits Continue: What a Credit Executive Needs to Consider

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The prolonged downturn of the U.S. economy reminds vendors of the financial challenges that customers face to be profitable. States, too, are finding it more difficult to meet their budgets as a result of declines in corporate and sales tax revenue, increased foreclosures and weak consumer spending. Indeed, 25 states are projecting budget deficits. States are reacting to these considering massive budget cuts, including cuts with public education. States are also looking for untapped revenue sources to close the budget gaps. In this setting, states are looking for sources of revenue, and abandoned property, as the press reports, may be that untapped source for states. It is expected that states may have a line item in their annual budget for escheatment may be a step to ease this budget crisis.

Escheatment revenue is an appealing source from the states' view as it does not require raising taxes, such as on tobacco and alcohol, or increasing lottery ticket sales. Given the budget crisis many states are facing, many are more aggressive in their collection of escheat dollars. Underscoring this, several private firms are working on behalf of states on a contingency fee basis to locate abandoned property that should have been turned over to the state.

Given this environment, how does a state's focus in abandoned property as revenue source affect the credit department? What

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Authenticating Emails at Trial: Not Always as Easy as It May Seem

Bradley D. Blakeley, Esq.

As a credit professional, you are asked by your attorney to provide the contents of your credit file to assist in the preparation of a lawsuit involving a contract dispute. You provide the copies of all of the documents that are electronically stored on your company's database concerning the dispute. However, many of the documents, including emails, are foreign to you and others in your company. The recent decision in the bankruptcy case of Second Chance Body Armor addresses what can happen in this situation if those documents are not properly authenticated.

In Second Chance Body Armor, a former manufacturer and distributor of bulletproof vests, the chapter 7 trustee filed 17 counts against To-

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Special points of interest:

- Escheatment
- Authenticating Emails
- Proof of claim
- U.S.C § 727 of the Bankruptcy Code
- Pre-trial procedure
- Sequential liability
- Accord and Satisfaction

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Vendors Beware: Courts May Require More From Vendors Than the Filing of a Proof of Claim

Ronald A. Clifford, Esq.

The question is a simple one. How does a vendor preserve their rights to a section 503 (b)(9) administrative expense priority claim in a bankruptcy case? Some courts are requiring vendors to do more than file proofs of claim to preserve their rights to a section 503(b)(9) claim. As will be explained in this article, filing a proof of claim, without doing more, may result in the loss of a section 503 (b)(9) claim forever.

Vendors have a couple of options available to them to preserve their rights to payment in a bankruptcy case. The first is to review the debtor's bankruptcy schedules to determine if their claim is listed as an undisputed, non-contingent and liquidated claim for the correct amount owed to them. If the bankruptcy schedules list the vendor's claim correctly, the vendor is not obligated to do anything further to preserved its claim unless a later court order instructs otherwise, or unless an objection is filed to the claim. The second approach, and the one most attorneys would advise be followed regardless of the bankruptcy schedules, is to file a proof of claim. There is an official form on most bankruptcy court websites that is normally used by creditors when filing proofs of claim. Most vendors identify the filing of a proof of claim as the sure way to preserve their right to payment in a bankruptcy case.

The steps outlined above, on the whole, work just fine for a general unsecured non-priority claim. However, what does a vendor do when they have a section 503(b)(9) administrative expense priority claim? To review, section 503(b)(9) of the Bankruptcy Code allows vendors that deliver goods to the debtor in the ordinary course of the debtor's business within the twenty (20) days prior to the petition date, an administrative expense priority claim for the value of those goods. This administrative expense priority claim enjoys a priority for payment above general unsecured non-priority claims.

There can be some confusion as to how a vendor preserves the right to payment of a section 503(b)(9) claim in a bankruptcy case. One of the areas of confusion stems from the fact that the official proof of claim form referenced above contains a section that allows creditors to list the priority portions of their claims. Many creditors use this box to identify their section 503(b)(9) claims. Those who utilize this practice should not feel unjustified in doing so. One of the options contained within this administrative expense box allows the creditor to insert section 507(a)(2) of the Bankruptcy Code for their priority claim, which section encapsulates section 503(b)(9). However, some courts, such as the court in In re DFI Proceeds, Inc., have held that listing one's section 503(b)(9) claim on the official proof of

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Objecting to a Debtor's Discharge for the Benefit of All Creditors Under 11 U.S.C § 727 of the Bankruptcy Code

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It is an all too common scenario, a creditor files suit in state court to collect a debt owed to it by a customer only to have the defendant file for bankruptcy relief in the middle of litigation. As a result of the automatic stay imposed by section 362 of the United States Bankruptcy Code, or "Code", the creditor is barred from further collection efforts and the state court litigation is stayed. While reviewing the debtor's Schedules and Statement of Financial Affairs the creditor notices that the debtor has failed to include many of its assets and has misstated its income. Further, the creditor is confident that the debtor transferred certain assets right before or after filing its bankruptcy petition.

So what is the creditor to do? Other than filing a proof of claim, a creditor is left with no op-

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Compelling Discoveries: A Primer in Pre-Trial Procedure for the Credit Professional

Johnny White, Esq.

The average credit professional is probably familiar with the term "discovery," and may have a rough idea of what it means. But many are unfamiliar (or, familiar but confused) about how it actually works. Depending on past experience, you may view discovery as daunting, boring, pointless, annoying, or all of the above. But your having a basic understanding could really help your attorney collect your delinquent account. And while it may be daunting, boring and annoying, it is not pointless.

What is Discovery and Where Does it Fit in to Lawsuits?

To understand where discovery fits in, think of a lawsuit as a chess game. In chess, you have three phases – an opening, a middle-game, and an endgame. In the opening, a chess player positions his pieces on the board and tries to get a read on his opponent. A lawsuit has something similar. The plaintiff files its basic outline of allegations against the defendant – the complaint – with the court. The defendant responds with its denials, or perhaps a countersuit. Then there may be motions relating to defects in the pleadings or issues as to proper service of them.

This first phase is important. A critical blunder could cost you the entire game pretty early on. But, if both sides are competent players, familiar with the basic principles and theories, it will often take on a routine feel. The game will move seamlessly (in a lawsuit, a couple of months) in to the middle-game, where the real strategy comes into play.

But let's skip the middle-game for now, and develop the analogy just a little further first. The endgame is the trial. And like the endgame, the trial is maybe not as exciting as it sounds (or television would have you believe). The game will frequently be over by the time you get to the endgame/trial. One player will have established a clear advantage beforehand, and will be able to finish off the game clinically. The biggest enemy is likely to be the clock.

If you are a chess nerd, who is till reading this, you have probably guessed that the middle-game is discovery. And the analogy, though contrived, is not that contrived. Both the middle-game and discovery have an ad hoc quality, are highly strategic, and go on for an indeterminate length. In both settings, games are, for the most part, won and lost during this phase.

The Methods of Discovery

Discovery involves the exchange by both parties of all the information and evidence they have about the case. The overarching purpose is to allow the parties to flush out all evidence,

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Maximizing Your Likelihood for Payment: Avoiding Sequential Liability

Marisa Commerford, Esq.

For vendors engaged in the business of advertising and media services, a hotly contested issue that might arise is the use of sequential liability clauses in contracts. Vendors should always seek to avoid sequential liability in order to maximize protection against non-payment.

Sequential liability involves the following three players: the agency, the advertiser, and the media vendor. Advertising agencies handle aspects of creating, planning, and advertising for their clients. The agency is independent from the client, the advertiser. Sequential liability provides that the agency is liable for payment to the vendor only if it has been paid by the advertiser. Until then, the advertiser is solely responsible for payment.

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Reminder to New York Collection Agents: Rubber-Stamping Things in the Workplace is as Important as Ever

David Mannion, Esq.

If the doctrine of "accord and satisfaction" made its debut today instead of 19th century England, it would probably be called "compromise and payment." However, at least outside of communications with significant others, we don't normally expect to be held to compromises we had no intention of reaching. That's the scary thing about an accord and satisfaction from a creditor's point of view. Compromise may have been the last thing on your mind. Nevertheless, you may be considered to have reached an accord and satisfaction.

Take the following example. You believe you're owed $100,000 by a debtor but there is some dispute concerning the amount of the sums owed. Then, out of the blue, you receive a check for $70,000. However, there's a notation on the memo-line or an indorsement on the reverse side saying that it's being given in "full and final settlement" of the debt. After six months of demand letters and phone calls, you finally have some money from this debtor in your hand. You definitely don't want to send it back, but you also have no intention of waiving the remaining $30,000 you believe you're owed. In other words, you don't want to deposit the check and sue for the remaining $30,000 only to have a court decide that an "accord and satisfaction" was reached and your claim was settled for $70,000. How do you protect yourself in this situation?

The New York Court of Appeals gave an answer over two decades ago in Horn Waterproofing Corp. v. Bushwick Iron & Steel Co., 66 N.Y.2d 321 (1985). However, it amazes me how few collection professionals seem to be aware of it. Given the simplicity of the solution, and the potentially devastating effects of being the unwitting victim of an accord and satisfaction, I think the case is always worth talking about.

Reluctantly, and without further ado, I'm going to destroy my narrative and end the suspense here. If there's ever any question in your mind about whether you're looking at a possible accord and satisfaction scenario, before depositing the potentially costly "full-payment" check, simply write the following on the back: "Deposited under protest, without prejudice, and with full reservation of rights." Even better, keep a rubber-stamp on your desk.

Of course, there are caveats. The check (or other "negotiable instrument") is the key. If someone dumps a bag of quarters in your lap, or tries to effect full-payment with bushels of corn, stewing in your dilemma remains necessary. In addition, as usual, New York is the odd one out.[1]

Given that there was just $580.00 at stake, there is doubtless some interesting story behind Horn Waterproofing's pilgrimage from Queens Civil Court, to the Appellate Term, to the Appellate Division for the Second Department, and all the way to the Court of Appeals in Albany. Perhaps one of the participants appreciated that it takes character to hold a grudge. Or that being right is better than being rich. Whatever it was, the case was passed upon by greatest number of courts possible in New York State.

The facts, as the Court of Appeals observed, were "uncomplicated." The parties had a verbal agreement where the plaintiff agreed to repair the defendant's leaking roof. After two days of work, the plaintiff decided the roof would have to be completely replaced, and submitted a bill to the defendant for the work that had already been done. The defendant disputed the amount of the bill and the plaintiff revised the bill downward from $1,241 to $1,080.

The defendant remained dissatisfied with the charges and sent the plaintiff a check for just $500. On the reverse side of the check, the defendant-debtor had written the following: "This check is accepted in full payment, settlement, satisfaction, release and discharge of any and all claims and/or demands of whatsoever kind and nature." Directly underneath the defendant's notation, the plaintiff-creditor printed the words "Under Protest," indorsed

1. The only other state whose highest appellate court has bestowed this ability to reserve rights on creditors is South Dakota, which led the way nine years before the New York Court of Appeals in Scholl v. Tallman, 247 N.W.2d 490 (1976). Intermediate appellate courts in Florida and Missouri have also followed the approach of New York and South Dakota. However, the highest appellate courts in those states have yet to put the matter to rest, and creditors there should proceed with extreme caution and seek legal advice before depositing full-payment checks.

Reminder to New York Collection Agents: Rubber-Stamping Things in the Workplace is as Important as Ever

the check with their stamp, and deposited it into their account. They then sued for the remaining $580 due on their revised bill.

The trial judge found for the plaintiff and was upheld on appeal by the Appellate Term. The building owner prevailed at the next appellate level, with one judge dissenting, before the plaintiff finally had the last word in the Court of Appeals.

The Court of Appeals started by acknowledging that "[i]t has long been the general rule in this State that 'if a debt or claim be disputed…at the time of payment, the payment, when accepted, of a part of the whole debt is a good satisfaction…" See Horn Waterproofing, supra at 324. "The theory underlying this…rule of accord and satisfaction is that the parties have thus entered into a new contract displacing all or part of their original one. *** [T]he rule of accord and satisfaction has generally been accepted as a legitimate and expeditious means of settling contract disputes." Id. at 325 (citations omitted).

Quoting from an academic treatise on the subject, the Court observed that "[o]ffering a check for less than the contract amount, but 'in full settlement' inflicts an exquisite form of commercial torture on the [creditor]. If the offer is reasonable it creates a marvelous anxiety in some recipients: 'Shall I risk the loss of $9,000 for the additional $1,000 that the bloke really owes me?' In general the law has authorized such [debtor] behavior by regarding such a check as an offer of accord and satisfaction which the [creditor] accepts if he cashes the check. Traditionally the [creditor] could write all manner of disclaimers over his indorsement without avail; by cashing the check he was held to have accepted the offer on the [debtor's] terms." Id. at 326. The Court agreed that "the…doctrine of accord and satisfaction creates a cruel dilemma for the good-faith creditor in possession of a full payment check. Under that rule, the creditor would have no other choice but to surrender the partial payment or forfeit his right to the remainder." Id. at 326-327.

Putting an end to this "exquisite form of commercial torture," at least as far as New York creditors are concerned, the Court held that Article 1-207 of the N.Y. Uniform Commercial Code permits creditors receiving "full-payment" checks in the context of disputed debts to avoid an accord and satisfaction by explicitly reserving their rights on the check with unequivocal language such as "under protest" or "without prejudice."[2]

What is particularly significant about Horn Waterproofing is the breadth of the decision. The ruling is implicated whenever a "negotiable instrument" is tendered as full payment of a disputed debt. The negotiable instrument is the key; not the nature of the underlying transaction. As the Court of Appeals put it:

[T]he payment of a contract debt by check or other commercial paper and its acceptance by the creditor fall within the reach of section 1-207. Whether the underlying contract between the parties be for the purchase of goods…or personal services, the use of a negotiable instrument for the purpose of payment or attempted satisfaction of a contract debt is explicitly and specifically regulated by the provisions of article 3 and, therefore, undeniably a Code-covered transaction. Consequently, a debtor's tender of a full payment check is an article 3 transaction which is governed by section 1-207, regardless of the nature of the contract underlying the parties' commercial relationship.[3]

A topic for another day will be the commercially indefensible evidentiary rule followed in California that allows courts to admit extraneous evidence to contradict the unambiguous terms of written contracts. Suffice it to say, however, for the moment, that Horn Waterproofing is one more reason prudent trade creditors conducting business outside New York may want to consider, where possible, having their business relationships governed by New York choice-of-law clauses.

2. It may be worth noting that the "Uniform" in Uniform Commercial Code is something of a misnomer. The UCC is not a federal statute that is binding on the states. Rather, it is a long-term joint project of the National Conference of Commissioners on Uniform State Laws and the American Law Institute, which began drafting the first version in 1942. The UCC has been adopted by each of the 50 states, albeit with modifications in some states, and is interpreted and applied by the courts of each state. Thus, despite having substantially identical language to the other states' incarnations of UCC Article 1-207, the New York courts have applied that provision differently from the vast majority of other state courts.

3. N.Y. UCC §3-104 provides that:

"(1) Any writing to be a negotiable instrument within this Article must
(a) be signed by the maker or drawer; and
(b) contain an unconditional promise or order to pay a sum certain in money and no other promise, order, obligation or power given by the maker or drawer except as authorized by this Article; and
(c) be payable on demand or at a definite time; and
(d) be payable to order or to bearer." Typically, "negotiable instruments" under the UCC will include garden-variety drafts, checks, certificates of deposit, or notes. If in doubt about whether you are holding a "negotiable instrument" as that term is contemplated by the UCC, seek legal advice.

Escheatment in the Spotlight as State Budget Deficits Continue: What a Credit Executive Needs to Consider

is considered unclaimed property as to the credit department that may fall under the escheat laws? Does a credit balance qualify? What may be the consequence if the vendor declares the unclaimed property as income and applies it to the bottom line, as the vendor views it as a windfall to offset losses from unrelated delinquent accounts?

Escheatment Defined

Businesses and individuals abandon over a billion dollars of tangible and intangible property annually. Every state has legislation that requires companies to abandon unclaimed property, to the state after some period. Escheatment includes all forms of property, both tangible and intangible. Escheatment laws provide that the state becomes the legal owner of abandoned property, based on the concept of state sovereignty.

Escheatable property that may be the accounting and reporting responsibilities of the credit department includes rebates, credit memos, discounts and allowances, customer overpayments, misapplied payments and unapplied credits to the customer. The last activity with the account is measured from when the credit was issued.

Development of Escheatment Law

The origin of escheatment law dates back to British law. Abandoned land was returned to the king. The states within the United States have followed this principle, broadening what qualifies as abandoned property.

Uniform Disposition of Unclaimed Property Act

With the growing popularity of state unclaimed property statutes as a new source of state revenue in the 1950's, uniformity of such laws became a necessity, as controversies between states over conflicting claims to property developed. For example, if a corporation abandons credits it holds based on a trade relationship with a customer, several states might attempt to claim custody of the credits. The credits could be covered under the law of the state where the company was incorporated, or the state where the corporate headquarters was located. In addition, any state that was doing significant business with the corporation might claim the property.

In 1954, the Uniform Disposition of Unclaimed Property Act (the "Uniform Act") was introduced to unify the state statutory scheme of escheatment. The Uniform Act was amended in 1966 and 1981. The Uniform Act attempts to prevent multiple sate claims for property by designating the last known address of the owner as the basic test of jurisdiction. Thus, under the Uniform Act, if two states claim the same property, the law of the state of the last known address of the owner governs. If property is abandoned, the state must establish its right to the property by proving that the property is located within its territorial limits.

Generally, if the property is considered to have a situs within the state, it is subject to escheat. The Uniform Act establishes a period for a presumption of abandonment for most types of property. For example, in California if the property is unclaimed for three years after it becomes payable. Presently, forty-two states (including California, New York, Texas, and Florida) and the District of Columbia have enacted some version of the Uniform Act.

Delaware receives a significant portion of escheated property, notwithstanding that its small population. This is because a large percentage of corporations incorporate in Delaware. Under the escheat laws, a party forwards the abandoned property to the company's state of incorporation, where the address of the owner can no longer be located.

States Interest in Escheatment

States are now collecting billions of dollars a year from companies by enforcing their escheatment laws. All states have escheatment laws. Escheatment, as it relates to the credit department, is intended to return unclaimed assets, such as credit balances in the form of

"ESCHEATABLE PROPERTY THAT MAY BE THE ACCOUNTING AND REPORTING RESPONSIBILITIES OF THE CREDIT DEPARTMENT INCLUDES REBATES, CREDIT MEMOS, DISCOUNTS AND ALLOWANCES, CUSTOMER OVERPAYMENTS, MISAPPLIED PAYMENTS AND UNAPPLIED CREDITS TO THE CUSTOMER. "

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customer concessions not taken such as rebates, discounts and allowances, customer overpayments, misapplied payments and unapplied credits to the customer. If the abandoned property is unclaimed by your customer, states have a greater right to the property than the vendor. While the escheatment laws are intended to return property to their rightful owner, it has become a way for states to increase revenue without increasing taxes.

States are especially attracted to escheatable property as they are looking to these unclaimed assets to cover their expenses. Vendors are now required businesses to turn over abandoned property more quickly. States have also strengthened enforcement by hiring private auditors to examine the vendor's compliance, who may be employed on a contingency basis.

By way of example of the windfall inuring to states under the escheatment laws, the Wall Street Journal recently reported that California holds more than $5 billion in unclaimed property, while collectively states hold $35 billion in unclaimed property. Each year states are increasing their abandoned property take, collecting $5.1 billion in 2006, while but three years before $3.6 billion was collected.

States regard property as "unclaimed" if the owner hasn't had contact with the custodian of an asset for a specified period of time. Delaware, the legal home to many big companies, is an aggressive collector of such assets. Delaware uses escheat audits to look for credit balances, and it collected $365 million for its 2007 fiscal year.

Risks of Not Escheating

Most states require businesses to review their records to determine whether any property has been unclaimed for the dormancy period and to submit an annual report. State escheat statutes have harsh provisions for parties that fail to timely report or turnover unclaimed property. In addition to interest that runs from the period that the property should have been turned over, a state may assess fines, penalties and damages.

Escheatment Audit

A state generally enforces its escheatment law through an audit. Audits are usually handled by the state treasurer's office or controller, although states are employing third parties to assist in collecting escheatable dollars. The scope of the audit usually goes back several years. The auditors usually request the following: (1) chart of accounts; (2) general ledger/trial balance; (3) annual report; (4) journal entries; (5) bank reconciliations; and (6) accounting policies.

Under Delaware's escheatment program, an investigation was undertaken as to whether companies incorporated in Delaware were submitting required annual reports on unclaimed property. Only a fraction were doing so. Delaware hired outside auditors and was able to double collections of escheatable property to $365 million in five years.

With escheatment, Delaware auditors, for example, ask for documentation going back to the early 1980s; if documents aren't available, the auditors use a sampling of recent records to estimate how much a company owes the state.

Steps to Protect Against Escheatment Claims

A credit executive should develop a game plan, and consider the following:

Step One: Determine the Situation

Review past compliance. Has the company every reported unclaimed property? If so, what, when and where?

Has the company ever been subject to an escheatment audit? If so, what were the results?

Are there any subsidiaries to be included?

Has the company made any recent acquisitions that should be included?

"STATES REGARD PROPERTY AS "UNCLAIMED" IF THE OWNER HASN'T HAD CONTACT WITH THE CUSTODIAN OF AN ASSET FOR A SPECIFIED PERIOD OF TIME"

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Step Two: Determine Eligible Property

Does your company have some of the property types covered by most states? For the credit professional these include:

• cash,

• credits, including rebates, discounts and allowances

• overpayments and misapplied payments

What states are represented among the names and addresses to be reported?

If this is an initial filing? What about years that may not be on the books?

Step Three: Perform the due diligence

What due diligence is required by the state? Specifically, focus on:

• the minimum dollar amount,

• timing, method and

• content.

Develop a strategy to minimize unclaimed property liability and review potentially reportable items.

Prepare the due diligence letter. This should include:

• response deadline

• identification number and amount

• property type/reason

• instructions for claiming

Step Four: Prepare Reports and Remittances

Identify due dates for states

Prepare a cover sheet with signature

Use the proper media, paper, diskette, etc.

Use the proper report format

Include the remittance, which might be a check, wire transfer, etc.

Step Five: Filing Reports and Remittances

File on time to avoid penalties and interest

If you get an extension, get it in writing. Only some states will grant them.

Step Six: Follow up and Reconcilement

Reconcile general ledger to detail

Reconcile paid items to appropriate accounts/divisions

File any necessary holder reimbursement claims with the states

Establish a filing system for reports and work papers.

Turning Over the Property

If your company decides to turnover the unclaimed property to the state, most state statutes provide that the vendor should turn the property over to the state controller. Most legislation requires the vendor to make reasonable efforts to notify the owner of the property by mail that the owner's property will escheat to the state. The notice should be mailed not less than six months before the property is to be turned over to the state controller.

Depending upon the nature of the property, all unclaimed property should either be delivered to the State Treasurer or Controller. When the unclaimed property is cash, delivery is made to the State Treasury; all other types of personal property go to the Controller.

The party delivering the property is relieved and held harmless by the state from all claims regarding the property. No action or lawsuit may be maintained against the holder of the property.

Prior to delivery, the holder must furnish notice to the Controller. At a minimum, notice must include the amount of cash, or nature or description of other personal property; the name and last known address of the person entitled to the property; and reference to a specific statutory provision under which the property is being transmitted.

"MOST LEGISLATION REQUIRES THE VENDOR TO MAKE REASONABLE EFFORTS TO NOTIFY THE OWNER OF THE PROPERTY BY MAIL THAT THE OWNER'S PROPERTY WILL ESCHEAT TO THE STATE"

Objecting to a Debtor's Discharge for the Benefit of All Creditors Under 11 U.S.C § 727 of the Bankruptcy Code

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tions, right? Not necessarily.

The bankruptcy code provides relief for a creditor in limited circumstances, among which is denial of the debtor's discharge under section 727 of the Code. Section 727 governs objections to the discharge of a debtor in a Chapter 7 liquidation case. Under section 727, creditors, or the Chapter 7 trustee or United States Trustee, may object to a debtor receiving a discharge of all debts in bankruptcy where the debtor has engaged in acts resulting in harm to creditors. A creditor implements section 727 by filing a complaint in the debtor's bankruptcy case within 60 days of the first date set for the 341(a) meeting of creditors, thereby initiating an adversary action.

In part, section 727(a), provides that, "the court shall grant the debtor a discharge, unless:

(2) the debtor, with the intent to hinder, delay, or defraud a creditor . . . has transferred, removed, destroyed, mutilated, or concealed, or has permitted to be transferred, removed, destroyed, mutilated, or concealed –

(A) property of the debtor, within one year before the date of the filing of the petition; or

(B) property of the estate, after the date of the filing of the petition . . .

(4) the debtor knowingly and fraudulently, in or in connection with the case—

(A) made a false oath or account.

Court's evaluate a case under section 727 based upon the totality of the circumstances. However, a creditor looking to file a complaint objecting to a debtor's discharge should give due consideration before proceeding. In general, section 727 is to be construed liberally in favor of the debtor and strictly against those objecting. It is only after a creditor meets its burden by a preponderance of the evidence that a Court may deny the debtor a discharge of all its debts.

Recently, the United States Bankruptcy Court for the District of Maryland decided such a case in In re Stephen Todd Stephens, 2010 Bankr. LEXIS 4400. In In re Stephen Todd Stephens, the plaintiff was the holder of a liquidated claim in the form of a confessed judgment in the sum of $854,514.30, entered in the circuit court. In objecting to the debtor's discharge, the plaintiff produced substantial evidence demonstrating that the debtor's schedules contained numerous deficiencies, errors and omissions concerning interests held by the debtor in various corporate entities. For example, the debtor failed to include his stock interests in several businesses, failed to disclose his income from his involvement with an enterprise, failed to state that he was an officer and director of a corporation during the six years preceding the bankruptcy and had sole possession of property which was in the name of a business he had concealed.

In finding that the plaintiff had satisfied its burden by a preponderance of the evidence, the Court opined that, "the cumulative effect of all the falsehoods together evidences a pattern of reckless and cavalier disregard for the truth . . . ," and that the "reason for this action, as well as numerous other actions undertaken by the Debtor, was to evade collection efforts on the part of the Plaintiff."

Further, a creditor should remember that section 727 denies a debtor the discharge of all of its debts, not just the creditor's claim. As a result, the creditor may not be benefitted by filing an action under 727 for the benefit of all creditors and instead should evaluate its claim under section 523, which pertains to nondischargeability of a single claim.

In any event, a creditor faced with a claim against a debtor should be aware of all of its options; it could mean the difference between recovering on its claim and losing its claim altogether.

"IN GENERAL, SECTION 727 IS TO BE CONSTRUED LIBERALLY IN FAVOR OF THE DEBTOR AND STRICTLY AGAINST THOSE OBJECTING"

Authenticating Emails at Trial: Not Always as Easy as It May Seem

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yobo and its U.S. subsidiary, suppliers of Zylon used by weavers that was then used by Second Chance to make the vests. While questioning a manager from Toyobo on the 39th day of trial, the trustee sought admission of an exhibit – an interoffice email from an employee of ITOCHU Corporation addressed to five other ITOCHU employees that dealt with ballistics testing.

Toyobo objected to the admission of the trustee's exhibit on grounds that it constituted hearsay and lacked proper authentication and foundation. In an oral bench ruling, the court provisionally admitted the trustee's exhibit. The court held that admission of the exhibit was conditioned upon factual findings at the conclusion of the case that ITOCHU was an agent of Toyobo in connection with the transactions in question. If no agency finding could ultimately be made, or if the document was not authenticated, the court explained that the exhibit would be expressly excluded from consideration and completely ignored by the court.

Responding to the court's ruling with permission by the court to supplement its argument, Toyobo reiterated its hearsay objection and argued that the trustee had failed to lay an adequate foundation establishing the authenticity of the document. Toyobo also asserted that, to the extent the court's ruling was based on grounds of potential agency, the document was subject to the attorney-client privilege and should be excluded from evidence on that basis. The court considered Toyobo's arguments, but declined to alter its evidentiary ruling. In large part, the court believed that provisionally admitting the trustee's exhibits was the best way to promote judicial economy.

The issue presented was whether this court should rescind its conditional admission of the trustee's exhibit into evidence over Toyobo's objection that the trustee had failed to lay a proper foundation regarding the document's authenticity.

There are four traditional types of evidence: real, demonstrative, documentary, and testimonial. The basic prerequisites of admissibility of evidence are relevance, materiality, and competence. In general, if evidence is shown to be relevant, material, and competent, and is not barred by an exclusionary rule, it is admissible. Evid. Code § 351; Fed. Rules Evid. 402.

When documents such as letters, contracts, invoices, wills, certificates and records are presented as evidence by a defendant, or, indeed, the prosecution, in a court of law, they are known as documentary evidence. This evidence can have serious consequences and can help determine the outcome of a case. It is, therefore, essential that documentary evidence is authentic.

Federal Rule of Evidence 901 states the general requirement for authentication of a document. Rule 901(a) provides: The requirement of authentication or identification as a condition precedent to admissibility is satisfied by evidence sufficient to support a finding that the matter in question is what its proponent claims." Rule 902 identifies several types of evidence that are "so well recognized as prima facie genuine" that they are considered self-authenticating. For evidence that is not self-authenticating, including e-mail messages, Rule 901(b) sets forth a non-exclusive list of ways in which the requirement of authentication may be satisfied. One of the most common ways to authenticate a document is for the proponent of the document to elicit testimony of a witness with knowledge that the document "is what it is claimed to be." When the document involved is an e-mail communication, a "participant in, or recipient of, that communication" will generally be able to authenticate the communication, so long as the person "was able to perceive who communicated what." Mark D. Robins, Evidence at the Electronic Frontier: Introducing E-mail at Trial in Commercial Litigation, 29 Rutgers Computer & Tech. L.J. 219, 226 (2003).

"RULE 901(B) SETS FORTH A NON-EXCLUSIVE LIST OF WAYS IN WHICH THE REQUIREMENT OF AUTHENTICATION MAY BE SATISFIED"

Authenticating Emails at Trial: Not Always as Easy as It May Seem

The court found that the trustee failed to lay an adequate foundation to establish that the document was authentic. As Toyobo's counsel asserted, the document is a purely internal communication between employees of ITOCHU. The Toyobo witness who was questioned about the document was not listed as a recipient of the e-mail, and testified that he had never even seen the document before. Because the exhibit was neither self-authenticating, authenticated by a witness with knowledge, nor authenticated through any other permissible means, the court rescinded its ruling provisionally admitting the exhibit.

This decision underscores the importance of attorneys and their clients working together in preparation of their case in the age of electronically stored information. It also highlights that in complex cases involving hundreds or even thousands of documents, that a client's involvement can make the difference in the outcome of a decision.

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so that neither side can ambush the other when the trial takes place. It facilitates settlement by making the relative strengths and weaknesses of a party's case known ahead of time. Most, if not all, states allow a very broad right to discovery

There are five major methods of discovery it is important to be aware of.[1] They are:

Written Interrogatories
Requests for Admissions
Document Requests
Oral Depositions; and
Subpoenas

These are the bread and butter of discovery, and employing all of them should always be considered carefully.

Written interrogatories

Written interrogatories are typically served early in a lawsuit. A written interrogatory is really just a fancy way of saying "a written question," which the recipient has to answer under penalty of perjury. The idea is to pin down the other side on certain points and narrow or eliminate certain issues. Very often, a party will give away as little as possible at the pleadings stage. The party's attorney, still perhaps trying to get a grip on the underlying facts, will seek to preserve options as much as possible, and can be cagey in volunteering information. Interrogatories require a party to get specific. A well thought-out, well-framed interrogatory can cut right to the heart of the issues. It will force a party to take a specific position early on, and expose the weaknesses of a case (possibly yours). Asking a question in writing is obviously a lot cheaper than hiring a court reporter and taking an oral deposition too, so, it is a cost-effective way of getting certain fundamental information. However, in California, a party is limited to 35 written questions before trial, so care must exercised in choosing them, and it is prudent to not ask all your questions right away.

Requests for Admission

Like interrogatories, requests for admissions involve questions to the other side designed to narrow issues, and are generally served early in the case. They take the following form:

"Admit that ABC Ltd. shipped you $1,000 worth of goods on January 31, 2011."

In this example, the other party will have to admit or deny the truth of the statement that ABC Ltd. shipped it $1,000 worth of goods that day. If it denies, it will have to explain why it denies. If it admits, the fact that ABC Ltd. shipped it $1,000 worth of goods on January 31 becomes undisputed fact and no

1. There are other permissible methods of discovery, such as physical and mental examinations, which never (or very rarely) apply to commercial disputes, and exchange of expert evidence, which is appropriate to certain disputes. But they will not

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“THE DOCUMENTS THEMSELVES DO NOT HAVE TO CONSTITUTE ADMISSIBLE EVIDENCE”

evidence – such as a bill of lading or delivery receipt – need be adduced at trial to prove this fact.

The requests for admissions have a couple of interesting consequences. If a party denies without justification a fact that should have been admitted, the requesting party can recover the costs of proving that fact at trial. Accordingly, requests and their responses should be carefully thought out to avoid unnecessary costs (and loss of credibility) at a later date. Furthermore, once served with requests for admissions, a party will have a certain amount of time to respond. In some jurisdictions, such as New York, failing to respond in that time means the requests are deemed admitted. In other states, such as California, the requesting party can make a motion to have those facts admitted. But, either way, blowing a deadline to answer requests for admission is a trap for the unwary, and can have disastrous consequences.

Document Requests

Document requests are perhaps the most involved aspect of discovery. They seek to elicit each party’s documents relating to the case, and are often a source of great irritation to the average credit professional. For example, in a collection case, a credit manager may turn over his open invoices, account statement, proofs of delivery and credit application, and assume that his attorney will not need any more documents. Sometimes this is true, but often not.

Some debtors are fighters. They may assert issues with product quality or accounting issues. They may assert some contractual change based on the parties course of dealing. They may file a cross-complaint, alleging breach of contract themselves, and sue for an amount far in excess of the amount owed on the open invoices. If so, they will probably serve wide-ranging document requests, and be entitled to the documents. The scope of discovery is generally broad, even if you are not in the right. The Federal Rules of Civil Procedure permit discovery regarding any matter:

that is relevant to any party’s claim or defense… Relevant information need not be admissible at the trial if the discovery appears reasonably calculated to lead to the discovery of admissible evidence.

Most states employ a similar standard: it must be relevant to the “subject matter” of the action (i.e. not the issues as you perceive them). And the documents themselves do not have to constitute admissible evidence. For example, an email from a customer complaining of a defective product is not admissible evidence that the product is defective. That is just hearsay. But it may identify or allude to other documents that will be admissible evidence. Thus, the debtor suing for breach of warranty due to your allegedly defective product will be entitled to discovery of the email notwithstanding its inadmissibility.

Given this broad scope, it is critically important to preserve all information at the outset of a case. No potential evidence can destroyed. And in the era of proliferating electronically stored information, this can present enormous challenges. But documents that are relevant, even if not requested by the other side, should be provided to your attorney anyway. A document that may not seem relevant could have a legal relevance you are not aware of. If you have any question about the relevance of a document, send it to your attorney. Don’t worry about wasting their time. If it is irrelevant, they will perceive that quickly and ignore the document. But the risk of failing to show them something that turns out to be very relevant has far worse consequences.

What Happens if You Don’t Comply Fully with Document Requests?

If you don’t respond to the document requests thoroughly and comprehensively, the consequences can be dire. A party who has served discovery, and who has not received an adequate response can bring what is called a motion to compel. This is a motion where the court is asked to issue an order requiring one

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party to produce what the other has asked for. In California, a court is required to impose monetary sanctions on any party who resists discovery without substantial justification. The reason is that discovery is supposed to be "self-executing." The parties should be able to resolve discovery disputes without court supervision, which would otherwise clog up the courts system, and monetary sanctions provide a powerful incentive for the parties to do so. And of course, a party who comes before a Judge on the losing end of a motion to compel may also seriously damage their credibility before the very person that will ultimately decide their case.

But the consequences can be even worse. In California, monetary sanctions will be used the first time you fall foul of the discovery rules. After that, the stakes go up. A court can impose evidentiary sanctions – where a party is not allowed to introduce certain evidence at trial because it didn't produce it in discovery – or even "doomsday" sanctions, where it will simply enter judgment against a party for serial discovery abuse. These doomsday sanctions can also be employed if a party disposes of evidence.

Oral Depositions

While document requests may be the most annoying aspect of discovery, oral depositions are perhaps the most intimidating. A deposition is a witness examination in advance of trial. The witness takes an oath, and a court reporter will make a record of the testimony. During the deposition, a witness can be asked about anything within the permissible scope of discovery, which, as we have seen, is extremely broad. The opposing counsel will walk the witness through their document production, asking for explanations of certain matters the documents contain, as well as matters the documents don't cover. And it is time-consuming. You can expect a typical deposition to last one full business day, and sometimes longer.

A witness will generally be accompanied by their (or their company's) attorney, whose role will be "defend" the deposition. This will involve sitting next to the witness and objecting at appropriate junctures. Certain objections must be asserted on the spot at the deposition, or else they will be waived. These are known as objections to the form of questioning, e.g. "the question is leading," "the question assumes facts not in evidence," "the question is compound," or "the question calls for speculation." The idea behind having to assert these objections on the spot is that the questioning attorney may be able to correct these defects there and then. Other objections, such as objections to the relevance or admissibility of evidence do not have to be made at the deposition, and should not be. They can be raised later on (although attorneys frequently make them anyway). Unless specifically directed not to answer by their attorney (and the circumstances are limited in which such a direction is justified), witnesses must answer the question even if the attorney has objected.

While a deposition can sound intimidating, it is probably not as bad as you fear. Usually, the only people in the room will be you, your attorney, the Court reporter and the attorney asking you the questions. You will sit around a conference table, answering questions. Your attorney will be there to help if you are getting into trouble e.g. (by objecting, taking a break for you to regroup, etc.), and you should have spent a couple of hours preparing with him/her in advance so you know what's coming.

Subpoenas

The subpoena is a discovery method used to obtain evidence from third parties, who are not involved in the action. Non-parties can be asked to produce documents, or attend depositions when they are served with a subpoena. But, it becomes complicated when, as is often the case in commercial cases, the third party resides out of state. While parties to a lawsuit can be compelled to produce documents or attend at deposition regardless of where they are located, a non-party will not be subject to

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"A WITNESS CAN BE ASKED ABOUT ANYTHING WITHIN THE PERMISSIBLE SCOPE OF DISCOVERY, WHICH, AS WE HAVE SEEN, IS EXTREMELY BROAD"

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"THE SUBPOENA CAN BE A HANDY WAY OF EXERTING LEVERAGE"

the jurisdiction of the court if they reside out of state. So, a California court has no power to require a New York resident to testify or hand over documents. Instead, it must ask the California court to issue a request to a New York court, which will then issue an order requiring the non-party to comply, which, of course, is a cumbersome procedure.

For companies looking to collect on an open account though, and who are facing a cross-complaint, the subpoena can be a handy way of exerting leverage, especially if you use it to take out of state depositions. Generally, a debtor will not have the resources to pay his attorney to travel around the country attending depositions. You have wide latitude to obtain the facts underlying the case. And if there are witnesses out of state, fly out and quiz them. Requiring his attorney to do the same could bring him to the settlement table quickly enough.

Conclusion

A basic understanding of the above techniques may help a credit professional provide astute and time-saving help to his company's attorneys. Too often, discovery is treated as a pesky detail. It is of fundamental importance to trial preparation, and should be taken seriously.

Here are some basic tips to remember:

-You can never give your attorney too many documents relating to your case, only too little.

-At the outset of a case, ensure that all records are preserved. Spoiling evidence could result in a judgment against you, regardless of the underlying merits of your case.

-Don't treat discovery as just a nuisance. There can be serious consequences if you fail to take it seriously.

-If you have greater resources than your opponent, a well thought out discovery strategy can soon bring him to the settlement table.

Maximizing Your Likelihood for Payment: Avoiding Sequential Liability

(Continued from page 3)

The Roots of Sequential Liability

The American Association of Advertising Agencies' policy used to be that agencies accept sole liability for payment of media services. But in the1990s, the Association began to favor sequential liability. This practice was put in place to protect agencies from financially troubled clients that left bills unpaid. Generally, the sequential liability clauses read as follows:

The agency shall be solely liable for payment of all media invoices if the agency has been paid for those invoices by the advertiser. Prior to payment to the agency, the advertiser shall be solely liable.

The effect of the sequential liability clause is that it limits the remedies a vendor may seek when faced with non-payment. For example, if vendor sells ad space, and the advertiser fails to pay the agency, the vendor's sole recourse is to go after the advertiser for payment. This can be problematic should the advertiser become insolvent or file for protection under the Bankruptcy Code, leaving the vendor with limited means to recoup the balance owed.

Avoiding Sequential Liability: The Joint and Several Liability Clause

So what is a vendor to do when faced with a sequential liability clause in a contract? Vendors should seek to remove the sequential liability clause from the contract and replace with a joint and several liability provision. Joint and several liability is a form of liability that holds two or more parties either individually or mutually responsible for payment. This

Maximizing Your Likelihood for Payment: Avoiding Sequential Liability

will ensure that the vendor can look to both parties for payment.

Hypotheticals

1. Advertiser pays advertising agency. Agency goes insolvent. Vendor left unpaid.
2. Advertiser fails to pay agency. Advertiser goes insolvent. Vendor left unpaid.

Solutions

The advertising or services contract should include a "No Sequential Liability" clause; and should provide a "Joint and Several Liability" clause. Because of the potential for discrepancies between the vendor's contract language and any agreements between the agency and the advertiser, the vendor's contract should provide that any agreements between the agency and the advertiser regarding liability are void. The contract should also provide that the vendor will not release the agency or the advertiser from liability even if a sequential liability clause is included in an invoice, insertion order, contract, or any other correspondence and have both parties sign.

To ensure maximum protection, the vendor should require signed credit applications for both the agency and the advertiser. Credit applications should also include a clause which sets forth a joint and several liability provision. Additionally, vendors should be attentive to any communications received by and between the agency and the advertiser in order to effectively address any alterations in the agreement prior to any payment problems. Restatement of joint and several liability is recommended on all appropriate correspondence, such as invoices, insertion orders, letters attached to contracts, etc should a dispute ever arise.

Another protective measure for a vendor to consider in this context might be that a vendor could provide a document, which would be signed by the advertiser, confirming that the agency is authorized to negotiate and enter into a binding contract on the advertiser's behalf and including a statement that, if the advertiser entrusts the agent with money to pay Vendor, the advertiser will remain liable if the agency fails to pay. Additionally, the vendor can send the advertiser an agreement signed by the agency notifying the advertiser that the agency has bound him to the liability.

Examples:

The drafted terms and conditions below are to be used as a template. The form is based off of the "Standard Terms and Conditions for Interactive Media" version 3.0, drafted by IAB and AAAA as a model to provide a balance for the competing interests of agencies and the media.

1. **No Sequential Liability**. This agreement renders void any statements concerning liability which appear on any contracts and/or correspondence from Advertiser or Agency, and is irrevocable without the written consent of Vendor's Credit Department. It is further agreed that Vendor does not accept IOs [insertion orders], advertising orders or space reservations claiming sequential liability.
2. **Joint and Several Liability**. Advertiser and Advertising Agency are jointly and severally liable for payment. Vendor will not release Advertiser or its Advertising Agency from liability even if a sequential liability clause is included in the IO, contract, purchase order, or any other correspondence from Advertiser or Agency.

As the vendor seeking to avoid sequential liability, be prepared for reluctance on part of the agency and/or the advertiser to agree to a joint and several liability clause. In this type of situation, vendors should keep in mind that demanding payment upfront can be another route to protect themselves.

"TO ENSURE MAXIMUM PROTECTION, THE VENDOR SHOULD REQUIRE SIGNED CREDIT APPLICATIONS FOR BOTH THE AGENCY AND THE ADVERTISER"

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Vendors Beware: Courts May Require More From Vendors Than the Filing of a Proof of Claim

(Continued from page 2)

claim form does not in of itself preserve a vendor's section 503(b)(9) claim, even if it is listed in the administrative expense priority box of the proof of claim. 2009 Bankr. LEXIS 4296 (2009). In the DFI Proceeds, Inc. case, the debtor set a bar date for creditors to file section 503(b)(9) motions or applications for allowance. The vendor at issue in the case had already filed the official proof of claim form denoting its section 503(b)(9) claim thereon in the box related to administrative expense claims described above, and so it did not do anything further. Seems reasonable, right? There is a box that tends to lead vendors to believe that a section 503(b)(9) claim can be preserved through listing it on the official proof of claim form, right? Why punish the vendor for the confusion regarding the official proof of claim form? Well, the trustee in the case objected to the vendor's claim to the extent that it was entitled to administrative expense priority under section 503(b)(9). The trustee argued that a motion must have been filed for the vendor to have preserved its right to a section 503(b)(9) claim. The court agreed with the trustee and disallowed the vendor's claim as anything other than a general unsecured non-priority claim.

The court's reasoning was grounded in the specific wording of the Bankruptcy Code. Section 503(b)(9) specifically states that a section 503(b)(9) claim will only be allowed after a noticed hearing. This means that a vendor must file a motion with the court requesting allowance of its section 503(b)(9) claim unless there is a court order that directs otherwise. Listing the section 503(b)(9) claim on the official proof of claim form is not enough. The DFI Proceeds, Inc. court held that absent the filing of a motion requesting allowance prior to the bar date, vendors lost their rights to a section 503(b)(9) claim.

Vendors will want to monitor bankruptcy cases they have a claim in for section 503(b)(9) bar dates and special procedures related thereto. It is increasingly common for debtors to file motions setting section 503(b)(9) bar dates and procedures thereon early in cases. The orders on those motions may require that a motion be filed, such as in the DFI Proceeds, Inc. case, but they may also simply allow the denoting of a section 503(b)(9) claim on the official proof of claim form. It is critical to comply with those orders. However, the take away for vendors should be that the only sure way to preserve one's section 503(b)(9) claim in a bankruptcy case where there are not court ordered instructions otherwise is to file a motion with the court requesting allowance of the claim. Failure to do so may result in a loss of that claim for good. The official proof of claim form should probably be modified so as not to confuse vendors regarding the requirements to preserve one's section 503(b)(9) claim. As discussed, the official proof of claim form and the language of section 503(b)(9) seem to conflict. Until a revision of the Bankruptcy Code is made that allows the filing of a section 503(b)(9) claim on the official proof of claim form however, the DFI Proceeds, Inc. case has put vendors on notice of the current requirements.